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Reuven S. Avi-Yonah

University of Michigan Law School, aviyonah@umich.edu

Haiyan Xu

University of International Business & Economics, Beijing

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A GLOBAL TREATY OVERRIDE? THE NEW OECD MULTILATERAL TAX INSTRUMENT AND ITS LIMITS

*Reuven S. Avi-Yonah**

*Haiyan Xu***

1. INTRODUCTION

On June 7, 2017, seventy-six countries met in Paris for the official signing of a new multilateral tax instrument (MLI).¹ The text and commentary of the MLI were published in November 2016 by the Organization for Economic Cooperation and Development (OECD). The OECD stated:

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS will implement minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. It will also allow governments to strengthen their tax treaties with other tax treaty measures developed in the OECD/G20 BEPS Project. . . .

The new instrument will transpose results from the OECD/G20 Base Erosion and Profit Shifting Project (BEPS) into more than 2,000 tax treaties worldwide.²

* Irwin I. Cohn Professor of Law, the University of Michigan. We would like to thank Kim Brooks, Nir Fishbien, Pasquale Pistone, Omri Marian, Gianluca Mazzoni, Steven Ratner, Richard Reinhold, Fadi Shaheen, Victor Thuronyi, and participants in the October, 2017 MJIL conference on the MLI for their very helpful comments.

** Professor of Law, University of International Business & Economics, Beijing; SJD candidate, the University of Michigan.

1. *Ground-breaking multilateral BEPS convention signed at OECD will close loopholes in thousands of tax treaties worldwide*, Org. for Econ. Co-Operation and Dev. [OECD] (June 7, 2017), <http://www.oecd.org/tax/ground-breaking-multilateral-beps-convention-will-close-tax-treaty-loopholes.htm>; see OECD, SIGNATORIES AND PARTIES TO THE MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHARING (Dec. 20, 2017), <http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf> (listing the countries that have signed the treaty, plus countries that intend to sign soon). The signatories include the major OECD and EU members (except for the U.S.), China and India, as well as many important treaty shopping jurisdictions (e.g., the Netherlands and Mauritius) and tax havens (e.g., Singapore and Hong Kong). As of October 2017, 71 jurisdictions have signed the MLI but only one (Austria) has ratified it; four more ratifications are needed for the MLI to enter into force, which is expected to occur by early 2018.

2. *Countries adopt multilateral convention to close tax treaty loopholes and improve functioning of international tax system*, OECD (Nov. 24, 2016), <http://www.oecd.org/tax/countries-adopt-multilateral-convention-to-close-tax-treaty-loopholes-and-improve-functioning-of-international-tax-system.htm>.

The OECD went on to explain that:

[t]he multilateral convention was developed over the past year, via negotiations involving more than 100 jurisdictions including OECD member countries, G20 countries and other developed and developing countries, under a mandate delivered by G20 Finance Ministers and Central Bank Governors at their February 2015 meeting . . . The OECD will be the depositary of the multilateral instrument and will support governments in the process of its signature, ratification and implementation.³

There is no question that this event represents a milestone in the evolution of the international tax regime (ITR).⁴ But it also raises important questions about the function of tax treaties in the twenty-first century and whether other steps can be taken to improve the tax treaty network beyond the MLI.

To appreciate the importance of the MLI, it is useful to take a step back and consider its historical significance. Bilateral tax treaties were first negotiated in the nineteenth century,⁵ but their importance grew after World War I because of increased income tax rates and the risk of taxation by both country of residence and country that sources the income.⁶ The result was the publication of the first model bilateral tax treaty under the auspices of the League of Nations in 1928,⁷ followed by the Mexico (1943)⁸ and London (1946)⁹ models. The OECD took over from the League after World War II and published its own bilateral model (based on the London model) in 1963,¹⁰ while the UN published a bilateral model based on the Mexico model in 1980.¹¹ These models in turn inspired a network of over three thousand bilateral tax treaties that form the bul-

3. *Id.*

4. See generally REUVEN AVI-YONAH, *ADVANCED INTRODUCTION TO INTERNATIONAL TAX LAW* (2015) (discussing the international tax regime). For the importance of the MLI as a turning point in the evolution of the international tax regime, see A *GLOBAL ANALYSIS OF TAX TREATY DISPUTES* (Eduardo Baistrocchi ed., 2017).

5. For the history of the pre-World War I bilateral tax treaties, see, e.g., Sunita Jogarajan, *Prelude to the International Tax Treaty Network: 1815–1914 Early Tax Treaties and the Conditions for Action*, 31 *OXFORD J. OF LEGAL STUD.* 679 (2011). The first tax treaty was concluded between Prussia and Saxony in 1869. *Id.* at 696.

6. Bret Wells & Cym H. Lowell, *Income Tax Treaty Policy in the 21st Century: Residence vs. Source*, 5 *COLUM. J. TAX. L.* 1, 13 (2013).

7. See *Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.562M.178 1928 II (1928).

8. *Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion*, League of Nations Doc. C.2.M.2. 1945 II A (1945).

9. *Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion*, League of Nations Doc. C.88.M.88. 1946 II A. (1946).

10. OECD, *Draft double taxation convention on income and capital: report of the O.E.C.D. Fiscal Committee* (1963).

11. U.N. DEP'T OF ECON. & SOC. AFFAIRS, U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, U.N. DOC. ST/ESA/102,

wark of the ITR.¹² About eighty percent of the words of any two tax treaties are identical and derive from the OECD or UN models (which are themselves over eighty percent identical to one another).¹³

From the beginning, the League of Nations was interested in the possibility of negotiating a multilateral tax treaty, but it concluded that the differences among the tax laws of different states were too vast to allow for a successful negotiation.¹⁴ Subsequent efforts to negotiate multilateral tax treaties also failed.¹⁵ Most recently, the European Court of Justice refused to apply its freedom of movement of capital jurisprudence to force a harmonization of withholding tax rates among treaties within the EU.¹⁶

However, in the academic world as well as in practice, there has been increasing recognition of the need for a multilateral tax treaty.¹⁷ There are three reasons why a multilateral tax treaty makes more sense than a network of bilateral tax treaties. First, the rise of the General Agreement on Tariffs and Trade (GATT), and then the WTO after World War II, has shown that multilateral treaties governing important areas of international economic law are feasible if space is allowed for reservations (i.e., allowing countries to opt out of specific provisions). Second, there has been increas-

U.N. Sales No. E.80.XVI.3 (1980). United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, 1980).

12. REUVEN S. AVI-YONAH, *INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL REGIME* 5 (2007).

13. Reuven Avi-Yonah, *Double Tax Treaties: An Introduction*, in *THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT* 99 (Karl P. Sauvant & Lisa E. Sachs, eds., 2009); Elliott Ash and Omri Marian, *The Making of International Tax Law: Empirical Evidence from Natural Language Processing*, NTA Annual Meeting, Philadelphia, November 9, 2017.

14. Eran Lempert, *Crossing the Barrier: Towards a Multilateral Tax Treaty* (2009) (unpublished J.S.D. dissertation, New York University) (on file with authors).

15. *Id.* For an early appreciation of the need for a multilateral treaty, see Thomas S. Adams, *International and Interstate Aspects of Double Taxation*, 22 *PROC. OF THE ANN. CONF. ON TAX'N UNDER THE AUSPICES OF THE NAT'L TAX ASS'N*, 192-199 (1929) ("Now, in the long run, whatever solutions are adopted by different pairs of nations, it is probable that Nation A in concluding a bi-lateral convention with Nation B will adopt some solution different from that which it might adopt in a similar treaty with Nation X. And if this piece-meal bargaining goes on for twenty years or more, as it is likely to go on, it may possibly result in a tangle of conflicting solutions applicable to the nationals of different countries, which will be highly complicated and highly mysterious, and about as bad as the situation that now exists. In short, there is in my mind, looking to the 'longer future, the strongest reason for the adoption of one uniform solution, if we could get it, or the settlement of this problem by a multilateral convention, in which a large group of nations would adopt the same solutions for the detailed problems which have to be set.'").

16. Case C-376/03, *D v. Inspecteur van Belastingdienst*, 2005 E.C.R. I-05821.

17. See, e.g., Kim Brooks, *The Potential of Multilateral Tax Treaties*, in *TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS* (Michael Lang et al. eds., 2010); Jung-hong Kim, *A New Age of Multilateralism in International Taxation?*, 21 *SEOUL TAX L. REV.* 227 (2015); Richard L. Reinhold, *Some Things That Multilateral Tax Treaties Might Usefully Do*, 57 *TAX LAW.* 661 (2004); Thomas Rixen, *Bilateralism or Multilateralism? The Political Economy of Avoiding International Double Taxation*, 16 *EUR. J. OF INT'L REL.* 589 (2010); Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 *BROOK. J. INT'L L.* 1641 (2001).

ing convergence in the language of the various tax treaties; in particular, the OECD and UN models have become increasingly similar over time.¹⁸ Third, with globalization, tax competition treaty shopping (using treaties to obtain advantages for non-treaty country residents)¹⁹ and “triangular situations” (problems arising from treaty residents doing business in third countries in ways that affect the treaty but are not covered by it) have become far more common.²⁰

The main obstacle to a multilateral tax treaty has always been that investment flows vary by each pair of countries; therefore, appropriate withholding tax rates vary as well.²¹ That is the main reason for the remaining differences between the OECD and UN models, because flows between developed countries are more reciprocal than flows between developed and developing countries. But even that is changing, as more developing countries become capital exporters as well as importers.²² In addition, it has for some time been recognized that it may be possible to negotiate a multilateral treaty but leave the withholding tax rates to be settled by bilateral negotiation, as the UN model does.²³

The new OECD MLI represents the culmination of this line of thinking. It is not a full-fledged multilateral tax convention covering all the areas that are usually covered by bilateral tax treaties. Instead, it is a global consensual treaty override designed to apply the results of Base Erosion and Profit Shifting (BEPS) simultaneously to all the tax treaties where the countries involved agree. The MLI is implemented by countries signing and ratifying it according to their usual constitutional norms and then depositing the ratification with the OECD.²⁴ Upon ratification, the provisions of the MLI apply to modify the relevant provisions of the bilateral treaties of each depositing country with other depositing countries that

18. REUVEN SHLOMO AVI-YONAH, NICOLA SARTORI & OMRI MARIAN, *GLOBAL PERSPECTIVES ON INCOME TAXATION LAW* 150 (2011).

19. Reuven Avi-Yonah & C. H. Panayi, *Rethinking Treaty Shopping: Lessons for the European Union*, in *TAX TREATIES: BUILDING BRIDGES BETWEEN LAW AND ECONOMICS* 21 (Michael Lang et al. eds., 2010).

20. EMILY FETT, *TRIANGULAR CASES: THE APPLICATION OF BILATERAL INCOME TAX TREATIES IN MULTILATERAL SITUATIONS* (2014).

21. *Withholding Tax Rates 2017*, DELOITTE (Mar. 2017), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-withholding-tax-rates.pdf>

22. For an overview of the general trends of participation of developing countries in world trade, see Comm. on Trade and Dev., *Participation of developing countries in World Trade: Overview of major trends and underlying factors*, WTO Doc. WT/COMTD/W/15 (Aug. 16, 1996).

23. See Lempert, *supra* note 14.

24. Org. for Econ. Co-Operation and Dev. [OECD], *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, art. 27 (June 7, 2017), <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf> [hereinafter OECD 2017 MLI]; OECD, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, ¶ 263, <https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf> [hereinafter OECD MLI Explanatory Statement].

they both designate as “covered tax agreements,” unless there is a reservation (which is not allowed in some cases involving minimum BEPS standards).²⁵

One of those minimum standards that has been agreed to by all seventy-one signatories of the MLI is the “primary purpose test” (PPT), which states:

A [treaty] 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 Covered Tax Agreement.²⁶

The PPT, which was adopted over strenuous opposition from the United States, may influence treaty interpretation beyond the signatories of the MLI. In particular, the reference to the “object and purpose” of the tax treaty should be interpreted in light of the new preamble to the OECD model, which clarifies that the object and purpose of tax treaties is to prevent both double taxation and double non-taxation.²⁷ This adoption of the “single tax principle” can have wide-ranging ramifications for the interpretation of tax treaties, and may even impact the United States as a non-signatory because the prevention of double non-taxation is also incorporated into the 2016 U.S. model.²⁸

In addition, the new OECD MLI has a wide-ranging dispute resolution mechanism including mandatory arbitration.²⁹ Mandatory arbitration has recently been introduced into the OECD and U.S. models,³⁰ but it is still lacking in the UN model and most actual treaties. The effect of including it in the MLI may be to force binding arbitration on many existing treaties, which is likely to prove controversial.³¹

25. OECD MLI Explanatory Statement, *supra* note 24, ¶ 280.

26. OECD 2017 MLI, *supra* note 24, art. 7(1).

27. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report* 92 (Oct. 5, 2015), <http://dx.doi.org/10.1787/9789264241695-en> (“(State A) and (State B) . . . intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance”).

28. Reuven S. Avi-Yonah, *Full Circle: The Single Tax Principle, BEPS, and the New US Model*, 1 GLOBAL TAXATION 12 (2016).

29. OECD 2017 MLI, *supra* note 24, arts. 18–26.

30. U.S. DEP’T OF TREAS., UNITED STATES MODEL INCOME TAX CONVENTION, art. 25, ¶ 6–10, <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>; OECD, *Model Tax Convention on Income and on Capital*, art. 25 (2008), <http://www.oecd.org/tax/treaties/42219418.pdf>.

31. Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 FLA. TAX REV. 703 (2008).

This article will proceed as follows. Section 2 summarizes the main provisions of the MLI. Section 3 discusses the purpose of tax treaties in the twenty-first century, because it can be argued that they are less necessary under conditions of tax competition. Section 4 raises the question whether tax treaties can be improved short of a full-fledged multilateral tax treaty by inserting a most favored nation (MFN) provision similar to those found in bilateral investment treaties. Such an MFN provision operates over time to create a de facto multilateral treaty without the negotiation of one. Section 5 concludes this article.

2. THE NEW OECD MULTILATERAL INSTRUMENT (NEW MLI)

2.1 *The Mission of the MLI*

The mission of the MLI is described in the preamble as follows:

[T]o ensure swift, co-ordinated and consistent implementation of the treaty-related BEPS measures in a multilateral context . . . to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in those agreements for the indirect benefit of residents of third jurisdictions) . . . to implement agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement.³²

In short, the overall mission or purpose of the MLI is to implement tax-treaty-related BEPS measures in a swift, coordinated, and consistent manner across the network of existing tax treaties (Covered Tax Agreements) in a multilateral context without bilateral renegotiation of each agreement.

Although tax treaties have played an important role in eliminating double taxation and facilitating globalization of liberal investment and trade in past decades, the loopholes and mismatches in existing treaties are one of the root causes of widespread unregulated BEPS opportunism.³³ As a comprehensive response, BEPS Actions 2, 6, 7 and 14 have developed a series of treaty-related BEPS measures. Action 2 report aims at neutralizing the effects of hybrid mismatch arrangements.³⁴ Action 6 report aims at preventing the granting of treaty benefits in inappropriate circumstances.³⁵ Action 7 report aims at preventing the artificial avoid-

32. OECD 2017 MLI, *supra* note 24, preamble.

33. OECD, *Action Plan on Base Erosion and Profit Shifting* 13 (July 19, 2013), <http://dx.doi.org/10.1787/9789264202719-en>.

34. See OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report* (Oct.5, 2015), <http://dx.doi.org/10.1787/9789264241138-en>.

35. See OECD, *supra* note 27.

ance of Permanent Establishment (PE) (physical presence) status.³⁶ Action 14 report aims at making dispute resolution mechanisms more effective.³⁷

Beyond reflecting the BEPS measures in articles 3 through 26, the MLI further reinforces the single tax principle by “recognizing the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created,” and clarifying the position to eliminate both double taxation and non-taxation or reduced taxation through tax evasion or avoidance.³⁸

Multilateral problems demand multilateral solutions. Implementation of the BEPS Package will demand updates to model tax conventions, including the OECD Model Tax Convention and the UN Model Tax Convention, as well as the bilateral tax treaties that follow those model conventions.³⁹ Uncoordinated bilateral updates to the treaty network would be burdensome and time-consuming and would frustrate the implementation of BEPS measures by creating new BEPS opportunities.

To avoid uncoordinated and inconsistent unilateralism or bilateralism, pursuant to Action 15 Report, “Developing a Multilateral Instrument to Modify Bilateral Tax Treaties,” the MLI is intended to effectively and efficiently modify existing agreements in a multilateral context by creating and maintaining an effective, transparent, and reliable mechanism assisted by the Depositary, the Secretary General of OECD.⁴⁰ The MLI is not an amending protocol to a single existing treaty, and would not directly change the text of existing treaties.⁴¹ Instead, the MLI will be applied alongside existing tax treaties, serving as the compass to empower and enable the modification, interpretation, and application of the Covered Tax Agreements for the purpose of effective implementation of the treaty-related BEPS measures and the single tax principle.

The MLI would strengthen global partnerships and facilitate the smooth modification of the Covered Tax Agreements.⁴² All Parties would benefit from active participation either by developing consolidated versions of their Covered Tax Agreements as modified by the MLI, or by agreeing subsequently to different but functionally equivalent modifica-

36. See OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report* (Oct. 5, 2015) <http://dx.doi.org/10.1787/9789264241220-en>.

37. See OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report* (Oct. 5, 2015), <http://dx.doi.org/10.1787/9789264241633-en>.

38. OECD 2017 MLI, *supra* note 24, preamble.

39. OECD MLI Explanatory Statement, *supra* note 24, ¶ 4.

40. See OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report*, at 18, ¶ 11 (Oct. 5, 2015), <http://dx.doi.org/10.1787/9789264241688-en>.

41. See OECD MLI Explanatory Statement, *supra* note 24 ¶ 15.

42. *Countries adopt multilateral convention to close tax treaty loopholes and improve functioning of international tax system*, OECD (Nov. 24, 2016), <http://www.oecd.org/tax/countries-adopt-multilateral-convention-to-close-tax-treaty-loopholes-and-improve-functioning-of-international-tax-system.htm>.

tions to their Covered Tax Agreements.⁴³ It is not wise for any Party to be marginalized and isolated by the far-reaching reform of international tax regime led by the MLI and the BEPS project as a whole.

The MLI would ensure the coherent and consistent interpretation of the numerous Covered Tax Agreements. Article 31 of the Vienna Convention on the Law of Treaties requires that a treaty “be interpreted in good faith in accordance with the ordinary meaning of the terms of the treaty in context and in light of its object and purpose.”⁴⁴ Thus, the purpose of the MLI and the Covered Tax Agreement should be taken into account for the purpose of precisely understanding “the context” in question. To clarify the intent of the Parties to ensure that Covered Tax Agreements be interpreted in line with the mission of the MLI especially in controversial circumstances, article 6(1) requires the Covered Tax Agreements to be modified to include the penultimate paragraph of the preamble text of the MLI.⁴⁵

In addition to benefiting governments by closing the BEPS loopholes, the MLI is also intended to benefit MNEs by improving the transparency and predictability of the international tax regime and effectively minimizing and/or resolving disputes over the application of Covered Tax Agreements.⁴⁶

2.2 *The Principled Flexibilities in the MLI*

The MLI is both principled and flexible in response to the idealism and pragmatism of the BEPS package. The treaty-related minimum standards, including the prevention of treaty abuse under Action 6 and the improvement of dispute resolution under Action 14, must be implemented by and through the operation of the MLI in relation to the Covered Tax Agreements.⁴⁷ However, the MLI is principled not only because of its dedication to effective implementation of the minimum standards of BEPS measures, but also because of firm adherence to the single tax principle and multilateralism.⁴⁸

To some extent, it is difficult or even impossible to develop a “one-size-fits-all” BEPS solution.⁴⁹ Recognizing that not all the agreed BEPS

43. OECD MLI Explanatory Statement, *supra* note 24, ¶ 13.

44. Vienna Conventions on the Law of Treaties, art. 31, May 23, 1969, 1155 U.N.T.S. 331.

45. OECD 2017 MLI, *supra* note 24, art. 6.

46. Angel Gurría, Secretary-General, OECD, Remarks at Adoption Ceremony of the BEPS Treaty (Nov. 24, 2016), (transcript available at <http://www.oecd.org/tax/beps/remarks-at-adoption-ceremony-of-the-beps-treaty.htm>).

47. OECD, *Background Brief: Inclusive Framework on BEPS*, ¶ 5 (Jan. 2017), <https://www.oecd.org/ctp/background-brief-inclusive-framework-for-beps-implementation.pdf>.

48. For a brief discussion of the complexities of multilateralism in the context of BEPS, see CHRISTIANA HJI PANAYI, *ADVANCED ISSUES IN INTERNATIONAL AND EUROPEAN TAX LAW* 153–57 (2015).

49. MICHAEL LANG ET AL., *BASE EROSION AND PROFIT SHIFTING (BEPS): THE PROPOSALS TO REVISE THE OECD MODEL CONVENTION* 212 (2016).

measures are minimum standards or hard rules, and given that even the minimum standards can be achieved in multiple different ways, the MLI has to be flexible and moderate to enable the Parties to substantially and creatively meet the minimum standards and seek best practices pursuant to the purpose and object of the BEPS project. The Parties enjoy a variety of solutions to implement the MLI by and through free choice to opt in and/or opt out, win-win mutual agreements based on compromise, and invention of more effective methodology and tools in line with the mission and purpose of the MLI and the BEPS package.⁵⁰

First, the MLI only applies to the Covered Tax Agreements that are specifically listed by the Contracting Jurisdictions to those Agreements,⁵¹ although the MLI is intended to cover all existing tax treaties.⁵² A Party may choose to exclude a specific agreement from the scope of Covered Tax Agreements if such agreement “has been recently renegotiated to implement the outcomes of the BEPS Project, or is currently under renegotiation with the intent of implementing those outcomes in the renegotiated agreement.”⁵³

Second, the Parties may use a reservation to opt out of the entirety or parts of substantial provisions not reflecting the minimum standard in the MLI.⁵⁴ The reserved provision will not apply as between the reserving Party and all other Parties to the MLI, and the reserving Party is not obligated to modify the Covered Tax Agreements as foreseen by the reserved provision of the MLI.⁵⁵

Third, the Parties may use a reservation to opt out of the entirety or parts of provisions to be applied to “a subset of Covered Tax Agreements in order to preserve existing provisions that have specific, objectively defined characteristics.”⁵⁶ “[S]uch reservations will apply as between the reserving Party and all Contracting Jurisdictions to the Covered Tax Agreements covered by such reservations.”⁵⁷

Fourth, multiple alternatives or optional provisions addressing a particular BEPS issue offered in the MLI will apply only if all Contracting Jurisdictions to a Covered Tax Agreement affirmatively and expressly choose to apply them.⁵⁸ Parties may also feel free to supplement the main provision of the MLI with an additional provision in the Covered Tax Agreement.⁵⁹

50. OECD MLI Explanatory Statement, *supra* note 24, ¶ 13–14.

51. OECD 2017 MLI, *supra* note 24, art. 1–2.

52. OECD MLI Explanatory Statement, *supra* note 24, ¶ 26.

53. *Id.*, ¶ 14.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. *E.g.*, OECD 2017 MLI, *supra* note 24, art. 7(7); OECD MLI Explanatory Statement, *supra* note 24, ¶ 14.

59. OECD MLI Explanatory Statement, *supra* note 24, ¶ 14.

Fifth, the MLI provides great flexibility on the provisions relating to a BEPS minimum standard. Where a minimum standard could be satisfied in multiple alternative ways, the Contracting Jurisdictions may adopt their own favorite approaches or solutions.⁶⁰ In case of conflicts or disputes arising from different approaches between contracting jurisdictions, the conflicts are expected to be settled amicably by a mutually satisfactory solution consistent with the minimum standard.⁶¹ If a Party's Covered Tax Agreements have already satisfied a specific minimum standard, this Party may opt out of the provision reflecting this minimum standard.⁶² To encourage best efforts and the honest implementation of minimum standards, the effectiveness and adequacy of certain Covered Tax Agreement in satisfying the minimum standard would be tested by the Inclusive Framework on BEPS.⁶³

Sixth, although Part VI provides for mandatory and binding arbitration,⁶⁴ Parties enjoy great autonomy and flexibility on the choice of arbitration rules. Part VI applies only between Parties that expressly choose to apply it with respect to their Covered Tax Agreements.⁶⁵ The Parties that choose to apply Part VI may also formulate their own reservations with respect to the scope of cases eligible for arbitration subject to acceptance by the other Parties, despite the defined reservations included in Part VI.⁶⁶

Seventh, the MLI encourages the Parties to choose recommended optional provisions.⁶⁷ Although many optional provisions are not required in order to meet the minimum standards, they are important "soft law" rules. Thus, it is wise for the Parties to introduce these best practices and policy recommendations into the Covered Tax Agreements. For instance, article 6 encourages Parties to include the following optional preamble language in their Covered Tax Agreements, "[d]esiring to further develop their economic relationship and to enhance their co-operation in tax matters."⁶⁸ If all Parties voluntarily pledge allegiance to the mission of the MLI, the solidarity of global partnership is expected to be further strengthened by and through more flexible and practical dialogue, negotiation, exchange and collaboration on the BEPS project.

60. *Id.*

61. *Id.*

62. *Id.*

63. OECD and G20 countries promised to work together to design and propose a more inclusive framework in early 2016 to support and monitor the implementation of the BEPS package. See OECD, Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, ¶ 11 (2015), <http://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf>.

64. OECD 2017 MLI, *supra* note 24, art. 19.

65. *Id.*, art. 18.

66. *Id.*, art. 28.

67. OECD 2017 MLI, *supra* note 24, preamble.

68. OECD 2017 MLI, *supra* note 24, art. 6(3).

2.3 The Macro Structure of the MLI

The MLI of 39 articles could be perceived as a dragon, with the preamble as its eyes, Part I as its head, Parts II through VI as its body, and Part VII as its tail. The core value of a single tax principle and almost all treaty-related BEPS measures agreed to in the BEPS Package have been fully reflected in the MLI.⁶⁹

Part I is intended to clarify the scope of the MLI and interpretation of terms.⁷⁰ Under Article 1, the MLI modifies all Covered Tax Agreements as defined in article 2 (1)(a).⁷¹ Article 2 interprets four terms and provides the general rules of interpretation of other undefined terms used in the MLI.⁷²

Part II addresses the measures on hybrid mismatches covered by the Action 2 Report.⁷³ Article 3 addresses treaty provision on transparent entities.⁷⁴ In addition to addressing dual-resident entities, article 4 addresses the tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals covered by the Action 6 Report.⁷⁵ Article 5 addresses the exemption method and the credit method.⁷⁶

Part III addresses treaty abuse covered by the Action 6 Report.⁷⁷ The Preamble and article 6 of the MLI clarify that tax treaties are not intended to be used to generate double non-taxation.⁷⁸ Article 7(1) and (4) address the rules aimed at arrangements, one of the principal purposes of which is to obtain treaty benefits.⁷⁹ Article 7(8) through (13) focus on the LOB rule.⁸⁰ Article 8 focuses on dividend transfer transactions.⁸¹ Article 9 focuses on transactions that circumvent the application of article 13(4).⁸² Article 10 focuses on the anti-abuse rule for PEs situated in third States.⁸³ Article 11 focuses on application of tax treaties to restrict a Contracting State's right to tax its own residents.⁸⁴

Part IV is intended to amend existing tax treaties to counter the artificial avoidance of PE status covered by the Action 7 Report.⁸⁵ Articles 12

69. *See id.*, Annex.

70. *Id.* arts. 1 – 2.

71. *Id.*, art. 1.

72. *Id.*, art. 2.

73. *Id.*, arts. 3 – 5; OECD *supra* note 34.

74. OECD 2017 MLI, *supra* note 24, art. 3.

75. *Id.* art. 4.

76. *Id.* art. 5.

77. *Id.*, arts 6 – 11; OECD, *supra* note 27.

78. OECD 2017 MLI, *supra* note 24, preamble, art. 6.

79. *Id.*, arts. 7(1), 7(4).

80. *Id.*, arts. 7(8) – 7(13).

81. *Id.*, art. 8.

82. *Id.* art 9.

83. *Id.*, art. 10.

84. *Id.*, art. 11.

85. *Id.*, arts. 12-16; OECD, *supra* note 36.

addresses *commissionnaire* arrangements and similar strategies.⁸⁶ Article 13 addresses specific activity exemptions.⁸⁷ Article 14 addresses splitting-up of contracts.⁸⁸ Article 15 defines the term “a person closely related to an enterprise” frequently used in Part IV.⁸⁹

Part V and Part VI reflect the Action 14 Report on making dispute resolution mechanisms more effective.⁹⁰ Part V focuses on improving dispute resolution (article 16 and article 17) by clarifying the elements of a minimum standard to ensure the timely, effective and efficient resolution of treaty-related disputes and best practices.⁹¹

Part VI (article 18 through article 26) represents a set of cohesive provisions on mandatory binding arbitration of mutual agreement procedure (MAP) cases, in which the competent authorities are unable to reach timely agreement.⁹² It contains both substantive content and modalities of its technical application to Covered Tax Agreements. Rules for compatibility with existing provisions are consolidated in article 26, rather than being scattered in each article.⁹³

Part VII addresses the procedural issues from article 27 through article 39, including signature and ratification, acceptance or approval, reservations, notifications, subsequent modifications of covered tax agreements, conference of the parties, interpretation and implementation, amendment, entry into force, entry into effect, entry into effect of part VI, withdrawal, relation with protocols, and depositary.⁹⁴

To clarify the approach taken in the MLI, the types of provisions of Covered Tax Agreements intended to be covered and the detailed ways for the MLI to affect Covered Tax Agreements, an “explanatory statement” was adopted on November 24, 2016.⁹⁵ It reflects the consensus of the negotiators with respect to the MLI. It is intended to clarify the operation of the MLI to modify Covered Tax Agreements, but not to interpret the underlying BEPS measures, except with respect to Part VI.⁹⁶

86. OECD 2017 MLI, *supra* note 24, art. 12.

87. *Id.*, art. 13.

88. *Id.*, art. 14.

89. *Id.*, art. 15.

90. *See* OECD, *supra* note 37, nd art. 14.

91. OECD 2017 MLI, *supra* note 24, arts. 16 – 17.

92. *Id.* arts. 18 – 26.

93. *Id.* art. 26.

94. *Id.* arts. 27 – 39.

95. OECD MLI Explanatory Statement, *supra* note 24, ¶ 12.

96. *Id.*

2.4 *The Micro Structure of Each Substantive Provision of Part II, III, IV & V*

Almost every substantive provision in Part II, III, IV and V (i.e., all except Part VI) contains a BEPS measure clause, a compatibility clause, a reservation clause and a notification clause.⁹⁷

2.4.1 BEPS Measures Clause

As BEPS measures are the backbone of the MLI, it is necessary for articles 3 through 17 to duplicate the language of the provisions of the OECD Model Tax Convention developed during the course of the BEPS Project, with minor technical modifications.⁹⁸ For instance, “Covered Tax Agreement” and “Contracting Jurisdiction” replaced “Convention” and “Contracting State” used in the OECD Model Tax Convention and the UN Model Tax Convention, respectively.⁹⁹ References to specific articles and paragraphs in provisions of existing tax agreements are also replaced with descriptions of those provisions for the purpose of precisely identifying specific provisions in Covered Tax Agreements.¹⁰⁰

2.4.2 Compatibility Clauses

The provisions of the MLI may overlap or conflict with provisions of Covered Tax Agreements on the same tax matters.¹⁰¹ To clarify the relationship between the provisions of the MLI and Covered Tax Agreements, there are four major types of compatibility clauses, whose uses depend on policy considerations and factual circumstances.¹⁰² First, a specified MLI provision applies only “in place of” an existing provision, and does not apply where such existing provision does not exist.¹⁰³ Second, a specified MLI provision “applies to” or “modifies” an existing provision by changing the application of the existing provision without replacing it.¹⁰⁴ Third, a specified MLI provision applies “in the absence of” an existing provision.¹⁰⁵ Fourth, a specified MLI provision applies “in place of or in the absence of” an existing provision, regardless of whether such existing provision exists and/or whether such existing provision has been notified to the Depository.¹⁰⁶ If an incompatible or conflicting provision exists, the provision of the MLI shall prevail.¹⁰⁷ In the absence of such existing provi-

97. *Id.*, ¶ 15. *See, e.g.*, OECD 2017 MLI, *supra* note 24, art. 3 (providing four paragraphs that respectively represent each kind of clause).

98. OECD MLI Explanatory Statement, *supra* note 24, ¶ 15.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. *See, e.g.*, OECD 2017 MLI, *supra* note 24, art. 5(7).

104. *See, e.g., id.*, art. 7(5).

105. *See, e.g., id.*, art. 16(4)(b)(i).

106. *See, e.g., id.*, art. 3(4).

107. OECD MLI Explanatory Statement, *supra* note 24, ¶ 15.

sion, the provision of the MLI shall be deemed to be automatically added to the Covered Tax Agreement.¹⁰⁸

2.4.3 Reservation Clauses

Reasonable reservations are necessary to respect the Parties' autonomy and to keep the elasticity of the MLI, while unregulated reservations would make chaos.¹⁰⁹ To ensure its harmonious application, the MLI contains reservation clauses to define and regulate the reservations.¹¹⁰ Parties may opt out of applying certain provisions to their Covered Tax Agreements within a closed list of permitted reservations specified in the reservation clauses.¹¹¹ To ensure transparency, a reserving Party is required to provide a list of the existing provisions within the scope of that reservation.¹¹² The reservation will apply as between the reserving Party and all other Parties to the MLI.¹¹³

2.4.4 Notification Clauses

To safeguard clarity, transparency, certainty, and predictability of its application, the MLI requires Parties to notify the Depositary of their choices and/or significant information regarding the Covered Tax Agreements.¹¹⁴ First, Parties should report their choices of optional provisions to the Depositary, "and describe the consequences of a mismatch between the Contracting Jurisdictions to a Covered Tax Agreement."¹¹⁵ Second, Parties should notify the Depositary of specific types of existing provisions within the scope of compatibility clauses that are superseded or modified by the MLI.¹¹⁶ Parties are expected to identify, notify, and disclose all provisions within the objective scope of the compatibility clause.¹¹⁷ In case of inadvertent omission of existing provisions, additional notifications are expected to be forthcoming.¹¹⁸ If the contracting jurisdictions disagree on whether existing provisions are within the scope of a compatibility clause, such disputes should be settled either through the mutual agreement procedure, or a Conference of the Parties.¹¹⁹

108. *Id.*

109. *Id.*, ¶ 14.

110. *Id.*

111. See OECD 2017 MLI, *supra* note 24, art. 28.

112. OECD MLI Explanatory Statement, *supra* note 24, ¶ 271.

113. OECD 2017 MLI, *supra* note 24, art. 28(3).

114. *Id.*, art. 29.

115. OECD MLI Explanatory Statement, *supra* note 24, ¶ 15; See e.g. OECD 2017 MLI, *supra* note 24, art. 5(10).

116. OECD MLI Explanatory Statement, *supra* note 24, ¶ 15; See e.g. OECD 2017 MLI, *supra* note 24, art. 8(4).

117. OECD MLI Explanatory Statement, *supra* note 24, ¶ 15.

118. OECD 2017 MLI, *supra* note 24, art. 29(6); OECD MLI Explanatory Statement, *supra* note 24, ¶ 18.

119. OECD MLI Explanatory Statement, *supra* note 24, ¶ 18.

2.5 Interpretation of Terms

2.5.1 Covered Tax Agreement

Article 2(1)(a) of the MLI defines the term “Covered Tax Agreement” as “an agreement for the avoidance of double taxation with respect to taxes on income . . . in force between two or more Parties[] and/or jurisdictions or territories . . . for whose international relations a Party is responsible, and with respect to which each such Party has made a notification to the Depository listing the agreement as well as any amending or accompanying instruments thereto . . . as an agreement which it wishes to be covered by this Convention.”¹²⁰

While agreements simultaneously covering capital taxes, taxes on capital gains, and income taxes are also Covered Tax Agreements, agreements applying solely to shipping and air transport or social security are not covered by the MLI.¹²¹

Under article 2 (1)(a)(i) of the MLI, Covered Tax Agreements are supposed to be in force between two or more Parties and/or jurisdictions or territories.¹²² If an agreement has been signed but has not yet entered into force, a Party may include such agreement in the list of Covered Tax Agreements, and must notify the Depository of the date of entry into force of that agreement.¹²³ Such an inclusive and enabling approach to interpretation would improve the transparency of the potential Covered Tax Agreements.

2.5.2 Party

Article 2(1)(b) defines the term “Party” used throughout the MLI as a State for which the MLI is in force, or a jurisdiction which has signed the MLI and for which the MLI is in force.¹²⁴ Therefore, Parties can be either States or Non-State jurisdictions.¹²⁵

2.5.3 Contracting Jurisdiction

The term “Contracting Jurisdiction” refers to a party to a Covered Tax Agreement, including States, jurisdictions, or territories.¹²⁶ Thus, “Contracting Jurisdiction” is broader than “Contracting State.” While “Contracting Party” exclusively refers to a Party to the MLI, “Contracting Jurisdiction” exclusively refers to a Party to the Covered Tax Agreements.¹²⁷

120. OECD 2017 MLI, *supra* note 24, art. 2(1)(a).

121. OECD MLI Explanatory Statement, *supra* note 24, ¶ 25.

122. OECD 2017 MLI, *supra* note 24, art. 2(1)(a).

123. OECD MLI Explanatory Statement, *supra* note 24, ¶ 32.

124. OECD 2017 MLI, *supra* note 24, art. 2(1)(b).

125. OECD MLI Explanatory Statement, *supra* note 24, ¶ 35.

126. *Id.*

127. *Id.*, ¶¶ 34-35.

The MLI may cover tax agreements entered into by a State Party on behalf of a non-State jurisdiction or territory for whose international relations it is responsible.¹²⁸ In such cases, the State Party should include those tax agreements in its list of tax agreements, and the list of reservations and notifications regarding that jurisdiction or territory may differ from the State Party's own list.¹²⁹

2.5.4 Signatory

The term "Signatory" exclusively used in Part VII, refers to a State or jurisdiction that has signed the MLI but for which the MLI is not yet in force.¹³⁰

2.5.5 Interpretation of Other Undefined Terms

Article 2(2) provides a general rule of interpretation for undefined terms used in the MLI.¹³¹ Unless the context requires otherwise, an undefined term "has the meaning that it has under the relevant Covered Tax Agreement at the time the Convention is being applied."¹³² As noted above, the purpose of the MLI and of the Covered Tax Agreement should be taken into account for the purpose of understanding "the context" required by article 2(2).¹³³

2.6 Hybrid Mismatches

2.6.1 Transparent Entities

Article 3 of the MLI is intended to address the application of tax treaties to the income earned through transparent entities, including partnerships and trusts, and to ensure that treaty benefits are granted in appropriate cases but not granted where neither Contracting State treats the income of an entity as the income of one of its residents.¹³⁴

Based on article 1(2) of the OECD Model Tax Convention of 2014 produced by the Action 2 Report, Article 3(1) restates that income derived by or through an entity or arrangement treated as fiscally transparent under the tax law of either Contracting Jurisdiction, shall be considered to be income of a resident of a Contracting Jurisdiction, but only to the extent that the income is treated for purposes of taxation by that Contracting Jurisdiction as the income of its resident.¹³⁵

To modify the application of the provisions related to methods for the elimination of double taxation, article 3(2) clarifies that the Provisions of a

128. OECD 2017 MLI, *supra* note 24, art. 2(1)(a)(i)(B).

129. OECD MLI Explanatory Statement, *supra* note 24, ¶¶ 27 – 28.

130. OECD 2017 MLI, *supra* note 24, art. 2(1)(d).

131. *Id.* art. 2(2).

132. OECD MLI Explanatory Statement, *supra* note 24, ¶ 37.

133. *Id.*

134. *Id.*, ¶¶ 39-40.

135. OECD 2017 MLI, *supra* note 24, art. 3(1).

Covered Tax Agreement that require Contracting Jurisdiction X to exempt from income tax or provide a deduction or credit equal to the income tax paid with respect to income derived by its resident which may be taxed in Contracting Jurisdiction Y according to the Covered Tax Agreement, shall not apply to the extent that such provisions allow taxation by Jurisdiction Y solely because the income is also income derived by its resident.¹³⁶

Article 3(3) addresses the link between article 3 and the saving clause in article 11 by adding an additional sentence to the end of paragraph 1: “In no case shall the provisions of this paragraph be construed to affect a Contracting Jurisdiction’s right to tax the residents of that Contracting Jurisdiction.”¹³⁷ It shall apply with respect to any Covered Tax Agreement for which one or more Parties has made reservation described in Article 11(3)(a).¹³⁸

Under the compatibility clause in article 3(4), article 3(1) will apply instead of or in the absence of existing provisions of the same type, whether such provisions are framed either through a general rule, or by identifying in detail the treatment of specific fact patterns or specific types of entities or arrangements.¹³⁹

Given that “a provision on fiscally transparent entities is not required in order to meet a minimum standard,”¹⁴⁰ the reservation clause in article 3(5) permits Parties to opt out of the entirety or part of Article 3.¹⁴¹ Parties may opt out of article 3(1) while retaining existing provisions denying benefits in the case of transparent entities established in third jurisdictions and/or identifying in detail the treatment of specific fact patterns and types of entities or arrangements.¹⁴² Parties may opt out of article 3(2).¹⁴³ Parties may reserve the right for article 3(1) to replace existing detailed provisions, while keeping existing shorter provisions.¹⁴⁴

To ensure clarity, article 3(6) provides the notification requirements for the Parties.¹⁴⁵

136. *Id.*, art. 3(2).

137. *Id.*, art. 3(3).

138. *Id.*

139. *Id.*, art. 3(4).

140. OECD MLI Explanatory Statement, *supra* note 24, ¶ 46.

141. OECD 2017 MLI, *supra* note 24, art. 3(5)(a).

142. *Id.*, art. 3(5).

143. *Id.*, art. 3(5)(f).

144. *Id.*, art. 3(5)(g).

145. *Id.*, art. 3(6).

2.6.2 Dual Resident Entities

Based on article 4(3) of the OECD Model Tax Convention of 2014,¹⁴⁶ Article 4(1) of the MLI is designed to modify the rules for determining the treaty residence of dual-resident entities.¹⁴⁷

Under article 4(1):

where by reason of the [existing] provisions . . . a person is a resident of more than one Contracting Jurisdiction, the competent authorities . . . shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident . . . having regard to its place of effective management, the place where it is incorporated or otherwise constituted, and any other relevant factors.¹⁴⁸

“In the absence of such agreement, the entity shall not be entitled to any relief or exemption . . . as may be agreed upon by the competent authorities.”¹⁴⁹ Since the failure to grant such benefits cannot be viewed as violation of the Covered Tax Agreement, the cases in which benefits are denied due to an agreement failure would not be eligible for arbitration under Part VI.¹⁵⁰

Under the compatibility clause in article 4(2), article 4(1) shall apply in place of or in the absence of all types of tie-breaker rules on the residence of entities, but it would not replace existing provisions “specifically addressing the residence of companies participating in dual-listed company arrangements”¹⁵¹ across several jurisdictions.

Recognizing that provisions addressing dual-resident entities are not required to meet the minimum standard,¹⁵² the reserving clause in article 4(3) permits Parties to opt out of the entirety of article 4 in different ways.¹⁵³ For instance, a Party may opt out of applying it to existing agreements that contain provisions with specific, objectively defined characteristics, by requiring the competent authorities to endeavor to reach tie-breaker agreement, setting out the treatment of an entity in case of agreement failure or simply denying treaty benefits without such requirement.¹⁵⁴

To ensure clarity, article 4(4) provides the notification requirements for the Parties.¹⁵⁵ In general, each Party should “notify the Depository of

146. OECD MLI Explanatory Statement, *supra* note 24, ¶ 49.

147. OECD 2017 MLI, *supra* note 24, art. 4(1).

148. *Id.*

149. *Id.*

150. OECD MLI Explanatory Statement, *supra* note 24, ¶ 58.

151. OECD 2017 MLI, *supra* note 24, art. 4(2).

152. OECD MLI Explanatory Statement, *supra* note 24, ¶ 54.

153. OECD 2017 MLI, *supra* note 24, art. 4(3).

154. *Id.*, arts. 4(3)(b)-(d).

155. *Id.* art. 4(4).

[the existing] provision . . . not subject to a reservation”.¹⁵⁶ Such a provision would be replaced by article 4(1) where all parties to the Covered Tax Agreement have notified accordingly.¹⁵⁷ “In other cases, [article 4(1)] would apply to the Covered Tax Agreement, [but would] supersede the [existing] provisions only to the extent that those provisions are incompatible with article 4(1).”¹⁵⁸

2.6.3 Application of Methods for Elimination of Double Taxation

As recommended by the Action 2 Report,¹⁵⁹ article 5 offers three options for Parties to address problems arising from the inclusion of the exemption method in treaties with respect to items of income not taxed in the jurisdiction of source.¹⁶⁰ Article 5(1) permits a Party to choose one or none of the options.¹⁶¹ Recognizing that asymmetrical application is normal in provisions on elimination of double taxation, the option chosen by each Jurisdiction shall apply with respect to its own residents, where Contracting Jurisdictions make different choices.¹⁶²

Under Option A, existing provisions

[t]hat would otherwise exempt income derived or capital owned by a resident of Contracting [Jurisdiction X] from tax in its jurisdiction for the purpose of eliminating double taxation shall not apply where Contracting Jurisdiction Y applies existing provisions to exempt such income or capital from tax or to limit the rate . . . In the latter case . . . [Jurisdiction X] shall allow as a deduction from the tax on the income or capital of that resident an amount equal to the tax paid in [Jurisdiction Y].¹⁶³

Under Option B, existing provisions

[t]hat would otherwise exempt income derived by a resident of Contracting [Jurisdiction X] from tax in its jurisdiction for the purpose of eliminating double taxation, because such income is treated as a dividend by [Jurisdiction X], shall not apply where such income gives rise to a deduction for the purpose of determining the taxable profits of a resident of [Contracting Jurisdiction Y] under the laws of [Jurisdiction Y]. In such case, [Jurisdiction X] shall allow as a deduction from the tax on the income of that resi-

156. *Id.*

157. *Id.*

158. *Id.*

159. OECD, *supra* note 34, ¶¶ 442-444.

160. OECD 2017 MLI, *supra* note 24, art. 5.

161. *Id.*, art. 5(1).

162. *Id.*, art. 5(1).

163. *Id.*

dent an amount equal to the income tax paid in [Jurisdiction Y].¹⁶⁴

Under Option C,

[w]here a resident of Contracting [Jurisdiction X] derives income or owns capital which may be taxed in Contracting [Jurisdiction Y] in accordance with the [existing] provisions . . . , [Jurisdiction X] shall allow, as a deduction from the tax on the income [or capital] of that resident, an amount equal to the income tax [or capital tax] paid in [Jurisdiction Y]. . . Such deduction shall not exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable to the income or the capital which may be taxed in [Jurisdiction Y]. Where in accordance with any [existing] provision, income derived or capital owned by a resident of Contracting [Jurisdiction X] is exempt from tax in [its] jurisdiction, [Jurisdiction X] may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.¹⁶⁵

To address the concerns that accepting asymmetrical application unconditionally might disrupt the balance of certain bilateral tax treaties “where the provision on the elimination of double taxation was the subject of bilateral compromise”,¹⁶⁶ article 5(8) allows a Party that chooses none of the Options to “reserve the right for the entirety of [article 5] not to apply with respect to . . . [its Covered Tax Agreements].¹⁶⁷ Given that “some Parties . . . comfortable with the asymmetrical application of Option A or B . . . may prefer to address more significant changes . . . through bilateral negotiation”,¹⁶⁸ article 5(9) permits a Party not choosing Option C, to permit the other Contracting Jurisdiction to not apply Option C.¹⁶⁹

Under the notification clause in article 5(10), “each Party . . . [choosing] to apply an Option . . . shall notify the Depository of its choice of Option”.¹⁷⁰ To ensure clarity, “an Option shall apply with respect to a provision of a Covered Tax Agreement only . . . [if the choosing Party] made such a notification¹⁷¹

164. *Id.*

165. *Id.* art. 5(6)(b).

166. OECD MLI Explanatory Statement, *supra* note 24, ¶ 72.

167. OECD 2017 MLI, *supra* note 24, art. 5(8).

168. OECD MLI Explanatory Statement, *supra* note 24, ¶ 73.

169. OECD 2017 MLI, *supra* note 24, art. 5(9).

170. *Id.*, art 5(10).

171. *Id.*

2.7 Treaty Abuse

2.7.1 Purpose of a Covered Tax Agreement

As the minimum standard for protection against the abuse of tax treaties under Action 6 of BEPS project,¹⁷² article 6(1) requires a Covered Tax Agreement to incorporate the following preamble language:

[I]ntending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions).¹⁷³

The compatibility clause in article 6(2) describes the interaction between article 6(1) and the preamble language of Covered Tax Agreements.¹⁷⁴

Article 6(3) encourages Parties to include the full preamble language produced in the Action 6 Report by adding the other part of the preamble of the OECD Model Tax Convention: “[d]esiring to further develop their economic relationship and to enhance their co-operation in tax matters.”¹⁷⁵ Since such an inclusion is not required to meet a minimum standard, article 6(3) shall modify a Covered Tax Agreement only where all Contracting Jurisdictions choose to apply it.¹⁷⁶

Article 6(4) permits a Party to opt out of applying article 6(1) only with respect to Covered Tax Agreements already satisfying the minimum standard.¹⁷⁷ Parties may preserve preamble language in their Covered Tax Agreements that “already . . . [refer to the intent] to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance . . . ”.¹⁷⁸

2.7.2 Prevention of Treaty Abuse

To address situations of treaty abuse, the Action 6 Report requests that countries implement (i) a principal purpose test (PPT) only; (ii) a PPT and either a simplified or detailed LOB provision; or (iii) a detailed LOB provision, supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties.¹⁷⁹ Based on Article X

172. OECD, *supra* note 29 ¶ 72.

173. OECD 2017 MLI, *supra* note 24, art. 6(1).

174. *Id.*, art. 6(2).

175. *Id.*, art. 6(3).

176. *Id.*, art. 6(6).

177. *Id.*, art. 6(4).

178. *Id.*

179. OECD, *supra* note 27, ¶ 22.

(Entitlement to Benefits) of the OECD Model Tax Convention, a result of the Action 6 Report, article 7 is the lengthiest article in the MLI.

Given that a PPT alone is the only approach that can satisfy the minimum standard, article 7(1) presents the PPT as the default option.¹⁸⁰ A treaty benefit

shall not be granted in respect to 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.¹⁸¹

Although the PPT is intended to identify the purpose behind the arrangement or transaction, this test is objective, rather than subjective, in terms of practical operation.

Under the compatibility clause in article 7(2), article 7(1)

shall apply in place of or in the absence of provisions of a Covered Tax Agreement that deny all or part of the benefits that would otherwise be provided where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.¹⁸²

Although article 7(1) is intended to replace narrower PPT provisions with a broader provision, it would not restrict the scope or application of various types of anti-abuse rules besides a PPT in existing agreements.¹⁸³

Given that the competent authorities need necessary discretion to grant benefits to qualified taxpayers in certain circumstances, Article 7(3) permits non-reserving Parties under Article 7(15)(a) to add Article 7(4) in Covered Tax Agreements.¹⁸⁴ Where a treaty benefit:

[I]s denied to a person under provisions of the Covered Tax Agreement . . . , the competent authority of Contracting [Jurisdiction X] that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that the benefits would have been granted to that per-

180. OECD MLI Explanatory Statement, *supra* note 24, ¶ 90.

181. OECD 2017 MLI, *supra* note 24, art. 7(1).

182. *Id.*, art. 7(2).

183. OECD MLI Explanatory Statement, *supra* note 24, ¶ 95.

184. OECD 2017 MLI, *supra* note 24, art. 7(3).

son in the absence of the transaction or arrangement. The competent authority . . . requested by a resident of Contracting [Jurisdiction Y] shall consult with the competent authority of [Jurisdiction Y] before rejecting the request.¹⁸⁵

Article 7(4) is an optional provision, and shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply it.¹⁸⁶

The compatibility clause in article 7(5) clarifies that article 7(4) shall apply to a PPT of a Covered Tax Agreement.¹⁸⁷ As a result, article 7(1) and article 7(4) may apply together in practice.¹⁸⁸

Article 7(6) permits Parties to supplement the PPT by choosing to apply a simplified LOB provision, which is optional, and applies with respect to a Covered Tax Agreement only “where all Contracting Jurisdictions have chosen to apply it”.¹⁸⁹ Where Parties disagree on its application, the PPT alone applies symmetrically by default.¹⁹⁰ However, it is problematic where one Party chooses the simplified LOB provision and opts out of article 7 entirely, while another contracting Party chooses not to apply the simplified LOB provision. To avoid such deadlock in the bilateral relationship, the simplified LOB provision shall apply when some but not all Contracting Jurisdictions have chosen to apply it, provided that there is agreement under article 7(7)(a) or (b).¹⁹¹ There are two possible outcomes. First, “all Contracting Jurisdictions choosing to apply the PPT alone may agree that the simplified LOB Provision applies symmetrically.”¹⁹² Second, all Contracting Jurisdictions choosing to apply the PPT alone may affirmatively permit asymmetrical application of the simplified LOB Provision.¹⁹³ Consequently, the Contracting Jurisdictions choosing to apply the simplified LOB Provision would apply both the PPT and the simplified LOB Provision, while the other Contracting Jurisdictions would apply the PPT alone.¹⁹⁴

Articles 7(8) through 7(13) contain a simplified LOB provision.¹⁹⁵ “Except as otherwise provided in the Simplified LOB Provision, a resident of a Contracting Jurisdiction shall not be entitled to a benefit that would otherwise be accorded by the Covered Tax Agreement”, unless such resi-

185. *Id.*

186. *Id.*, art. 17(b); OECD MLI Explanatory Statement, *supra* note 24, ¶ 98.

187. OECD 2017 MLI, *supra* note 24, art. 7(5).

188. OECD MLI Explanatory Statement, *supra* note 24, ¶ 99.

189. OECD 2017 MLI, *supra* note 24, art. 7(6).

190. OECD MLI Explanatory Statement, *supra* note 24, ¶ 101.

191. OECD 2017 MLI, *supra* note 24, art. 7(7).

192. *Id.*, art. 7(7)(a).

193. *Id.*, art. 7(7)(b).

194. OECD MLI Explanatory Statement, *supra* note 24, ¶ 102.

195. OECD 2017 MLI, *supra* note 24, arts., 7(8) – (13).

dent is a “qualified person” at the time that the benefit would be accorded.¹⁹⁶

Article 7(9) lists five categories of “qualified persons” as follows:

a) an individual; b) a Contracting Jurisdiction, or a political subdivision or local authority thereof, or an agency or instrumentality of any such Contracting Jurisdiction, political subdivision or local authority; c) a company or other entity, if the principal class of its shares is regularly traded on one or more recognized stock exchanges; d) a person, other than an individual, that i) is a non-profit organization of a type agreed to by the Contracting Jurisdictions through an exchange of diplomatic notes or ii) is an entity or arrangement established in that Contracting Jurisdiction, treated as a separate person under its domestic taxation laws, and is: A) established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and regulated as such by that Contracting Jurisdiction or one of its political subdivisions or local authorities; or B) established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in Subdivision A); e) a person other than an individual, if, on at least half the days of a twelve-month period that includes the time when the benefit would otherwise be accorded, persons who are residents of that Contracting Jurisdiction and that are entitled to benefits of the Covered Tax Agreement under subparagraphs a) to d) own, directly or indirectly, at least fifty percent of the shares of the person.¹⁹⁷

Under article 7(10),

[A] resident of Contracting Jurisdiction X will be entitled to benefits with respect to an item of income derived from Contracting Jurisdiction Y, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in [Jurisdiction X] and the income derived from [Jurisdiction Y] emanates from, or is incidental to, that business.¹⁹⁸

[I]f a resident of [Jurisdiction X] derives income from business activity conducted by that resident in [Jurisdiction Y], or arising in [Jurisdiction Y] from a connected person, the [qualification] conditions . . . for the benefits shall be considered to be satisfied with respect to such income only if the business activity carried on by the resident in [Jurisdiction X] to which the income is related is substantial in relation to the same activity or a complementary

196. *Id.*, art. 7(8).

197. *Id.*, art. 7(9).

198. *Id.*, art. 7(10).

business activity carried on by the resident or such connected person in [Jurisdiction Y].¹⁹⁹

Under article 7(11),

A resident of a Contracting Jurisdiction to a Covered Tax Agreement that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded by the Covered Tax Agreement with respect to an item of income if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least seventy-five percent of the beneficial interests of the resident.²⁰⁰

Under article 7(12),

[I]f a resident of [Contracting Jurisdiction X] . . . is neither a qualified person . . . nor entitled to benefits under [article 7(10) or (11)], the competent authority of [Contracting Jurisdiction Y] may nevertheless grant the benefits . . . or benefits with respect to a specific item of income, taking into account the object and purpose of the Covered Tax Agreement, but only if [the] resident demonstrates to the satisfaction of [the] competent authority that neither its establishment, acquisition, maintenance, nor the conduct of its operations, had [the acquisition of treaty benefits] as one of its principal purposes. . . . Before either granting or denying a request made . . . by a resident of [Jurisdiction X], the competent authority of [Jurisdiction Y] . . . shall consult with its counterpart in [Jurisdiction X].²⁰¹

Article 7(13) defines five terms for the purposes of the Simplified LOB Provision, including “recognized stock exchange,” “principal class of shares,” “equivalent beneficiary,” “shares” and “connected persons.”²⁰²

Unlike the Simplified LOB Provision, article 7 does not include a detailed LOB provision, which necessitates substantial bilateral customization.²⁰³ Parties preferring a detailed LOB provision may either opt out of the PPT and agree to endeavor to reach a bilateral agreement that satisfies the minimum standard²⁰⁴ or accept the PPT in article 7(1) as an interim measure and express such intent in their notification to the Depository.²⁰⁵

The compatibility clause in article 7(14) clarifies that the simplified LOB Provision is intended to apply in place of or in the absence of ex-

199. *Id.* art. 7(10)(b).

200. *Id.*, art. 7(11).

201. *Id.*, art. 7(10).

202. *Id.*, art. 7(13).

203. OECD MLI Explanatory Statement, *supra* note 24, ¶ 90.

204. *Id.*

205. *Id.*

isting LOB provisions, but not to restrict the scope or application of other types of anti-abuse rules in Covered Tax Agreements.²⁰⁶

Under the reservation clause in article 7(15), Parties intending to satisfy the minimum standard by adopting a combination of a detailed LOB provision and either rules to address conduit financing structures or a PPT, may opt out of article 7(1) but should “endeavor to reach a mutually satisfactory solution [satisfying the minimum standard].”²⁰⁷ Parties may opt out of either articles 7(1) and 7(4) with respect to Covered Tax Agreements already containing a PPT, or the simplified LOB Provision with respect to their Covered Tax Agreements already containing a LOB provision described in article 7(14).²⁰⁸

Under article 7(16), “except where the Simplified LOB Provision applies [under Article 7(7)], a Party [choosing under article 7(6)] to apply the Simplified LOB Provision may reserve the right to have the entirety of [article 7] not apply with respect to its Covered Tax Agreements . . . [and] the Contracting Jurisdictions shall endeavor to reach a mutually satisfactory solution [meeting] the minimum standard.”²⁰⁹

Article 7(17) describes very detailed notification requirements to ensure clarity as to the application of article 7.²¹⁰

2.7.3 Dividend Transfer Transactions

Based on article 10(2) of the OECD Model Tax Convention revised by the Action 6 Report,²¹¹ article 8(1) introduced a minimum shareholding period for a company to be entitled to exemption or a reduced rate on dividends from a subsidiary.²¹²

Provisions of a Covered Tax Agreement [exempting from tax] dividends paid by a company which is a resident” of Contracting Jurisdiction X or limiting the tax rate on dividends “provided that the beneficial owner or the recipient . . . is a resident of [Contracting Jurisdiction Y] and . . . owns, holds, or controls more than a certain amount of the capital, shares, stock, voting power, voting rights, or similar ownership interests of the company paying the dividends, shall apply only if the ownership conditions described in those provisions are met throughout a 365-day period that includes the day of the payment of the dividends.”²¹³

206. OECD 2017 MLI, *supra* note 24, art. 7(14).

207. *Id.*, art. 7(15)(a).

208. *Id.*, art. 7(15)(b) and (c).

209. *Id.*, art. 7(16).

210. *Id.*, art. 7(17).

211. *See* OECD, *supra* note 27, ¶ 36.

212. OECD 2017 MLI, *supra* note 24, art. 8(1).

213. *Id.*

However, article 8(1) is not intended to modify conditions or elements of Covered Tax Agreement, including tax rates, ownership thresholds and forms of ownership.²¹⁴

The compatibility clause in article 8(2) clarifies that the 365-day minimum shareholding period “shall apply in place of or in the absence of a minimum holding period in [existing] provisions”²¹⁵

Given that a provision addressing dividend transfer transactions is not required in order to meet a minimum standard, the reservation clause in Article 8(3) allows Parties to opt out of Article 8 entirely, either unconditionally or conditionally to the extent that the existing provisions already include a minimum holding period, regardless of whether it is shorter or longer than a 365-day period.²¹⁶

To ensure clarity, the notification clause in Article 8(4) sets out notification requirements and clarifies that Article 8(1) “shall apply with respect to an [existing] provision only where all Contracting Jurisdictions have made such a notification with respect to the that provision”.²¹⁷

2.7.4 Capital Gains from Alienation of Shares or Interests of Entities Deriving Their Value Principally from Immovable Property

Based on Article 13(4) of the OECD Model Tax Convention as revised by the Action 6 Report and Article 13(4) of the UN Model Tax Convention,²¹⁸ Article 9(1) addresses situations in which assets are contributed to an entity shortly before the sale of shares or comparable interests in that entity in order to dilute the proportion of the value of the entity that is derived from immovable property.²¹⁹

Under Article 9(1):

Provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction (or provided that more than a certain part of the property of the entity consists of such immovable property (real property)): a) shall apply if the relevant value threshold is met at any time during the 365 days preceding the alienation; and b) shall apply to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or

214. OECD MLI Explanatory Statement, *supra* note 24, ¶ 122.

215. OECD 2017 MLI, *supra* note 24, art. 8(2).

216. *Id.* art. 8(3).

217. *Id.* art. 8(4).

218. *See* OECD, *supra* note 27, ¶ 44.

219. OECD 2017 MLI, *supra* note 24, art. 9(1).

interests are not already covered) in addition to any shares or rights already covered by the provisions.”²²⁰

Given that article 9(1) is intended to “introduce a testing period and to [expand the scope of covered interests], the threshold provided in existing provisions would be preserved”.²²¹ The exceptional rule on the application of the existing provisions would continue to apply.²²² For example, “some Covered Tax Agreements may exclude gains derived from the alienation of shares of listed companies. . .”.²²³

The compatibility clause in article 9 (2) clarifies that the 365-day testing period “shall apply in place of or in the absence of a time period for determining whether the relevant value threshold in [existing] provisions was met”.²²⁴

Under article 9(3), parties may apply optional article 9(4), based on article 13(4) of the OECD Model Tax Convention,²²⁵ “to their Covered Tax Agreements, rather than incorporating a testing period and expanding interest covered by existing capital gains provisions”.²²⁶

[F]or purposes of a Covered Tax Agreement, gains derived by a resident of Contracting Jurisdiction [X] from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in Contracting [Jurisdiction Y] if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than fifty percent of their value directly or indirectly from immovable property (real property) situated in [Jurisdiction Y].²²⁷

The compatibility clause in article 9(5) clarifies that article 9(4) “shall apply in place of or in the absence of [existing]provisions of Covered Tax Agreements . . . [addressing capital gains] from the alienation of shares or [interests in entities] . . . [deriving their value principally] from immovable property”.²²⁸

“Given that a provision addressing capital gains from alienation of shares or interests in entities deriving their value principally from immovable property is not required in order to meet the minimum standard,”²²⁹ the reservation clause in article 9(6) allows Parties to opt out of either

220. *Id.*

221. OECD MLI Explanatory Statement, *supra* note 24, ¶ 131.

222. *Id.*

223. *Id.*

224. OECD 2017 MLI, *supra* note 24, art. 9(2).

225. OECD MLI Explanatory Statement, *supra* note 24, ¶ 133.

226. OECD 2017 MLI, *supra* note 24, art. 9(3).

227. *Id.* art. 9(4).

228. *Id.* art. 9(5).

229. OECD MLI Explanatory Statement, *supra* note 24, ¶ 136.

article 9(1) entirely, or opt out of article 9(1)(a) and (b) separately.²³⁰ Parties may also opt out of [article 9(4)] with respect to their Covered Tax Agreements that already contain a provision described in article [9(5)] . . .”²³¹

The reservation clause in article 9(7) clarifies that article 9(1) “shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision”.²³²

Under article 9(8), article 9(4) “shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have [chosen to apply it and notified the Depository of its choice]”.²³³ In such a case, article 9(1) would not apply.²³⁴

2.7.5 Anti-abuse Rule for PEs Situated in Third Jurisdictions

Articles 10(1) through (3) are based on the text of the OECD Model Tax Convention produced in the Action 6 Report.²³⁵ Under Article 10(1),

[W]here an enterprise of Contracting [Jurisdiction X] derives income from Contracting [Jurisdiction Y] and [Jurisdiction X] treats such income as attributable to a PE of the enterprise situated in a third [jurisdiction Z], and the profits attributable to that PE are exempt from tax in [Jurisdiction X], the [treaty] benefits shall not apply to any item of income on which the tax in [jurisdiction Z] is less than sixty percent of the tax that would be imposed in [Jurisdiction X] on that item of income if that PE were situated in [Jurisdiction X].²³⁶ In such a case, any income to which the provisions of [article 10(1)] apply shall remain taxable according to the domestic law of [Jurisdiction Y], notwithstanding any other provisions of the Covered Tax Agreement.²³⁷

However, under article 10(2), article 10(1)

[S]hall not apply if the income [of Jurisdiction Y is] derived in connection with or is incidental to the active conduct of a business carried on through the PE (other than the business of making, managing, or simply holding investments for the enterprise’s own account, unless these activities are banking, insurance, or securi-

230. OECD 2017 MLI, *supra* note 24, art. 9(6).

231. *Id.*, art. 9(6)(f).

232. *Id.*, art. 9(7).

233. *Id.*, art. 9(8).

234. *Id.*, art. 9(6).

235. OECD, *supra* note 27, ¶ 52.

236. OECD 2017 MLI, *supra* note 24, art. 10(1).

237. *Id.*

ties activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).²³⁸

Article 10(3) empowers the competent authorities to grant treaty benefits in certain justified circumstances.²³⁹ “If benefit[s] . . . are denied pursuant to [article 10(1)] with respect to an item of income derived by a resident of [Jurisdiction X], the competent authority of [Jurisdiction Y] may, nevertheless, grant these benefits with respect to that item of income, if . . . [the] authority determines that granting such benefits is justified in light of the reasons [the] resident did not satisfy the requirements of [article 10(1) and (2)]”.²⁴⁰ “The competent authority . . . shall consult with [its counterpart in Jurisdiction X] before either granting or denying the request”.²⁴¹

The compatibility clause in article 10(4) clarifies that articles 10(1) through (3) shall apply in place of or in the absence of a provision addressing PEs situated in third jurisdictions.²⁴²

“Given that a provision addressing [PE]s situated in third jurisdictions is not required in order to meet the minimum standard,”²⁴³ the reservation clause in Article 10(5) permits a Party to opt out of article 10 in three different ways.²⁴⁴

The notification clause in article 10(6) requires the non-reserving Parties to notify the Depository.²⁴⁵ “Where all Contracting Jurisdictions have [notified] with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by [articles 10(1) through (3)]”.²⁴⁶ Articles 10(1) through (3) shall supersede the existing provisions only to the extent of incompatibility.²⁴⁷

2.7.6 Application of Tax Agreements to Restrict a Party’s Right to Tax Its Own Residents

Based on article 1(3) of the OECD Model Tax Convention as set out in the Action 6 Report,²⁴⁸ the saving clause in article 11(1) is intended to preserve the right of a Contracting Jurisdiction to tax its own residents.²⁴⁹

Under article 11(1), a Covered Tax Agreement shall not affect the taxation by a Contracting Jurisdiction of its residents, except with respect

238. *Id.*, art. 10(2).

239. *Id.*, art. 10(3).

240. *Id.*

241. *Id.*

242. *Id.*, art. 10(4).

243. OECD MLI Explanatory Statement, *supra* note 24, ¶ 145.

244. OECD 2017 MLI, *supra* note 24 art. 10(5).

245. *Id.*, art. 10(6).

246. *Id.*

247. *Id.*

248. OECD, *supra* note 27, ¶ 63.

249. OECD 2017 MLI, *supra* note 24, art. 11(1).

to the following ten categories of treaty benefits: i) business profits of a PE or profits of an associated enterprise; ii) government service; iii) qualified student, business apprentice or trainee, teacher, professor, lecturer, instructor, researcher or research scholar; iv) credit method and exemption method); v) non-discrimination; vi) mutual agreement procedure; vii) members of diplomatic missions, government missions, or consular posts; viii) pensions or other payments made under social security legislation; ix) pensions and similar payments, annuities, alimony payments, or other maintenance payments; or x) other provisions that expressly limit taxation rights of the residence jurisdiction or allow taxation rights exclusively to the source jurisdiction.²⁵⁰

The compatibility clause in article 11(2) clarifies that article 11(1) replaces existing provisions “stating that the Covered Tax Agreements would not affect the taxation by a Contracting Jurisdiction of its residents,” or is added where such provisions do not exist.²⁵¹

“Given that a saving clause is not required to meet the minimum standard,”²⁵² and recognizing that some Parties may prefer a more targeted solution,²⁵³ article 11(3)(a) allows Parties to opt out of article 11 entirely.²⁵⁴ In such a case, article 3(3) applies to introduce a saving clause that relates solely to the provision in article 3(1).²⁵⁵ Recognizing that an existing saving clause provision is usually customized based on the content of such Agreements, article 11(3)(b) allows the Parties to opt out of article 11 entirely with respect to Covered Tax Agreements already containing a saving clause.²⁵⁶

The notification clause in article 11(4) clarifies that an existing provision of a Covered Tax Agreement would be replaced by the provisions of article 11(1), “where all Contracting Jurisdictions have made such a notification with respect to the [existing provision]”.²⁵⁷ In other cases, article 11(1) would supersede the existing provisions only to the extent of incompatibility.²⁵⁸

2.8 Avoidance of PE Status

2.8.1 Artificial Avoidance of PE Status Through *Commissionnaire* Arrangements and Similar Strategies

Article 12(1) of the new MLI, based on article 5(5) of the OECD Model Tax Convention produced in the Action 7 Report,²⁵⁹ states that:

250. *Id.*

251. *Id.*, art. 11(2).

252. OECD MLI Explanatory Statement, *supra* note 24, ¶ 153.

253. *Id.*

254. OECD 2017 MLI, *supra* note 24, art. 11(3)(a).

255. *Id.*, art. 3(3).

256. *Id.*, art. 11(3)(b).

257. *Id.*, art. 11(4).

258. OECD MLI Explanatory Statement, *supra* note 24, ¶ 155 .

259. OECD, *supra* note 36, at 16.

[W]here a person is acting in a Contracting Jurisdiction . . . on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are: a) in the name of the enterprise; or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or c) for the provision of services by that enterprise, that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement.²⁶⁰

Based on article 5(6)(a) of the OECD Model Tax Convention produced in the Action 7 Report,²⁶¹ article 12(2) clarifies that article 12(1) “shall not apply where the person acting in Contracting [Jurisdiction X] on behalf of [an enterprise of Contracting Jurisdiction Y carries on business in Jurisdiction X as] an independent agent and acts for the enterprise in the ordinary course of that business”.²⁶² “Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent []with respect to any such enterprise.”²⁶³

The compatibility clause in article 12(3) describes the interaction between article 12(1) and (2) and various existing provisions.²⁶⁴ Article 12(1) “would [replace existing provisions] describing the conditions under which an enterprise shall be deemed to [have a] PE in a Contracting Jurisdiction in respect of an activity which a person other than an [independent] agent undertakes for the enterprise, but only to the extent that such provisions address the situation in which [the] person has, and habitually exercises, [authority] in that Contracting Jurisdiction to conclude contracts in the name of the enterprise”.²⁶⁵ However, article 12(1) would not apply to a provision providing that an enterprise can be deemed to have a PE for a reason other than an authority to conclude contracts that are binding on another enterprise.²⁶⁶ Article 12(2) would replace existing provisions providing “that an enterprise shall not be deemed to have a PE in a Con-

260. OECD 2017 MLI, *supra* note 24, art. 12(1).

261. OECD, *supra* note 36, at 7.

262. OECD 2017 MLI, *supra* note 24, art. 12(2).

263. *Id.*, art. 12(2).

264. *Id.* art. 12(3).

265. *Id.*, art. 12(3)(a).

266. *Id.*

tracting Jurisdiction in respect of an activity which an agent of an independent status undertakes for the enterprise”.²⁶⁷

Given that provisions addressing the issues of article 12 are not required to meet the minimum standard,²⁶⁸ article 12(4) allows a Party to opt out of article 12 entirely.²⁶⁹

The notification clauses in article 12(5) and (6) clarify that article 12(1) or (2) would apply with respect to an existing provision only where all Contracting Jurisdictions to such Agreement have made such a notification.²⁷⁰

2.8.2 Artificial Avoidance of PE Status Through the Specific Activity Exemptions

Article 13 is intended to reflect the changes brought by the Action 7 Report to the wording of article 5(4) of the OECD Model Tax Convention of 2014, so as to address situations in which the specific activity exemptions give rise to BEPS concerns.²⁷¹ Article 13(1) permits a Party to choose to apply Option A or Option B or to apply neither Option.²⁷²

To address concerns of artificial avoidance of PE status through the specific activity exemptions, Option A explicitly states:

[T]hat the activities listed therein will be deemed not to constitute a PE only if they are of a preparatory or auxiliary character, including: a) the activities specifically listed in [existing provisions] as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character; b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a); c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b).²⁷³

Option B is designed as an alternative provision to address inappropriate use of the specific activity exemptions through anti-fragmentation rules.²⁷⁴ The term “PE” shall be deemed not to include:

a) the activities specifically listed in the [existing provisions] as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the

267. *Id.*, art. 12(3)(b).

268. OECD MLI Explanatory Statement, *supra* note 24, ¶ 165.

269. OECD 2017 MLI, *supra* note 24, art. 12(4).

270. *Id.*, art. 12(5) – (6).

271. OECD MLI Explanatory Statement, *supra* note 24, ¶ 168.

272. OECD 2017 MLI, *supra* note 24, art. 13(1).

273. *Id.*, art. 13(2).

274. OECD MLI Explanatory Statement, *supra* note 24, ¶ 169.

relevant [existing] provisions provides explicitly that a specific activity shall be deemed not to constitute a PE provided that the activity is of a preparatory or auxiliary character; b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a), provided that this activity is of a preparatory or auxiliary character; c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.²⁷⁵

The application of Option A will permit Parties to preserve the exceptions for activities described in existing provisions, but will require that those activities must be preparatory or auxiliary.²⁷⁶ In contrast, the application of Option B will permit Parties to preserve the exceptions for activities described in existing provisions, but “will require that those exceptions will apply irrespective of whether the activity is of a preparatory or auxiliary character”.²⁷⁷

To address the fragmentation of activities between closely related parties and avoid the abuse of the exceptional rules on the definition of PE, article 13(4) clarifies that a provision of a Covered Tax Agreement

[T]hat lists specific activities deemed not to constitute a PE shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting Jurisdiction and: a) that place or other place constitutes a PE for the enterprise or the closely related enterprise under the provisions of a Covered Tax Agreement defining a PE; or b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.²⁷⁸

The compatibility clause in article 13(5) (a) clarifies that Option A or Option B “shall apply in place of the relevant parts of [existing] provisions [listing] specific activities that are deemed not to constitute a PE even if

275. OECD 2017 MLI, *supra* note 24, art. 13(3).

276. OECD MLI Explanatory Statement, *supra* note 24, ¶ 171.

277. *Id.*, ¶ 173.

278. OECD 2017 MLI, *supra* note 24, art. 13(4).

the activity is carried on through a fixed place of business”.²⁷⁹ Further, Article 13(5)(b) “shall apply to existing provisions [listing] specific activities that are deemed not to constitute a PE even if the activity is carried on through a fixed place of business”.²⁸⁰ Such existing provisions would include those modeled after article 5(4) of the OECD Model Tax Convention of 2014 or article 5(4) of the UN Model Tax Convention of 2011 and bilaterally negotiated provisions of the same type.²⁸¹

“Given that provisions addressing artificial avoidance of PE status through the specific activity exemptions [] are not required to meet the minimum standard”,²⁸² article 13(6) permits a Party to opt out of either article 13 entirely, or Option A with respect to existing provisions already explicitly stating “that [listed] activities shall be deemed not to constitute a PE only if [the activities is] preparatory or auxiliary”, or Article 13(4).²⁸³

The notification clause in article 13(7) requires Parties choosing “to apply an Option [to] notify the Depository of its choice of Option”.²⁸⁴ “An Option shall apply [] to a provision [] only where all Contracting Jurisdictions have chosen to apply the same Option and have made such a notification . . .”.²⁸⁵

Article 13(8) requires Parties not opting out of applying article 13(4) (or the entirety of Article 13) to notify the Depository of each of its Covered Tax Agreements that includes specific activity exemptions.²⁸⁶ Article 13(4) “shall apply to [an existing] provision only where all Contracting Jurisdictions have made [such] a notification . . .”.²⁸⁷

2.8.3 Splitting-up of Contracts

Article 14 is designed to address abusive splitting-up of contracts as a potential strategy for the artificial avoidance of PE status, as a response to the Action 7 Report.²⁸⁸

Under article 14(1), “for the sole purpose of determining whether the period (or periods) referred to in an [existing] provision that stipulates a period (or periods) of time after which specific projects or activities shall constitute a PE has been exceeded”:

- a) where an enterprise E of Contracting Jurisdiction X carries on activities in Contracting Jurisdiction Y at a place that constitutes a building site, construction project, installation pro-

279. *Id.* art. 13(5).

280. *Id.*, art. 13(5)(a).

281. OECD MLI Explanatory Statement, *supra* note 24, ¶ 178.

282. *Id.*, ¶ 179.

283. OECD 2017 MLI, *supra* note 24, art. (6).

284. *Id.*, art. 13(7).

285. *Id.*

286. *Id.*, art. 13(8).

287. *Id.*

288. OECD MLI Explanatory Statement, *supra* note 24, ¶ 182.

ject or other specific project identified in the relevant existing provision, or carries on supervisory or consultancy activities in connection with such a place, in the case of an existing provision referring to such activities, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding the period or periods referred to in the relevant existing provision;

- b) where connected activities are carried on in Jurisdiction Y at (or in connection with) the same building site, construction or installation project, or other place identified in the relevant existing provision during different periods of time, each exceeding 30 days, by one or more enterprises closely related to enterprise E, these different periods of time shall be added to the aggregate period of time during which enterprise E has carried on activities at that building site, construction or installation project or other place identified in the relevant existing provision.²⁸⁹

The compatibility clause in article 14(2) clarifies that article 14(1) “shall apply in place of or in the absence of [existing] provisions to the extent that such provisions address the division of contracts into multiple parts to avoid the application of a time period or periods” that determine whether a PE exists for specific projects or activities.²⁹⁰ Although anti-splitting rules in many treaties apply to a wide range of activities, article 14(2) is only intended to replace existing rules to the extent that they relate to the activities described in article 14(1), and leaves those rules intact with respect to activities not within the scope of article 14(1).²⁹¹

Given that anti-splitting provisions are not required in order to meet the minimum standard,²⁹² the reservation clause in article 14(3) permits a Party to opt out of the entirety of Article 14.²⁹³ Recognizing that the anti-contract-splitting rules addressing the exploration for or exploitation of natural resources are generally carefully negotiated,²⁹⁴ a Party may opt out of the entirety of article 14 “with respect to [existing] provisions relating to the exploration for or exploitation of natural resources”.²⁹⁵

The notification clause in article 14(4) clarifies that article 14(1) shall replace anti-splitting provisions to the extent provided in article 14(2) where all Contracting Jurisdictions to the Covered Tax Agreement have notified accordingly.²⁹⁶ “In other cases, [article 14(1)] shall apply to [the

289. OECD 2017 MLI, *supra* note 24, art. 14(1).

290. *Id.*, art. 14(2).

291. OECD MLI Explanatory Statement, *supra* note 24, ¶ 185.

292. *Id.*

293. OECD 2017 MLI, *supra* note 24, art. 14(3)(a).

294. OECD MLI Explanatory Statement, *supra* note 24, ¶ 186.

295. OECD 2017 MLI, *supra* note 24, art. 14(3)(b).

296. *Id.*, art. 14(4).

Covered Tax Agreement, but will] supersede the existing provisions only to the extent of incompatibility . . .”²⁹⁷

2.8.4 Definition of a Person Closely Related to an Enterprise

Based on article 5(6)(b) of the OECD Model Tax Convention,²⁹⁸ article 15(1) describes the conditions under which a person will be considered “closely related” to an enterprise for the purposes of articles 12, 13 and 14.²⁹⁹

A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. [Specifically], a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than fifty percent of the beneficial interest in the other (or, in the case of a company, more than fifty percent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than fifty percent of the beneficial interest (or, in the case of a company, more than fifty percent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) in the person and the enterprise.³⁰⁰

Since article 15(1) is essential to understand the term “closely related to an enterprise” used in the MLI, Parties can opt out of Article 15 only if they have made the reservations described in Article 12(4), Article 13(6)(a) or (c), and Article 14(3)(a).³⁰¹

2.9 Improving Dispute Resolution

Given that the minimum standard for improving dispute resolution declared in the Action 14 Report can be complemented by a set of best practices, Part V of the MLI is designed to provide ways to incorporate some of those best practices into Covered Tax Agreements.³⁰²

2.9.1 Mutual Agreement Procedure

To provide for taxpayer’s rights in the context of international tax law, articles 16(1) through (3) are intended to effectively incorporate articles 25(1) through (3) of the OECD Model Tax Convention into Covered Tax Agreements and to set out the requirements for the mutual agreement procedure (MAP).³⁰³

297. *Id.*

298. OECD, *supra* note 36, at 16 –17.

299. OECD 2017 MLI, *supra* note 24, art. 15(1).

300. *Id.*

301. *Id.*, art. 15(2).

302. OECD MLI Explanatory Statement, *supra* note 24, ¶ 191.

303. *Id.*, ¶ 191.

Where a person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement, that person may present the case to the competent authority of either Contracting Jurisdiction within three years of the first notification of the [aforesaid action] The competent authority shall endeavor, . . . to resolve the case by mutual agreement with its counterpart in the other Contracting Jurisdiction, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions. The competent authorities shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention³⁰⁴

The compatibility clause in Article 16(4) permits Parties to retain existing provisions relating to dispute resolution to the extent that those provisions are consistent in content with the provisions of article 16(1) through (3), and subject to any reservations provided in article 16(5).³⁰⁵

The reserving clause in article 16(5) permits Parties to implement element 1.1 of the Action 14 minimum standard through administrative measures, as provided under elements 3.1 and 3.3 of the Action 14 minimum standard.³⁰⁶

A Party may opt out of applying the first sentence of article 16(1)

[On the basis that it intends to meet the minimum standard [under the BEPS Package by ensuring] that under each of its Covered Tax Agreements, . . . the taxpayer may present its case to the competent authority of the Contracting Jurisdiction of which it is a resident . . . or a national and that [such] competent authority will implement a bilateral notification or consultation process with [its counterpart] in the other Contracting Jurisdiction for [the MAP] cases in which [such] competent authority [does not consider the taxpayer's objection to be justified].³⁰⁷

A Party may opt out of applying the three-year period requirement of article 16(1) on the basis that it intends to meet the minimum standard by ensuring that, “where its tax treaty does not contain a provision stipulating the time period for the taxpayer to present the [MAP] case”, the taxpayer is allowed to present the MAP case within a period of at least three years.³⁰⁸ “It is anticipated, therefore, that this reservation would only be

304. *Id.*, art. 16(3).

305. *Id.*, art. 16(4).

306. OECD MLI Explanatory Statement, *supra* note 24, ¶ 199.

307. OECD 2017 MLI, *supra* note 24, art. 16(5)(a).

308. OECD 2017 MLI, *supra* note 24, art. 16(5)(b).

made by a Contracting Jurisdiction if its domestic regulations apply automatically and are more favorable in their effects to the taxpayer, either because they allow a longer time for presenting objections or because they do not set any time limits for such purpose.”³⁰⁹

A Party may also reserve on the application of the second sentence of article 16(2) only on the basis that either (i) all MAP agreements “shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions”³¹⁰; or (ii) it intends to meet the minimum standard by accepting, in its bilateral treaty negotiations, alternative treaty provisions that limit the time during which a Contracting Jurisdiction may make an adjustment pursuant to provisions modeled after article 9(1) or article 7(2) of the OECD Model Tax Convention, in order to avoid late adjustments with respect to which MAP relief will not be available.³¹¹

Article 16(6) requires a number of notifications to ensure clarity as to how Covered Tax Agreements will be modified by article 16.³¹²

2.9.2 Corresponding Adjustments

Given that the Action 14 Report noted that it would be more efficient if jurisdictions had the possibility to unilaterally provide for corresponding adjustments in cases in which they find the objection of the taxpayer to be justified.³¹³ Recognizing that Best Practice No. 1 contained in the Action 14 Report states that jurisdictions should include article 9(2) of the OECD Model Tax Convention in their tax treaties,³¹⁴ article 17 is intended to provide a mechanism for Parties to implement this Best Practice.³¹⁵

Article 17(1) requires corresponding adjustments.³¹⁶ “Where a Contracting Jurisdiction [X] includes in the profits of an enterprise of [its] Jurisdiction —and taxes accordingly— profits on which an enterprise of [] Contracting Jurisdiction [Y] has been charged to tax in Jurisdiction [Y], and the profits so included are profits which would have accrued to the enterprise of Jurisdiction [X] (if the conditions made between the two enterprises had been those which would have been made between independent enterprises), then [Jurisdiction Y] shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Covered Tax Agreement and the competent au-

309. OECD MLI Explanatory Statement, *supra* note 24, ¶ 201.

310. OECD 2017 MLI, *supra* note 24, art. 16(4)(b).

311. OECD 2017 MLI, *supra* note 24, art. 16(5)(c).

312. *Id.*, art. 16(6).

313. OECD, Making Dispute Resolution Mechanisms More Effective, *supra* note 37, ¶ 43.

314. *Id.*

315. OECD MLI Explanatory Statement, *supra* note 24, ¶ 209.

316. OECD 2017 MLI, *supra* note 24, art. 17(1).

thorities of [Jurisdictions X and Y] shall if necessary consult each other.”³¹⁷

The compatibility clause in article 17 (2) provides that article 17(1) “shall apply in the place of or in the absence of a provision that requires a Contracting Jurisdiction to make an appropriate adjustment. . . where the other Contracting Jurisdiction [makes an adjustment that reflects the arm’s length profits of an enterprise] . . .”³¹⁸ Some existing provisions are modeled after article 9(2) of the OECD Model Tax Convention or the UN Model Tax Convention. If certain existing provisions only *permit*, but do not *require*, a Contracting Jurisdiction to make a corresponding adjustment, such provisions would be outside the scope of article 17(2) and would continue to apply except in the case of incompatibility.³¹⁹ If such provisions would permit a Contracting Jurisdiction to choose not to make an appropriate adjustment even when the adjustment made by the other Contracting Jurisdiction was justified, the provisions would be superseded by article 17(1).

“Given that the inclusion of article 9(2) of the OECD Model Tax Convention in tax treaties is a best practice . . . , not the minimum standard, [and recognizing that] element 1.1 of the Action 14 minimum standard requires that jurisdictions provide access to the MAP in transfer pricing cases and implement the resulting mutual agreements regardless of whether the tax treaty contains a provision modeled after article 9(2) of the OECD Model Tax Convention,”³²⁰ the conditional reservation clauses in Article 17(3) permit a Party to reserve the right for article 17 not to apply to its Covered Tax Agreements that already contain a provision of the same type.³²¹ “A Party may also opt out of article 17 “on the basis that in the absence of a provision referred to in [article 17(2)], in [article 17(2)], it shall make the appropriate adjustment referred to in [article 17(1)], or its competent authority shall endeavor to resolve the case under the [existing] provisions [relating to MAP].”³²² A reserving Party under article 16(5)(c)(ii) may opt out of article 17 “on the basis that in its bilateral treaty negotiations it shall accept a treaty provision of the type contained in [article 17(1)], provided that the Contracting Jurisdictions were able to reach agreement on that provision and on the provisions described in [article 16(5)(c)(ii)].”³²³

The notification clause in article 17(4) requires Parties to notify the Depository of whether each of its Covered Tax Agreements contains an existing requirement to make a corresponding adjustment.³²⁴ The provisions of article 17(1) will replace such provisions where all Contracting

317. *Id.*

318. *Id.*, art. 17(2).

319. *But c.f. Id.*

320. OECD MLI Explanatory Statement, *supra* note 24, ¶ 212.

321. OECD 2017 MLI, *supra* note 24, art. 17(3)(a).

322. *Id.*, art. 17(3)(b).

323. *Id.*, art. 17(3)(c).

324. *Id.*, art. 17(4).

Jurisdictions to a Covered Tax Agreement have made such a notification.³²⁵ In other cases, article 17(1) will supersede existing provisions only in the case of incompatibility.³²⁶

2.10 Arbitration

2.10.1 Choice to Apply Part VI

Article 18 encourages Parties to choose to apply Part VI of the MLI with respect to its Covered Tax Agreements.³²⁷ However, Part VI is intended to apply only between Parties that explicitly choose to apply it by notifying the Depository of such choice.³²⁸ “A Party is permitted to formulate reservations with respect to the scope of cases eligible for arbitration”.³²⁹

2.10.2 Mandatory Binding Arbitration

Article 19 (1) contains the core arbitration provision.³³⁰ “Where the competent authorities are unable to reach an agreement on a case pursuant to the MAP under the Covered Tax Agreement . . . within a period of two years . . . any unresolved issues arising from the case shall, at the request of the person presenting the case, be submitted to arbitration in the manner described in [Part VI].”³³¹ However, prior to the expiration of the two-year period, the competent authorities may agree to a longer or shorter time period with respect to a particular case, and should notify the person presenting the case of such agreement.³³² Article 19 (8) permits a Party to reserve the right to substitute a three-year period for the two-year period for the purposes of applying article 19 to its Covered Tax Agreements.³³³

Article 19 (2) is intended to avoid a complicated and unpredictable situation and to ensure that one remedy process will take place before the other, where a taxpayer’s case goes through both the MAP and domestic court or administrative proceedings.³³⁴ The period for arbitration request shall stop running if a competent authority has suspended the MAP because a case related to one or more of the same issues is pending before the court or administrative tribunal.³³⁵ The period will start running again when a final decision has been rendered by the court or administrative

325. *Id.*

326. *Id.*

327. *Id.*, art. 18.

328. *Id.*

329. OECD MLI Explanatory Statement, *supra* note 24, ¶ 216.

330. OECD 2017 MLI, *supra* note 24, art. 19(1).

331. *Id.*

332. *Id.*, art. 19(1)(b).

333. *Id.*, art. 19(8).

334. OECD MLI Explanatory Statement, *supra* note 24, ¶ 217.

335. OECD 2017 MLI, *supra* note 24, art. 19(2).

tribunal or the case has been suspended or withdrawn.³³⁶ The period will also stop running if a person presenting the case and a competent authority have agreed to suspend the mutual agreement process for any reason, especially for taxpayer-friendly consideration of unexpected personal hardships. The period will start running again once that suspension has been lifted.³³⁷

Given that additional information from the taxpayer might be requested by either competent authority to undertake substantive consideration of the case, article 19(3) permits the period for arbitration request to be extended, “where both competent authorities agree that a person directly affected by the case has failed to provide in a timely manner any [requested] additional material information . . . for an amount of time equal to the period beginning on the date [of] information request and ending on the date of ultimate provision of information . . .”.³³⁸

Article 19(4)(b) is intended to clarify the validity of the arbitration decision.³³⁹ First, the arbitration decision shall be final,³⁴⁰ and “cannot be changed either by the competent authorities or by the arbitration panel unless . . . article 24 appl[ies] to permit agreement on a different resolution.”³⁴¹ Second, because the arbitration process is an extension of the MAP in case of deadlock, and the arbitration decision is *per se* unable to automatically resolve all the issues without the subsequent supportive mutual agreement, the arbitration decision shall be implemented through mutual agreement concerning the case.³⁴² “Third,

[T]he arbitration decision shall be binding on both Contracting Jurisdictions except in [three circumstances]: i) if a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. In such a case, the case shall not be eligible for any further consideration by the competent authorities) . . . ; ii) if a final decision of the courts of one of the Contracting Jurisdictions holds that the arbitration decision is invalid. In such a case, the request for arbitration [] shall be considered not to have been made, and the arbitration process shall be considered not to have taken place, . . . and a new request for arbitration may be made unless the competent authorities agree that such a new request should not be permitted); and iii) if a person directly affected by the case pursues litigation on the issues

336. *Id.*

337. *Id.*

338. *Id.*, art. 19(3).

339. *Id.*, art. 19(4)(b).

340. *Id.*, art (19(4)(a).

341. OECD MLI Explanatory Statement, *supra* note 24, ¶ 220.

342. OECD 2017 MLI, *supra* note 24, art. 19(4)(a); OECD MLI Explanatory Statement, *supra* note 24, ¶ 220.

which were resolved in the mutual agreement implementing the arbitration decision in any court or administrative tribunal.”³⁴³

Articles 19(5) through (7) set forth detailed requirements as to the dates for the competent authority to notify the person presenting the case and the other competent authority regarding the receipt of the MAP request and the request for additional information.³⁴⁴

Articles 19(8) through (9) provide detailed rules to establish the start date of the period before unresolved issues in a case are first eligible to be submitted to arbitration, depending on whether the competent authorities have requested additional information.³⁴⁵

To ensure smooth and predictable functioning of the arbitration process by and through close collaboration between the competent authorities based on jointly agreed procedural and operational rules, article 19(10) requires that the competent authorities “settle the mode of application of the [arbitration] provisions [by mutual agreement] . . . , including the minimum information necessary for each competent authority to undertake substantive consideration of the case. Such an agreement shall be concluded before the date on which unresolved issues in a [MAP] case are first eligible to be submitted to arbitration.”³⁴⁶ This mode of application may be changed from time to time thereafter.³⁴⁷

Article 19(11) allows a Party to “reserve the right to replace the two-year period set forth in [Article 19(1)(b)] with a three-year period”³⁴⁸ for the purposes of applying Part VI to its Covered Tax Agreements.

Under Article 19(12), a Party may reserve the right to exclude from arbitration issues with respect to which a decision has been rendered by a court or administrative tribunal of either Contracting Jurisdiction.³⁴⁹ First, “any unresolved issue arising from a [MAP] case shall not be submitted to arbitration, if a decision on this issue has already been rendered by a court or administrative tribunal of either Contracting Jurisdiction.”³⁵⁰ Second, the arbitration process shall terminate, if a court or administrative tribunal decision is rendered during the arbitration process.³⁵¹ The reason is that some jurisdictions do not permit a mutual agreement concluded by the competent authority to override the decision of domestic court or administrative tribunal, either as a matter of law or practice.³⁵²

343. OECD 2017 MLI, *supra* note 24, art. (4)(b).

344. *Id.*, art. 19(5) – (7).

345. *Id.*, art. 19(8) – (9).

346. *Id.*, art. 19(10).

347. OECD MLI Explanatory Statement, *supra* note 24, ¶ 230.

348. OECD 2017 MLI, *supra* note 24, art. 19(11).

349. *Id.*, art. 19(12).

350. *Id.*, art. 19(12)(a).

351. *Id.*, art. 19(12)(b).

352. OECD MLI Explanatory Statement, *supra* note 24, ¶ 232.

2.10.3 Appointment of Arbitrators

Although Article 20 sets out detailed default rules for the appointment and qualifications of arbitrators, the competent authorities may mutually agree on different rules, either generally or with respect to a particular case.³⁵³

“The arbitration panel consist of three individual members with expertise or experience in international tax matters.”³⁵⁴ “Each competent authority shall appoint one panel member within 60 days of the date of request for arbitration.”³⁵⁵ The two members shall then, “within 60 days of the latter of their appointments, appoint a third member who is not a national or resident of either Contracting Jurisdiction to serve as Chair of the panel.”³⁵⁶ Each member must maintain her or his impartiality and independence of the arbitrators through the arbitration proceedings.³⁵⁷

If the competent authority fails to appoint a panel member, or if the two initial members fail to appoint the Chair, within the specified or agreed time periods, the highest ranking official of the OECD Centre for Tax Policy and Administration that is not a national of either Contracting Jurisdiction, shall appoint the vacant member or the Chair respectively.³⁵⁸

2.10.4 Confidentiality of Arbitration Proceedings

Confidential information in arbitration proceeding is not supposed to be leaked without due authorization process.³⁵⁹ Article 21 is intended to ensure smooth arbitration proceedings without undermining the confidentiality of the MAP.³⁶⁰

The “information received by the arbitration panel or prospective arbitrators and information that the competent authorities receive from the arbitration panel shall be considered information [] exchanged [under the exchange of information and administrative assistance provisions of the Covered Tax Agreement]”.³⁶¹ “The competent authorities . . . shall ensure that [panel] members and their staff agree in writing . . . to treat any information relating to the arbitration proceeding consistently with the confidentiality and nondisclosure [requirements].³⁶² . . .The consequences of breach of confidentiality will be determined under the agreement terms and the domestic laws of the Contracting Jurisdictions.³⁶³

353. OECD 2017 MLI, *supra* note 24, art. 20(1); OECD MLI Explanatory Statement, *supra* note 24, ¶ 234.

354. OECD 2017 MLI, *supra* note 24, art. 20(2)(a).

355. *Id.*, art. 20(2)(b).

356. *Id.*

357. *Id.* art. 20(2)(c).

358. *Id.*, art. 20(3).

359. OECD MLI Explanatory Statement, *supra* note 24, ¶ 238.

360. *See id.*

361. OECD 2017 MLI, *supra* note 24, art. 21(1).

362. *Id.*, art. 21(2).

363. OECD MLI Explanatory Statement, *supra* note 24, ¶ 239.

2.10.5 Resolution of a Case Prior to the Conclusion of the Arbitration

Given that arbitration is the last resort for the disputes between the competent authorities arising from MAP cases,³⁶⁴ and recognizing the significance of the taxpayer's autonomy, article 22 provides that if the competent authorities reach a mutual agreement to resolve the case, or if the taxpayer withdraws either its request for arbitration or MAP during the arbitration process, the MAP and the arbitration procedure with respect to such case shall terminate.³⁶⁵

2.10.6 Type of Arbitration Process

To expedite the arbitration process, article 23 offers the “final offer” approach and the “independent opinion” approach as default types.³⁶⁶ However, the competent authorities may mutually agree on different rules.³⁶⁷

Under the “final offer” approach, “the competent authorities [] shall [each] submit to the panel . . . a proposed resolution which addresses all unresolved issue(s) in the case, . . . [but including only] the disposition of specific monetary amounts [] or [] the maximum rate of tax charged pursuant to the Covered Tax Agreement.”³⁶⁸ Where the unresolved issues include threshold questions, “such as whether an individual is a resident or whether a permanent establishment exists, the competent authorities may submit alternative proposed resolutions . . . contingent on resolution of [the unresolved] threshold questions”.³⁶⁹ Each competent authority may submit a supporting position paper or a reply submission in response to the proposed resolution and supporting position paper submitted by the other competent authority.³⁷⁰ The panel shall select one of the proposed resolutions, and shall not include a rationale or any other explanation of the decision.³⁷¹

A Party unwilling to accept the “final offer” approach may adopt the “independent opinion” approach.³⁷² Each competent authority shall provide all panel members with any information necessary for the arbitration decision.³⁷³ The panel shall decide the issues pursuant to the applicable provisions of the Covered Tax Agreement and, subject to these provisions, of the domestic laws of the Contracting Jurisdictions.³⁷⁴ The panel shall also consider any other sources identified by mutual agreement of the

364. *Id.*, ¶ 240.

365. OECD 2017 MLI, *supra* note 24, art. 22.

366. OECD MLI Explanatory Statement, *supra* note 24, ¶¶ 242, 246.

367. OECD 2017 MLI, *supra* note 24, art. 23(1).

368. *Id.*, art. 23(1)(a).

369. *Id.*

370. *Id.*, art. 23(1)(b).

371. *Id.*, art. 23(1)(c).

372. *Id.*, art. 23(2).

373. *Id.*, art. 23(2)(a).

374. *Id.*, art. 23(2)(b).

competent authorities.³⁷⁵ The decision shall indicate the sources of law relied upon and the reasoning which led to its result.³⁷⁶

The arbitration decision shall be delivered to the competent authorities in writing but will not have any precedential value.³⁷⁷

Where two Parties prefer different types of arbitration processes, the competent authorities shall endeavor to reach agreement on the type of arbitration process that shall apply with respect to all cases arising under that Covered Tax Agreement.³⁷⁸ Until such an agreement is reached, article 19 shall not apply.³⁷⁹

A Party may choose to apply article 23(5) “with respect to its Covered Tax Agreements.”³⁸⁰ The competent authorities, prior to the beginning of arbitration proceedings, should ensure that each taxpayer presenting the case and their advisors sign a confidentiality agreement.³⁸¹ A material breach of the nondisclosure agreement after the request for arbitration and before the panel has delivered its decision shall result in the termination of the MAP and the arbitration proceedings on the case.³⁸² However, Parties may opt out of article 23(5).³⁸³ A Party choosing to apply article 23(5) may reserve the right for Part VI not to apply with respect to all Covered Tax Agreements with the reserving Contracting Jurisdiction.³⁸⁴

Articles 23(4) though article 23(7) are intended to encourage the best practice of confidentiality.³⁸⁵ Where Parties disagree on the significance of confidentiality, Parties considering confidentiality essential may opt out of arbitration entirely if a Party opts out of the nondisclosure rule.³⁸⁶

2.10.7 Agreement on a Different Resolution

Article 24 permits both Contracting Jurisdictions to choose to apply an optional provision, which allows the competent authorities to depart from the arbitration decision and to agree on a different resolution within three calendar months after the decision has been delivered to them.³⁸⁷ Given that such a provision would be unlikely to be applied where the “final offer” approach is used, Parties may apply article 24 only to its Cov-

375. *Id.*

376. *Id.*, art. 23(2)(c).

377. *Id.*

378. *Id.*, art. 23(3).

379. *Id.*

380. *Id.*, art. 23(4).

381. *Id.*, art. 23(5).

382. *Id.*

383. *Id.*, art. 23(6).

384. *Id.* art. 23(7).

385. See OECD MLI Explanatory Statement, *supra* note 24, ¶¶ 250-251.

386. *Id.* ¶ 251.

387. OECD 2017 MLI, *supra* note 24, art. 24.

ered Tax Agreements for which the “independent opinion” approach applies.³⁸⁸

2.10.8 Costs of Arbitration Proceedings

Under article 25, costs of arbitration proceedings “shall be borne by the Contracting Jurisdictions in a manner to be settled by mutual agreement between the competent authorities”³⁸⁹ “In the absence of such agreement, each Contracting Jurisdiction shall bear its own expenses and those of its appointed [arbitrator]”.³⁹⁰ “The cost of the chair . . . and other expenses associated with the conduct of the arbitration proceedings shall be borne by the Contracting Jurisdictions in equal shares.”³⁹¹

2.10.9 Compatibility

The compatibility clause in article 26 clarifies that Part VI

[S]hall apply in place or in the absence of provisions of a Covered Tax Agreement that provide for arbitration of unresolved issues arising from a [MAP] case. Each Party that chooses to apply Part VI shall notify the Depository [accordingly] Where two Contracting Jurisdictions have made [such] a notification . . . , that provision shall be replaced by [Part VI] as between those Contracting Jurisdictions.³⁹²

To avoid duplicative arbitration efforts,³⁹³ “any unresolved issue arising from a [MAP] case . . . shall not be submitted to arbitration [under Part VI] if an arbitration panel or similar body has previously been set up [with respect to the issue under another] bilateral or multilateral convention that provides for mandatory binding arbitration [for] unresolved issues”³⁹⁴

Nothing in Part VI is intended to “affect the fulfillment of wider obligations with respect to the arbitration of unresolved issues arising in the context of a [MAP] resulting from other conventions to which the Contracting Jurisdictions are or will become parties.”³⁹⁵

“A Party may preserve the right for . . . Part [VI] not to apply with respect to one or more identified Covered Tax Agreements . . . that al-

388. OECD MLI Explanatory Statement, *supra* note 24, ¶ 252.

389. OECD 2017 MLI, *supra* note 24, art. 25.

390. Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, art. 25.

391. *Id.*

392. *Id.*

393. OECD MLI Explanatory Statement, *supra* note 24, ¶ 257.

394. OECD 2017 MLI, *supra* note 24, art. 26(2).

395. *Id.*, art. 26(3).

ready provide for mandatory binding arbitration of unresolved issues arising from a [MAP] case.”³⁹⁶

2.11 Final Provisions of the MLI

2.11.1 Signature and Ratification, Acceptance, or Approval

As of December 31, 2016, the MLI was open for signature by all States, three listed jurisdictions, and any other non-State jurisdiction authorized to become a Party by consensus of Parties and Signatories. Signature of the MLI shall be followed by ratification, acceptance, or approval.³⁹⁷

2.11.2 Reservations

Article 28 (1) lists twenty-one authorized reservations by reference to the provision in which they are set out.³⁹⁸ With the exception of reservations to Part VI, these are the only reservations which may be made under the MLI.³⁹⁹

To provide Parties committing to arbitration with flexibility to tailor the scope of cases based on their domestic policies,⁴⁰⁰ article 28(2) permits any Party that chooses to apply Part VI to formulate one or more reservations as to the scope of cases eligible for arbitration under Part VI.⁴⁰¹ Reservations are subject to acceptance.⁴⁰²

Article 28(3) clarifies the symmetric effect (i.e., reciprocal application) of reservations made under article 28(1) or (2) on the application of the relevant provisions of the MLI between the reserving Party and the other Parties.⁴⁰³ “Unless explicitly provided otherwise . . . , a reservation will modify . . . the [relevant] provisions of the Convention” as between the reserving Party and all other Parties to the Convention in a symmetric way.⁴⁰⁴

Article 28(4) requires the State Party responsible for the international relations of a jurisdiction or territory to deposit a separate list of reservations for that jurisdiction or territory, which may be different from the State Party’s own list of reservations.⁴⁰⁵

Articles 28(5) through (7) impose the timing requirements for making reservations.⁴⁰⁶ A provisional list of reservations shall be provided to the

396. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* Id., art. 26(4).

397. *Id.*, art. 27.

398. *Id.*, art. 28(1).

399. OECD MLI Explanatory Statement, *supra* note 24, ¶ 264.

400. *Id.*, ¶ 265.

401. OECD 2017 MLI, *supra* note 24, art. 28(2).

402. *Id.*, art. 28(2)(b).

403. *Id.*, art. 28(3).

404. *Id.*

405. *Id.*, art. 28(4).

406. *Id.*, art. 28(5) – (7).

Depositary at the time of signature,⁴⁰⁷ and a final list of reservations shall be provided at the time of the deposit of the instrument of ratification, acceptance, or approval.⁴⁰⁸ It is permitted for a final list of reservations to be provided to the Depositary at the time of signature.⁴⁰⁹ If reservations are not made at the time of signature, a provisional list of expected reservations shall be provided to the Depositary at that time.⁴¹⁰

Under article 28(8), when reservations are made under the fifteen types of listed provisions, an exhaustive list of the Covered Tax Agreements which are within the scope of the reservation as defined in the relevant provision must be provided.⁴¹¹

To encourage comprehensive modifications of the Covered Tax Agreements by the MLI, article 28(9) permits a Party to withdraw a reservation or replace it with a reservation which is more limited in scope by notifying the Depositary.⁴¹² Articles 28(9)(a) and (b) set out the dates on which such a withdrawal or replacement of a reservation will take effect.⁴¹³

2.11.3 Notifications

Article 29 sets forth detailed requirements for the notification procedure.⁴¹⁴ The twenty categories of notification specified in the MLI shall be made either at the time of signature or when depositing the instrument of ratification, acceptance, or approval.⁴¹⁵ The State Party responsible for the international relations of the jurisdiction or territory shall provide a list of notifications with respect to that jurisdiction or territory, which may be different from the State Party's own list of notifications.⁴¹⁶

"If notifications are made at the time of signature, they shall be confirmed upon deposit of the instrument of ratification, acceptance, or approval, unless the document containing the notifications explicitly specifies that it is to be considered definitive."⁴¹⁷ "If notifications are not made at the time of signature, a provisional list of expected notifications shall be provided at that time."⁴¹⁸

The list of agreements described in article 2(1)(a)(ii) may be extended at any time by notifying the Depositary.⁴¹⁹ If the agreement falls

407. *Id.*, art. 28(7).

408. *Id.*, art. 28(6).

409. OECD MLI Explanatory Statement, *supra* note 24, ¶ 276.

410. OECD 2017 MLI, *supra* note 24, art. 28(7).

411. *Id.*, art. 28(8).

412. *Id.*, art. 28(9).

413. *Id.*, art. 28(9)(a), 28(9)(b).

414. *Id.*, art. 29.

415. OECD MLI Explanatory Statement, *supra* note 24, ¶ 292.

416. OECD 2017 MLI, *supra* note 24, art. 29(2).

417. *Id.*, art. 29(3).

418. *Id.*, art. 29(4).

419. *Id.*, art. 29(5).

within the scope of any of the reservations made by the Party listed in article 28(8), the Party must specify this in this notification.⁴²⁰ The Party shall also specify any additional required notifications to reflect the inclusion of additional agreements.⁴²¹ “If the extension results for the first time in the inclusion of a tax agreement entered into by or on behalf of a [non-State jurisdiction or territory] . . . , [the responsible Party] shall specify [at that time] any reservations or notifications applicable to Covered Tax Agreements.”⁴²² On the date on which a newly added agreement becomes a Covered Tax Agreement, “Article 35 . . . shall govern the date on which the modifications to the Covered Tax Agreement shall have effect.”⁴²³

Parties may make additional notifications under articles 29(1)(b) through (s) by notifying the Depository.⁴²⁴ Articles 29(6)(a) and (b) clarify when such additional notifications will take effect.⁴²⁵ The provision mirrors article 28(9) relating to the date on which the withdrawal or replacement of a reservation will take effect.⁴²⁶

2.11.4 Subsequent Modifications of Covered Tax Agreements

Recognizing the necessity of subsequent treaty modification,⁴²⁷ article 30 provides that “the provisions in [the MLI] . . . are without prejudice to subsequent modifications to a Covered Tax Agreement which may be agreed to by the Contracting Jurisdictions.”⁴²⁸

2.11.5 Conference of the Parties

Article 31 authorizes the Parties to “convene a Conference of the Parties for the purposes of taking any decisions or exercising any functions as may be required or appropriate under the provisions of . . . [the MLI]”.⁴²⁹ “Any Party may request a Conference by communicating a request to the Depository.”⁴³⁰ The Depository will then convene a Conference provided that the request is supported by one-third of the Parties within six calendar months of the communication by the Depository of the request.⁴³¹

2.11.6 Interpretation and Implementation

Under article 32, “any question[s] arising from the interpretation or implementation of the provisions of a Covered Tax Agreement . . . shall be

420. *Id.*

421. *Id.*

422. *Id.*

423. *Id.*

424. *Id.*, art. 29(6).

425. *Id.*, art. 29(6)(a), 29(6)(b).

426. OECD MLI Explanatory Statement, *supra* note 24, ¶ 307.

427. OECD MLI Explanatory Statement, *supra* note 24, ¶ 310.

428. OECD 2017 MLI, *supra* note 24, art. 30.

429. *Id.*, art. 31(1).

430. *Id.*, art. 31(3).

431. *Id.*

determined under the relevant provision(s) of [that] . . . Agreement [itself] . . . [and] any questions arising as to the interpretation or implementation of . . . [the MLI] may be addressed either by a Conference of the Parties” or by the agreement between the competent authorities.⁴³²

2.11.7 Amendment

Article 33 permits any Party to propose an amendment to the MLI “by submitting the proposed amendment to the Depository.”⁴³³ “A Conference of the Parties may be convened to consider the proposed amendment.”⁴³⁴

2.11.8 Entry into Force

Under article 34, the MLI “shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of deposit of the fifth instrument of ratification, acceptance, or approval.”⁴³⁵ “For each Signatory ratifying, accepting, or approving . . . [the MLI] after the . . . [fifth deposit], . . . [the MLI] shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit by such Signatory of its instrument of ratification, acceptance, or approval.”⁴³⁶

2.11.9 Entry into Effect

Article 35 sets out when the provisions of the MLI shall take effect in each Contracting Jurisdiction with respect to two categories of taxes which fall within the scope of a Covered Tax Agreement.⁴³⁷

Article 35(1)(a) addresses the entry into effect of provisions of the MLI “with respect to taxes withheld at source on amounts paid or credited to non-residents”.⁴³⁸ The first taxes for which the MLI shall have effect are those for which “the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which the [MLI] enters into force for each Contracting Jurisdiction . . .”.⁴³⁹

Article 35(1)(b) addresses the entry into effect of provisions of the MLI “with respect to all other taxes levied by a Contracting Jurisdiction”.⁴⁴⁰ Unless the Contracting Jurisdictions agree to apply a shorter period, the first taxes for which provisions of the MLI will enter into effect

432. *Id.*, art. 32.

433. *Id.*, art. 33(1).

434. *Id.*, art. 33(2).

435. *Id.*, art. 34(1).

436. *Id.*, art. 34(2).

437. *Id.*, art. 35(1).

438. *Id.*, art. 35(1)(a).

439. *Id.*

440. *Id.*, art. 35(1)(b).

are those levied “with respect to taxable periods beginning on or after the expiration of a period of six calendar months from the latest of the dates on which the MLI enters into force for each of the Contracting Jurisdictions . . .”.⁴⁴¹

To address the situations in which the taxable period does not follow the calendar year in some Contracting Jurisdictions, article 35(2) permits a Party to “choose to substitute “taxable period” for “calendar year”” solely for the purposes of its own asymmetrical application of article 35(1)(a) and (5)(a).⁴⁴²

To allow the MLI to enter into effect only after the start of a calendar year in certain Contracting Jurisdictions,⁴⁴³ article 35(3) permits a Party to replace the reference to “taxable periods beginning on or after the expiration of a period” with a reference to “taxable periods beginning on or after 1 January of the next calendar year beginning on or after the expiration of a period” solely for the purposes of its own asymmetrical application of article 35(1)(b) and (5)(b).⁴⁴⁴

To ensure that the MAP provisions apply as soon as possible,⁴⁴⁵ article 35(4) clarifies that article 16 “shall have effect with respect to a Covered Tax Agreement for a case presented to the competent authority on or after the latest of the dates on which the MLI enters into force for each of the Contracting Jurisdiction”, except for cases that were ineligible to be presented prior to the modification of Covered Tax Agreement by the MLI, regardless of the taxable period to which the case relates.⁴⁴⁶ However, a Party may opt out of article 35(4),⁴⁴⁷ in which case the entry into effect of article 16 for its Covered Tax Agreement will be governed by article 35(1) through (3).⁴⁴⁸

Article 35(5) provides for the entry into effect in each Contracting Jurisdiction of the MLI’s provisions for new Covered Tax Agreements resulting from an extension of the list of agreements notified under article 2(1)(a)(ii).⁴⁴⁹ The time periods run similarly to those described in article 35(1) in many respects.⁴⁵⁰

Article 35(7) permits a Party to reserve the right to delay the date of entry into effect of the provisions of the MLI, of the withdrawal or replacement of a reservation, of an additional notification with respect to that Covered Tax Agreement, or of Part VI (Arbitration), until that Party

441. *Id.*

442. *Id.*, art. 35(2).

443. OECD MLI Explanatory Statement, *supra* note 24, ¶ 331.

444. OECD 2017 MLI, *supra* note 24, art. 35(3).

445. OECD MLI Explanatory Statement, *supra* note 24, ¶ 333.

446. OECD 2017 MLI, *supra* note 24, art. 35(4).

447. *Id.*, art. 35(6).

448. OECD MLI Explanatory Statement, *supra* note 24, ¶ 337.

449. OECD 2017 MLI, *supra* note 24, art. 35(5).

450. OECD MLI Explanatory Statement, *supra* note 24, ¶ 335.

has completed its internal procedures for this purpose.⁴⁵¹ In such cases, the default specific rules on entry into effect would apply as from the date 30 days after the Depositary has received the latest notification by each reserving Contracting Jurisdiction that it has completed its internal procedures for the entry into effect of the provisions of the MLI with respect to that specific Covered Tax Agreement.⁴⁵²

2.11.10 Entry into Effect of Part VI

Article 36 exclusively addresses the entry into effect of the provisions of Part VI, notwithstanding the provisions of article 28(9) (addressing the withdrawal of a reservation), article 29(6) (addressing additional notifications), and article 35 (other than paragraph 7) (addressing the entry into effect of the Convention).⁴⁵³

Under article 36(1), Part VI shall take effect with respect to cases presented to the competent authority . . . on or after the later of the dates on which the [MLI] enters into force for each of the Contracting Jurisdictions”.⁴⁵⁴ However, to allow competent authorities to reasonably defer the eligibility of existing cases until they have agreed on the mode of application of Part VI, Part VI shall take effect “with respect to cases presented to the competent authority [] prior to the later of the dates on which the [MLI] enters into force for each of the Contracting Jurisdictions [], on the date when both Contracting Jurisdictions have notified the Depositary that they have reached mutual agreement [on the application of Part VI], along with information regarding the date or dates on which such cases shall be considered to have been presented to the competent authority . . . according to the terms of that mutual agreement.”⁴⁵⁵

Recognizing that the arbitration eligibility deferral under article 36(1)(b) is unlikely to alleviate the challenging resource constraints for Contracting Jurisdictions with a large backlog of cases to apply Part VI effectively to those cases, article 36(2) permits Parties to “reserve the right for Part VI to apply to an [existing MAP] case . . . only to the extent that [both] competent authorities agree that it will apply to that specific case”.⁴⁵⁶

Articles 36(3) through 36(5) address the entry into effect of Part VI in the case in which a Party begins applying Part VI to a Covered Tax Agreement only after incorporating a new Covered Tax Agreement into the extended list of agreements, withdrawing or replacing a reservation made “under article [26(4)] pursuant to [article 28(9)], or the withdrawal of an

451. OECD 2017 MLI, *supra* note 24, art. 35(7).

452. OECD 2017 MLI, *supra* note 24, art. 35(5); OECD MLI Explanatory Statement, *supra* note 24, ¶ 338.

453. OECD 2017 MLI, *supra* note 24, art. 35(6).

454. *Id.*, art. 36(1)(a).

455. *Id.*, art. 36(1)(b).

456. *Id.*, art. 36(2).

objection to a reservation made under article [28(2)]”.⁴⁵⁷ In all such cases, the date of entry into effect is based on the date of communication by the Depositary of the notification of the extension of the list of agreements, withdrawal or replacement of reservation, or withdrawal of objection, rather than the date of entry into force of the MLI.⁴⁵⁸

2.11.11 Withdrawal

Article 37 permits any Party to withdraw from the MLI at any time.⁴⁵⁹ In cases where the MLI has entered into force with respect to all Contracting Jurisdictions to a Covered Tax Agreement before the date on which a Party’s withdrawal becomes effective, that Covered Tax Agreement shall remain as modified by this Convention.⁴⁶⁰ The rationale is that a unilateral withdrawal from the MLI does not have any retrospective effects, and would not reverse the modifications already made to the Covered Tax Agreement.⁴⁶¹

2.11.12 Relation with Protocols

Article 38 provides that the MLI may be supplemented by one or more protocols.⁴⁶² To become a party to a protocol, a State or jurisdiction must be a Party to the MLI.⁴⁶³ “A Party to . . . [the MLI] is not bound by a protocol unless it becomes a party to the protocol in accordance with its provisions.”⁴⁶⁴

2.11.13 Depositary

Article 39 defined the role of the Depositary.⁴⁶⁵ The Secretary-General of the OECD shall be the Depositary of the MLI and any protocols.⁴⁶⁶ “The Depositary shall notify the Parties and Signatories within one calendar month” of the specified list of acts, notifications, or communications in relation to the MLI.⁴⁶⁷ The Depositary shall maintain publicly available lists of Covered Tax Agreements, reservations made by the Parties, and notifications made by the Parties.⁴⁶⁸

457. *Id.*, art. 36(3) – 36(5).

458. *Id.*

459. *Id.*, art. 37(1).

460. *Id.*, art. 37(2).

461. OECD MLI Explanatory Statement, *supra* note 24, ¶ 353.

462. OECD 2017 MLI, *supra* note 24 art. 38(1).

463. *Id.*, art. 38(2).

464. *Id.*, art. 38(3).

465. *Id.*, art. 39.

466. *Id.*, art. 39(1).

467. *Id.*, art. 39(2).

468. *Id.*, art. 39(3).

3. Why Are Tax Treaties Necessary?

Before we proceed to evaluate the MLI, it is helpful to raise a more fundamental question: Why are tax treaties needed in the twenty-first century?

Traditionally, tax treaties were thought to be needed to prevent classical “juridical” double taxation, in which both the source and the residence jurisdictions taxed the same taxpayer on the same income, one on the basis of source (in rem) jurisdiction and the other on the basis of residence (in personam) jurisdiction.⁴⁶⁹ This problem was the reason the League of Nations drafted the first model “convention for the prevention of double taxation” in 1927 – 28.⁴⁷⁰ But as Stanley Surrey already pointed out in 1957 and as Tsilly Dagan has emphasized more recently, tax treaties are not needed to prevent double taxation because almost all residence countries grant relief from double taxation by way of credit or exemption unilaterally, without the need for a treaty.⁴⁷¹ Other double taxation situations (dual residence, source/source) are not always resolved even with a tax treaty in place.

As Dagan also pointed out, the main function of tax treaties is to enforce the “Benefits Principle”, i.e., the compromise reached in the 1920s between the tax claims of residence and source jurisdictions.⁴⁷² Under the Benefits Principle, which is incorporated into every tax treaty, active (business) income should be taxed primarily at source as long as the taxpayer meets the “Permanent Establishment” threshold, while passive (investment) income should be taxed primarily at residence.⁴⁷³ Since without a treaty both active and passive income are taxed at source with relief granted by the residence jurisdiction, the main function of the treaty is to shift the right to tax passive income from source to residence by limiting withholding tax rates. Under the OECD model, withholding taxes are limited to fifteen percent for dividends, ten percent for interest and zero per-

469. For example, Article 1 of the Mexico and London Models states that “[t]he present Convention is designed to prevent double taxation in the case of taxpayers of the contracting states.” *Model Bilateral Convention for the Prevention of International Double Taxation of Income and Fiscal Evasion*, *supra* note 10, art. I (Mexico Draft); *Model Bilateral Convention on the Prevention of the Double Taxation of Income and Property*, *supra* note 11, art. I (London Draft).

470. MICHAEL KOBETSKY, *INTERNATIONAL TAXATION OF PERMANENT ESTABLISHMENTS: PRINCIPLES AND POLICY* 106 – N 108 (2011).

471. Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT’L L. & POL. 939, 939 (2000); Stanley S. Surrey, *The Pakistan Tax Treaty and “Tax Sparing”*, 11 Nat’l Tax J. 156, 156 (1958).

472. Dagan, *supra* note 471, at 941 – 942.

473. Reuven S. Avi-Yonah & Haiyan Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 HARV. BUS. L. REV. 185, 188 (2016). On the benefits principle and its origins, see REUVEN S. AVI-YONAH, *ADVANCED INTRODUCTION TO INTERNATIONAL TAX LAW* ch. 1 (2015); Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507 (1997); Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301 (1996).

cent for royalties, capital gains and “other income” (e.g., payments on derivatives).⁴⁷⁴ That leaves the residence country with the right to tax such payments without granting too much foreign tax credit.

Dagan goes on to argue that this means that tax treaties are helpful among developed countries because the investment flows are reciprocal, but injurious to developing countries.⁴⁷⁵ Others (including the developing countries) have rejected this argument because they believe tax treaties are helpful in attracting investment and guaranteeing some measure of tax stability to the investors.⁴⁷⁶

But are tax treaties necessary to enforce the Benefits Principle? It can be argued that the answer is no under conditions of tax competition. Economists have long argued that a small, open economy should not tax inbound investment because the tax will cause the investment to either go elsewhere or be shifted to source country taxpayers, who can be taxed directly.⁴⁷⁷ The latter is not entirely convincing because it may be administratively easier for the source country to levy withholding taxes even if the burden is shifted, but the argument that the investment will go elsewhere is generally convincing, especially for interest but increasingly also for dividends (capital gains cannot usually be taxed by withholding).

Under conditions of tax competition to attract investment, there are two possible scenarios. The first and more common is that the same return can be earned in many places and is therefore subject to tax competition. For interest that is clearly the case and that is why after the United States unilaterally eliminated its withholding on interest in 1984,⁴⁷⁸ most countries went along.⁴⁷⁹ No tax treaty is needed to reduce withholding on portfolio interest, while “direct” interest among related parties is better policed by transfer pricing and thin capitalization rules.

In the case of dividends, it can perhaps be argued that an investment is more unique, but (a) it is hard to distinguish dividends from interest, especially if derivatives that can be used to convert equity to debt are not taxed at source, and (b) the uniqueness of equity investments is declining as multinationals become more similar to each other under globalization. In addition, dividends are optional and not deductible, so it is not clear what

474. OECD, *Model Tax Convention on Income and on Capital* arts. 10–13, 21 (July 15, 2014).

475. See Dagan, *supra* note 471.

476. See, e.g., Arjan Lejour, *The Foreign Investment Effect of Tax Treaties*, (CPB Neth. Bureau for Econ. Policy Analysis, Working Paper No. 14/03, 2014), http://www.eesc.europa.eu/resources/docs/2014-the-foreign-investment-effects-of-tax-treaties_oxford-univ-centre-for-business-taxation.pdf.

477. Assaf Razin & Efraim Sadka, *Capital Income Taxation in the Globalized World*, (Nat'l Bureau of Econ. Research Working Paper No. 10630, 2004), <http://www.nber.org/papers/w10630.pdf>.

478. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 127(a), 98 Stat. 494, 648-50 (codified as amended at I.R.C. § 871(h) (1994)).

479. Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1581 (2000).

function is achieved by having a withholding tax on dividends, and a tax treaty should not be needed to eliminate such taxes.

This leaves royalties, where the tax treaty is the only effective way to reduce withholding tax. But royalties from intellectual property generally represent economic “rents,” i.e., unique returns from specific assets, and in that case, it is hard to see the rationale for reducing the withholding tax because the investor cannot earn the returns elsewhere. Admittedly, multinationals have become extremely adept at locating IP in low-taxed jurisdictions and using deductible royalties to shift profits there. But that is precisely why royalties should be subject to full withholding tax rates by source countries (or alternatively not be deductible). Most royalties in any case are paid within multinationals and represent active income that should be taxed at source.

Thus, it can be argued that treaties are not needed to enforce the Benefits Principle under conditions of tax competition because the income can either be earned somewhere else, in which case the competition will lead to unilateral erosion of the withholding tax, or not, in which case the withholding tax should not be reduced.

But what about the function of tax treaties to attract investment and guarantee tax stability? While the empirical literature does suggest that tax treaties help investment, the same function can be achieved by bilateral investment treaties (BITs).⁴⁸⁰ BITs have two advantages over tax treaties: they are closer to being functionally multilateral because they contain a “most favored nation” (MFN) clause,⁴⁸¹ and they have much stronger dispute resolution mechanisms.⁴⁸² If a source country changes its tax rules in a way that injures investors, they can force it into binding arbitration under the BIT, as the government of India found out recently when it overturned its own Supreme Court to tax Vodafone retroactively.⁴⁸³

So can we just dispense with tax treaties? The question may seem too theoretical to be worth pursuing. However, current developments, and es-

480. See Peter H. Egger et. al, *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Evidence*, 39 CANADIAN J. ECON. 901 (2006); Mumtaz Hussain Shah & Saba Qayyum, *Impact of Double Taxation Treaties on Inward FDI in Latin American and Caribbean Developing Countries*, 7 BUS. & ECON. REV. 1 (2015); Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1501 (2007); Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity* (Univ. of Or. Econ. Dep’t Working Paper No. 2001-14, 2011), <https://ssrn.com/abstract=445980>; K. V. Bhanu Murthy & Niti Bhasin, *The Impact of Bilateral Tax Treaties on FDI Inflows: The Case of India* (March 18, 2013) (unpublished manuscript), <https://ssrn.com/abstract=2234966>.

481. MFN clauses link investment agreements by ensuring that parties to one treaty provide treatment no less favorable than the treatment they provide investors under other treaties. See, e.g., German Model Treaty 1998, art. 3.

482. See U.N. Conference on Trade and Development, *Dispute Settlement: Investor-State*, U.N. Doc UNCTAD/ITE/IIT/30, at 41 (May 2003) (noting that in a survey of 335 BITs in force in 1992, 334 contained provisions for arbitration).

483. See Stephanie Soong Johnston, *Vodafone Goes To International Court Over Indian Tax Dispute*, 82 TAX NOTES INT’L 41 (2016).

pecially the proliferation of new taxes designed to avoid treaty limitations such as the UK “diverted profits tax” and similar enactments elsewhere,⁴⁸⁴ raise the possibility that the whole bilateral tax treaty network will collapse, and perhaps that is no great loss. Countries will either tax at the source or not, depending on whether the tax competition market allows them to do so. Double taxation will be avoided unilaterally, and in those cases in which source countries can tax, the BIT network (which is larger than the tax treaty network) will prevent abuses by the source country.

However, tax treaties in the twenty-first century have another function: they can serve to enforce the other principle underlying the ITR, the Single Tax Principle. The Single Tax Principle is the idea that underlies the OECD BEPS project, namely that cross-border income should not be subject to double taxation but also not to double non-taxation.⁴⁸⁵ This means that source taxation should generally not be reduced unless residence taxation is in place.⁴⁸⁶

For active income, the Single Tax Principle can be achieved without a treaty because if this income is not taxed at source, residence jurisdictions can tax it under “controlled foreign corporation” (CFC) rules without a tax treaty (in fact, tax treaties have been used in some cases to undermine CFC rules).⁴⁸⁷ But for passive income, in the absence of a tax treaty network, reduction of withholding taxes are achieved unilaterally by tax competition without any assurance that the income will be taxed at source. The prime culprit is the U.S. portfolio interest exemption from 1984, which has led not just to massive capital flight from developing countries to the “tax haven” United States, but also to U.S. residents pretending to be foreign and investing into the United States through “incorporated pocketbooks” in the Caymans and friendly Swiss banks.⁴⁸⁸ This practice is illegal but hard to prevent in the absence of withholding or information exchange, and the latter can only be achieved by treaty.

For individual taxpayers, the needed exchange of information to enforce residence based taxation can be achieved by special treaties like bilateral tax information exchange agreements (TIEAs) and the new

484. On these developments see Reuven S. Avi-Yonah, *Three Steps Forward, One Step Back? Reflections on “Google Taxes” and the Destination-Based Corporate Tax*, 2 *Nordic Tax J.* 69 (2016).

485. Reuven S. Avi-Yonah & Haiyan Xu, *supra* note 473, at 208 (2016); see OECD 2017 MLI, *supra* note 24, pmb1. See also Reuven S. Avi-Yonah, *supra* note 28, at 12–22; Daniel Shaviro, *The Two Faces of the Single Tax Principle* (N.Y. Univ. Law & Econ. Working Papers, Paper 419, 2015), http://lsr.nellco.org/cgi/viewcontent.cgi?article=1421&context=nyu_lewp.

486. See Reuven Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy*, 59 *N. Y. L. SCH. L. REV.* 305 (2015).

487. Marcellin N. Mbwa-Mboma, *France-Switzerland Treaty Overrides CFC Regime, French Tax Court Rules*, 27 *TAX NOTES INT’L* 143 (2002).

488. Reuven Avi-Yonah, *What Goes Around Comes Around: Why the US is Responsible for Capital Flight (And What It Can Do About It)* (Jan. 23, 2013) (Univ. of Mich. Pub. Law & Legal Theory Research Paper Series, Paper No. 307, 2013), <https://ssrn.com/abstract=2208553>.

Multilateral Agreement on Administrative Assistance in Tax Matters (MAATM).⁴⁸⁹ These instruments do not require a full-fledged tax treaty, although in our opinion they are imperfect and it would be preferable if the United States and the EU could agree to reinstate withholding taxes on interest and only reduce them by treaty (so that only residents in countries that tax income and exchange information could benefit from reduced withholding tax rates). Since portfolio interest is always earned in developed countries, the cooperation of tax havens is not needed to achieve this result.

But for corporate taxpayers, the tax treaty network is needed to implement the single tax principle. That can be seen from the experience of countries that allow one of their treaties to be abused by not enforcing a limitation on benefit principles, so any taxpayer can come and use the treaty. The result is a reduction in source taxes on active income (business profits, royalties, direct dividends) without assurance that the income is taxed at residence.

The whole point of the BEPS project and the MLI is to enforce the single tax principle by ensuring that source taxation will apply in situations where there is no residence taxation because of tax arbitrage or the use of pass-through entities.⁴⁹⁰ And that is why in the absence of the MLI treaties could become useless, but with the MLI they are still quite useful.

A United States example can be used to illustrate this point. Before 1984, investors into the United States used the Netherlands Antilles treaty as a way of deriving interest, dividends, and royalties from U.S. sources at reduced rates.⁴⁹¹ The Antilles treaty was a “treaty with the world,” like the Russia-Cyprus or India-Mauritius treaties (although the latter was recently revised).⁴⁹² But in 1984 the United States unilaterally terminated the Antilles treaty and at the same time started inserting Limitation on Benefits (LOB) clauses in all its treaties.⁴⁹³ LOBs are designed to enforce the Single Tax principle, and they have become an essential and non-negotiable element in U.S. treaty practice and now through the MLI OECD treaty practice as well.

In the absence of treaties with LOBs, it is increasingly likely that corporate taxpayers could derive not just interest but even royalties without paying tax at source or at residence. That is the situation in Europe because of the EU Directives, which override the treaties.⁴⁹⁴ The MLI is

489. See Reuven Avi-Yonah & Gil Savir, *IGAs vs. MAATM: Has Tax Bilateralism Outlived Its Usefulness?* (Univ. of Mich. Pub. Law & Legal Theory Research Paper Series, Paper No. 384, 2014), <https://ssrn.com/abstract=2392702>.

490. See Avi-Yonah, *supra* note 28; Reuven Avi-Yonah & Haiyan Xu, *supra* note 473.

491. See Avi-Yonah, *supra* note 28 at 14.

492. For a general discussion, see Leslie E. Papke, *One-Way Treaty with the World: The U.S. Withholding Tax and the Netherlands Antilles*, 7 INT'L TAX & PUB. FIN. 295 (2000).

493. Avi-Yonah, *supra* note 486.

494. See Phillipe Freun & Kelly Stricklin-Coutinho, *United Kingdom, in TAXATION OF INTERCOMPANY DIVIDENDS UNDER TAX TREATIES AND EU LAW 984* (Guglielmo Maisto ed., 2012); HM REVENUES & CUSTOMS, *UK Residents with Foreign Income or Gains: Divi-*

designed to prevent this type of BEPS by requiring LOBs so that source taxes are not reduced unless there is likely to be tax at residence. That is what the treaties are needed for in the twenty-first century, and that is why the MLI is such a useful addition.

3. A MFN CLAUSE FOR TAX TREATIES?

Now that the MLI has been adopted by most of the OECD and G20 (excluding the United States), what next?

A full-fledged multilateral tax convention remains an unlikely idea even if the withholding tax rates and method for preventing double taxation are left for bilateral negotiations.⁴⁹⁵ But there may be another way to create a de facto multilateral treaty: inserting a MFN clause into tax treaties.⁴⁹⁶

BITs have MFN clauses.⁴⁹⁷ The effect has been that innovations in any given BIT tend to spread automatically, and by now the BIT network is close to a de facto multilateral one, despite the lack of consensus that derailed the attempt to negotiate the multilateral investment agreement in the 1990s.⁴⁹⁸

dends: EC Directive, in INTERNATIONAL MANUAL (2018), <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm164030>.

495. Although the desire to develop a multilateral convention has been expressed as early as 1927, *Report Presented by the Committee of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.216.M.85. 1927 II (1927), at 8, and expressed again in 1958, Fiscal Committee of the Org. for European Econ. Cooperation, *The Elimination of Double Taxation* (1958), the introduction to the 2014 OECD Model Convention still states that “[t]here are no reasons to believe that the conclusion of a multilateral tax convention involving all member countries could now be considered practicable.” Model Tax Convention on Income and on Capital, *supra* note 30, at 16.

496. See Albert J. Radler, *Most Favored Nation Concept in Tax Treaties*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 1–14 (Michael Lang, ed., 1998). It should also be pointed out that there has been a discussion on whether the non-inclusion of MFN treatment in EU bilateral tax treaties violates EU law. See, e.g., Georg W. Koeffler, *Most-Favored-Nation Treatment in Direct Taxation: Does EC Law Provide For Community MFN in Bilateral Double Taxation Treaties?*, 5 Houston Bus. & Tax L.J. 1 (2005); Luc Hinnekens, *Compatibility of Bilateral Tax Treaties with European Community Law - Applications of the Rules*, 4 EC Tax Review, 209 (1995); Helmut Loukota, *Multilateral Tax Treaty versus Bilateral Treaty Network*, in MULTILATERAL TAX TREATIES: NEW DEVELOPMENTS IN INTERNATIONAL TAX LAW 100–101 (Michael Lang, ed., 1998).

497. See, e.g., 2012 U.S. Model Bilateral Investment Treaty art. 4, which provides the following: (1.) Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory. (2.) Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

498. Chalamish, Efraim, *The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?* 34 BROOK. J. INT’L L. 304, 304–53 (2009).

The obvious difference between tax treaties and BITs is that tax treaties directly affect revenues and therefore countries may resist MFNs because that will force them to give up revenue if investment flows differ from one treaty partner to another.

But this argument is not entirely convincing. First, investment flows can change under current treaties, and that does not deter countries from entering treaties. They know that treaties can be renegotiated if the change in flows upsets the treaty bargain.

Second, the knowledge that MFN exists can simply be incorporated in treaty negotiations. Suppose the United States had MFN in its tax treaties and that it did not wish to reduce its withholding tax rate on portfolio dividends below fifteen percent. Knowing that MFN exists would simply ensure that it sticks by this position because it knows that a lower rate will spread to all existing treaties. On the other hand, suppose the United States decided that the right rate for direct dividends is zero rather than five percent. Having an MFN clause would mean this new negotiating position spreads automatically to all U.S. treaties without requiring opening treaties to renegotiation.⁴⁹⁹

In the case of a country like the United States that already has treaties with most of the countries that it wants to have treaties with, and that already reduces most withholding taxes to zero by its existing treaties (the U.S. model has zero for interest, royalties, capital gains and other income), adopting MFN is unlikely to lead to significant revenue losses and can make it easier to install innovations like the zero-tax rate for direct dividends across the U.S. treaty network. It is likely that other OECD member countries are in the same position.⁵⁰⁰ Developing countries may be more reluctant, and should be free to avoid the MFN, but for the OECD

499. An MFN clause is included in several Indian treaties. For example, under the tax treaty between India and Switzerland, if the Indian government grants better terms to another OECD member country with respect to taxes on interest, dividends, and royalties, and for fees for technical services, an automatic most-favoured-nation clause applies, whereby the reduced rate of tax granted to the other OECD member country is automatically provided to Switzerland under the tax treaty. There are many double tax treaties that include MFN clauses or clauses with similar consequences. *E.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Protocol ¶ 3, Arg.-Belg., June 12, 1996, 2091 U.N.T.S. 279; Agreement on the Promotion and Reciprocal Protection of Investment, Protocol Ad. art. 5, Mex.-Switz., July 7, 1995, 1965 U.N.T.S. 269; Agreement for the Avoidance of Double Taxation with Respect to Taxes on Income and Certain Other Taxes art. 24, ¶ 4, Can.-Ger., July 17, 1981, 1387 U.N.T.S. 135; Convention with Respect to Taxes on Income and Capital art. XXV, Can.-U.S., Sept. 26, 1980, T.I.A.S. No. 11087. The IBFD Tax Research Platform yields almost 250 treaties in force that include MFN clauses.

500. Interestingly, although paras. 54 and 55 of the 1977 OECD Commentary on Model Tax Convention explicitly rejected the application of MFN treatment, both of these paragraphs were deleted from the 1992 OECD Commentary on Model Tax Convention. Compare OECD, *Commentaries on the Articles of the Model Tax Convention* ¶¶ 54, 55 (1977), with OECD, *Commentaries on the Articles of the Model Tax Convention* p. C(24)–31 (1992).

including the MFN clause in tax treaties would seem a logical next step toward the ultimate goal of a full-fledged multilateral tax convention.

4. CONCLUSION: THE MLI AND THE FUTURE OF THE ITR

The MLI is an important innovation in international law. Hitherto, international economic law was built primarily on bilateral treaties (e.g., tax treaties and BITs) or multilateral treaties (the WTO agreements). The problem is that in some areas, like tax and investment, multilateral treaties have proven hard to negotiate, but only a multilateral treaty can be amended simultaneously by all its signatories.

The MLI provides an ingenious solution: a multilateral instrument that automatically amends all the bilateral treaties of its signatories. If the MLI succeeds, it can be a useful model in other areas, such as investment, where a multilateral agreement was not successful but there is a growing consensus about the need to adjust the terms of BITs to address investor responsibilities and the definition of investment comprehensively.

Whether the MLI will succeed remains to be seen. While its adoption by seventy countries (with more to come) is an achievement, the absence of the United States is important, and other OECD members have agreed to only a limited set of provisions. On the other hand, the MLI may prove more appealing to developing countries because it enhances source-based taxation and limits treaty shopping.

If the MLI is successfully adopted by the majority of taxing jurisdictions, this will have implications for non-taxing jurisdictions as well. For example, it is likely that the PPT will be used by courts in signatory countries to interpret treaties with non-signatory countries like the United States if those countries have signaled their agreement with the single tax principle embodied in the PPT by, for example, incorporating the LOB in their tax treaties.

Even a limited MLI would be a step forward. The current tax reform proposals in the United States pose a significant threat to the ITR, because they would sharply reduce the U.S. corporate effective tax rate to attract investment from other jurisdictions.⁵⁰¹ Countries that wish to limit the damage would be wise to accede to the MLI this year and prevent a massive race to the bottom that could ensue if the United States becomes (from the perspective of the rest of the world) a giant tax haven.

501. On these proposals see Reuven S. Avi-Yonah & Kimberly Clausing, *Problems with Destination-Based Corporate Taxes and the Ryan Blueprint*, 8 Colum. J. Tax L. 229 (2017); for the current tax reform framework, which has dropped the controversial border adjustment tax but retains a lower effective corporate tax rate see Reuven S. Avi-Yonah, *Slicing and Dicing: The Structural Problems of the Tax Reform Framework* (U of Michigan Law & Econ Research Paper No. 17-015, 2017), <https://ssrn.com/abstract=3048375>.