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BEPS Action 15: Release of Multilateral Instrument

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The release of the Multilateral Instrument constitutes an important step towards the most significant re-write of international tax rules in a `century. It is the multilateral convention enabling the simultaneous amendment of more than 3,000 existing bilateral conventions for the avoidance of double taxation. It aims at eliminating loopholes and mismatches among them, which are susceptible to allow aggressive tax planning. In thirty-nine articles, it implements measures indicated in Actions 2, 6, 7 and 14 of the Base Erosion and Profit Shifting (BEPS) Project, regarding hybrid mismatches, treaty abuse, artificial avoidance of permanent establishment status and dispute resolution of international tax disputes.

1 Introduction

An important step towards the '*most significant re-write of international tax rules in a century*'[1] was made on 24 November 2016 with the release of the Multilateral Instrument (MI). The MI has been envisaged, within the framework of Base Erosion and Profit Shifting (BEPS) Project,[2] as a multilateral convention allowing the simultaneous renegotiation and amendment of more than 3,000 existing bilateral double taxation (DTCs).[3]

BEPS Project may be characterized as the global response to the global problem of misfunctioning national tax systems,[4] a problem confirmed by Luxembourg Leaks, Panama Papers and – more recently – Bahamas Leaks.[5] Aggressive tax planning, unfair taxation and the financial crisis brought together more than 100 countries in an inclusive framework with the commitment to develop comprehensive measures to tackle them.[6] The idea was that BEPS is enabled by defective tax rules[7]; the solution should hence lie with changing the rules.[8] The Project was launched in 2013 with the OECD's report '*Addressing Base Erosion and Profit Shifting*'[9] identifying cases where domestic and international tax rules were not aligned with modern business means and procedures[10] and facilitated tax avoidance, as a result. The goals set were to (1) stop loss of corporate tax revenue for states – estimated at no less than USD 100–USD 240 billion on an annual basis (4%–10% of global corporate income tax (CIT) revenue[11]) – (2) ensure taxation of income where economic value is created, and (3), even more importantly, rebuild fair tax systems to restore and build taxpayers' trust. The same year a 15 Actions Plan[12] was

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1 OECD/ G20, *Base Erosion and Profit Shifting Project. Information Brief* (2015).

2 OECD, *Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS* (2015).

3 Cf. P. Valente, *Convenzioni Internazionali Contro le Doppie Imposizioni* 3 et seq. (IPSOA Wolters Kluwer 2016).

4 Cf. P. Valente, *Elusione Fiscale Internazionale* 3 et seq. (IPSOA Wolters Kluwer 2014).

5 Luxembourg Leaks (or Lux Leaks), Panama Papers and Bahamas Leaks are financial scandals, revealed by the International Consortium of Investigative Journalists (ICIJ) on 5 Nov. 2014, 4 Apr. 2016 and 21 Sept. 2016 respectively.

6 OECD, *About BEPS and the Inclusive Framework*, http://www.oecd.org/tax/beps/beps-about.htm (accessed 28 Nov. 2016).

7 A. Dourado, *The Base Erosion and Profit Shifting (BEPS) Initiative Under Analysis*, 43(1) Intertax (2015).

8 In the words of Raffaele Russo, head of the project, '*BEPS is recognition of the fact that the (tax) structures* [implemented by multinational enterprises in order to reduce their tax bills] *are in most cases legal so the problem is not the structures but the rules. What we are doing is changing the rules so that these things are not legal any more*'. Cf. C. Keena, C. Taylor, *OECD Says LuxLeaks Revelations Not Surprising*, Irish Times (2014), http://www.irishtimes.com/business/economy/oecd-says-luxleaks-revelations-not-surprising-1.1990609 (accessed 28 Nov. 2016).

9 OECD, *Addressing Base Erosion and Profit Shifting* (2013).

10 P. Valente, *L' Impresa Invisibile*, Il Sole 24 Ore 3 et seq. (2001).

11 OECD, *About BEPS and the Inclusive Framework*, http://www.oecd.org/tax/beps/beps-about.htm (accessed 28 Nov. 2016).

12 OECD, *Action Plan on Base Erosion and Profit Shifting* (2013).

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agreed to address the cases identified in the above report, and two years later, Final Reports on the 15 Actions followed, defining the measures to be taken.[13]

Action 15 of the BEPS Action Plan conceived the development of a MI, giving the following mandate:

> *Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.*

Hence, the MI is devoted to implementation and in particular to implementation of measures targeting BEPS issues arising from DTC norms that are either too '*old-fashioned*' to address the challenges of modern business environment, or not sufficiently coherent among themselves and with the domestic laws and consequently leave gaps to avoid tax in '*a legal way*'. The objective pursued through the MI is the swift and synchronized modification of existing DTCs to align them with the current *way of doing business* and between and/or among themselves while avoiding the costs (and risks) of separate negotiations.[14] The Final Report on Action 15 concluded that this mission was possible. An ad hoc Group, open to all interested States and eventually formed by almost 100, operating under the aegis of OECD and the G20, undertook to carry out the mandate until the end of 2016. With the MI release the mission has been accomplished.

This article aims at providing a brief overview of the provisions included in the MI and their possible implementation. It first analyses the structure of the instrument and the manner in which its provisions may be incorporated to the existing DTCs. It then details the substantive provisions that have been included in the MI in order to address BEPS. In this respect, a practical example is provided as well, of the impact such provisions could be envisaged to have on four important Italian DTCs, i.e. with Germany, China, the UK and the US[15] The example is construed on the assumption that all parties to these DTCs will properly sign and ratify the MI, will duly notify any DTC provisions to be replaced and will not reserve any rights as to application of MI provisions; with respect to options available to MI parties in relation to certain provisions, the example refers to the cases considered most important.

2 Structure and application of MI provisions

2.1 *MI Structure and Classification of the Provisions*

From the outset it must be noted that the MI may affect solely DTCs that have been notified to the OECD Secretary-General (Depositary) by all parties thereto, which are also parties to the MI. A DTC and the effects it produces may be changed to a larger or lesser extent depending on its existing provisions; DTCs that are more updated, more aligned with the current version of the OECD's Model Tax Convention (MTC),[16] may be amended to a lesser extent than others.[17] In addition, the scope of amendment of a DTC depends largely on the choices and reservations that will be made by its parties upon signature and ratification of the MI.

The provisions of the MI may be divided into three categories, i.e. (1) provisions forming part of the so-called *minimum standard*, i.e. a minimum level of alignment among DTCs, (2) provisions that apply to the – notified as per above – DTCs of the parties, upon ratification of the MI, provided that no reservation has been made, but without need for an explicit choice, and (3) provisions that do not apply unless specifically chosen by the parties. This categorization serves purposes comprised in the mandate for the development of the MI and, in particular, the indication that it should be constructed taking into account '*whether each provision is optional or whether it will be part of the minimum standard for joining the instrument.*'[18] Thus, an effort was made to reach a golden mean between the need for flexibility and the need for effectiveness: only a flexible instrument can be '*attractive*' to a large number of jurisdictions with different policies, legal and tax systems and cultures; at the same time there is no question that certain basic principles should be in place (minimum standard), guaranteeing that the MI actually constitutes a step forward in the fight against BEPS.

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13 M. Gilleard, *The End of the (Tax) World as We Know It? OECD Delivers Final BEPS Recommendations*, Intl. Tax Rev. (Oct. 2015), https://www.internationaltaxreview.com/Article/3494613/The-end-of-the-tax-world-as-we-know-it.html (accessed 28 Nov. 2016).

14 *Base Erosion and Profit Shifting (BEPS)* 328 et seq. (M. Lang, P. Pistone, A. Rust, J. Schuch & C. Staringer eds, Linde 2015).

15 For a commentary on the DTC between Italy and the US, Valente, *supra* n. 3, at 1107 et seq.

16 OECD, *Model Tax Convention on Income and on Capital* (2014).

17 It is noteworthy that the DTCs between Italy and Germany, China, UK and the US entered into force: two in 1990, and the other two in 1992 and 1999; they may hence be considered to be far from 'updated' with the last version of the MTC.

18 OECD, *supra* n. 2.

In view of the above, the minimum standard includes provisions considered indispensable for a successful MI implementation. In particular, all DTCs falling under the MI shall include: (1) a preamble clearly stating their spirit substantiating any motivations against the creation of tax avoidance opportunities, (2) a principal purpose test (PPT) clause, preventing the unintended granting of treaty benefits, and (3) the undertaking of the parties to apply a mutual agreement procedure (MAP) for the resolution of differences in relation to double taxation. With respect to these provisions, parties to the MI may only make reservations under specific conditions, as detailed below (under 2.2), ensuring in all cases that their DTCs include provisions satisfying the minimum standard in an equivalent way. Thus, the minimum standard is adequately safeguarded while the parties to the MI always enjoy some margin to apply it in a way that is consistent with their legal and cultural characteristics.

More flexibility is pursued through the second and third categories of provisions. The second category includes, among others, rules on (1) income derived by or through transparent entities, (2) award of DTC benefits to dual-resident legal entities, (3) tax advantages in case of dividend payments, (4) proper treatment of income attributable to permanent establishments (PEs) in jurisdictions that are not parties to the applicable DTC, (5) rules against artificial avoidance of PE status. Parties to the MI may reserve their rights with respect to application of the provisions of this category, even in their entirety. The third category includes complementary optional provisions that will form part of a DTC following choice by both parties.[19] Here belong, among others (1) options for the proper application of methods for elimination of double taxation, (2) options for the struggle against artificial avoidance of PE status through exploitation of specific activity exemptions, (3) complementary provisions, such as additional preamble wording (apart from the one included in the minimum standard), (4) a simplified limitation of benefits (LOB) clause, and (5) agreement to arbitrate tax disputes not resolved through a MAP.

2.2 *Entry into Force, Application of Provisions and Reservations Procedures*

States or tax jurisdictions wishing to join the MI must sign it and also deposit a ratification, acceptance or approval instrument with the Depositary. The MI shall enter into force three months after the deposit of the fifth instrument of ratification, acceptance or approval. Following this date, for each new MI party, it will enter into force three (3) months after the deposit of such new party's ratification, acceptance or approval. Any party may withdraw from the MI at any time upon notification to the Depositary. The MI is open as of 31 December 2016 to all States as well as to certain named jurisdictions, e.g. Guernsey, Jersey, while its parties may consent to participation of any other jurisdiction.

MI provisions are envisaged to be added to DTCs that do not include similar provisions or replace DTCs' existing provisions with a similar but not identical effect. Provisions falling under the third category described above may only be thus included in DTCs following express respective choice of the parties thereto. As regards the provisions of the first and second categories, to the extent the parties have not expressed reservations on their application, in accordance with their margin under the MI, they are introduced to the DTCs notified as above to the Depositary once both parties ratify the MI. They shall then become effective three months from ratification of the MI by both parties.[20]

In particular as regards introduction of the MI provisions to the DTCs falling thereunder, provided no relevant reservation was made, three possible scenarios may be discerned. Firstly, in case a DTC's provisions are not similar to the ones provided by the MI, it is supplemented by those of the MI. Secondly, if a DTC includes a provision with a similar effect to that of an MI provision, it will be replaced by the new provision, provided that all DTC parties have proceeded with proper notification to the Depositary of the specific provision, apart from the DTC. Thirdly, in case a DTC does contain a provision that is similar to any MI provision and that should be replaced, but the parties did not notify the specific provision to the Depositary as per the MI, or only some of the parties so notified the specific provision, the existing provision shall remain applicable, but superseded by the new MI provision to the extent they are incompatible. Different application rules are provided with respect to certain provisions, under which parties are faced with a choice between different options. The underlying rationale is that in these cases the possibility that DTC parties may proceed with different choices must be taken into due consideration. Therefore, for example, as regards Article 5, any option chosen by a MI party shall be applicable to its residents without need for notification by its counterparty of the DTC provision, without the further need for its counterparty to select the same option. Another example refers to the Simplified LOB clause under Article 7 of the MI, where it may apply to a specific DTC without the parties to it having chosen a Simplified LOB[21] to apply to their DTCs in general.

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[19] In case of Art. 5 of the MI, however, the options provided are applicable upon choice of even one DTC party, to its own residents.

[20] The MI includes details on the entry into effect of specific provisions, such as MAPs or arbitration.

[21] This applies subject to conditions, e.g. that Simplified LOB has been chosen by some of the parties to a DTC and all of them consent on its application thereto.

Any MI party wishing to express reservations with respect to one or more provisions thereof,[22] must do so either at the time of signature, or at the time of submission of the ratification, acceptance or approval of the MI.[23] Reservations expressed at the time of signature must either be specified as '*definitive*' at that time, or be confirmed upon ratification, acceptance or approval. In case the signing party has not concluded on any reservation, it should submit a provisional list of reservations under consideration. The same applies to notifications. Reservations may be withdrawn at any time upon notification to the Depositary. They can also be replaced, but only with more limited ones. As regards notifications of DTCs falling under the scope of the MI and specific DTC provisions to be replaced pursuant to the MI, any party thereto may at any time add DTCs or DTC provisions to the ones already notified, through new notification to the Depositary.

3 Main MI provisions

The MI implements in its Articles 3 to 26 the treaty-related measures included in the Final Reports on Actions 2, 6, 7 and 14 within the framework of the BEPS Project.[24]

3.1 Implementation of Action 2: Neutralizing Hybrid Mismatches Effects[25]

The outcomes reflected in the Final Report on Action 2 are mirrored in the MI in its Part II, addressing hybrid mismatches, i.e. '*arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries { … } often leading to double non-taxation*'[26] or equivalent results. More specifically, Article 3 refers to transparent entities or arrangements, Article 4 to dual resident entities, and Article 5 to methods for elimination of double taxation. They are based on the principle of linking the ways of effective tax treatment of entities or instruments by the different parties to a DTC.

Transparent or flow-through are entities or arrangements whose income, under applicable national law, is wholly or partially taxed at the level of the persons with an interest in it,[27] e.g. owners or investors, and not at the level of the entity or arrangement. Typical examples are general partnerships, limited partnerships and limited liability partnerships as well as US S. corporations, income trusts and limited liability companies.[28] Article 3 is underpinned by the principle that benefits under a DTC must be denied with respect to income not taxable as income of a resident by any of the DTC parties. Therefore, it provides that, in order to apply a DTC to entities or arrangements that are transparent under the law of one of the parties to the DTC, their income, i.e. any income earned by or through them, must be taxed as income of resident by one of the parties. An example used by the OECD in its 2014 Public Discussion Draft illustrates the problem and the solution: it is assumed that a DTC between states A and B is applied to interest payment by debtor-resident of state A to entity of state B, the latter being transparent under the laws of B (but not under the laws of A). State A will or will not tax the payment pursuant to the DTC and the benefits it provides with a view to avoiding double taxation. As the entity is transparent for state B, however, B will tax the interest payment at the hands of the owners, i.e. if the owners are not its tax residents, it will not tax it at all. It follows that any advantage given by A under the DTC might not be matched with tax treatment in B. Under Article 3 of the MI, the payment will be treated under the DTC between states A and B, to the extent it is actually taxable by B at the hands of a resident taxpayer. For this purpose, it is clarified that DTC provisions (1) exempting certain income from tax or (2) providing for credit/deduction for tax paid (in the same State) shall not apply, where the sole reason for the benefit is that the income in question is also income of resident(s) of the other party.

With a view to preventing treaty benefits being abusively obtained through dual residence,[29] Article 4 specifies that legal entities, tax residents in more than one DTC party shall not be entitled to any tax relief or exemption under such DTC until the parties agree (1) on single tax residence for the purposes of the DTC or alternatively, (2) specific DTC benefits that may be granted to specified legal entities (independently from agreement on single tax residence). Exemption applies for dual – listed company arrangements.

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22 G. Fitzmaurice, *Reservations to Multilateral Conventions*, 2(1) Intl. & Comp. L.Q. 1–26 (1953).

23 It is noted that special provisions apply in case of reservations with respect (1) to a DTC subsequently added to the list of DTCs notified by a party and (2) to Part VI (Arbitration) of the MI, where a party chooses to apply it after having ratified the MI.

24 Valente, *supra* n. 4, at 1895 et seq.

25 OECD, *Action 2: 2015 Final Report* (2015).

26 OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (2012).

27 OECD, *Public Discussion Draft: BEPS, Action 2: Neutralize the Effects of Hybrid Mismatch Arrangements (Treaty Issues)* (19 Mar. 2014–2 May 2014).

28 M. Verhoog & A. Breuer, *Hybrid Entity Issues in a Tax Treaty Context: OECD Approach v. Actual Tax Treaties*, 44(8/9) Intertax (2016); G. Valente & S. Mattia, *Trasparenza Fiscale per I Soggetti non Residenti*, 8 Commercio Internazionale (2005).

29 For a commentary on dual residence, Valente, *supra* n. 3, at 295 et seq.

The risk that DTC provisions on elimination of double taxation are applied so that certain income remains untaxed is the focus of Article 5, which provides three alternative solutions. They target issues arising from application of DTCs in connection with domestic laws. Parties to the MI may choose one of the three options of Article 5 or none. Briefly stated, the options are: (1) additional condition to DTCs providing for exemption of income or capital of resident from tax in the residence-jurisdiction: that the item of income or capital to be exempted is not tax-exempt also in the source-jurisdiction under the same DTC[30] (Option A), (2) additional condition to DTCs providing for exemption of dividend from tax in residence-jurisdiction: that the dividend is not treated as deductible in the source-jurisdiction [31] (Option B), and (3) for DTCs providing for the exemption from tax in the residence-jurisdiction of income or capital taxable in the source-jurisdiction pursuant to the DTC, elimination of double taxation through deduction from tax payable in residence-jurisdiction of tax paid in source-jurisdiction while exemption of income or capital of resident (i.e. regardless of taxation in source-jurisdiction) shall apply with progression (Option C). A party to the MI not opting for the third option may prevent its application to identified DTCs (irrespective of the choice of its counterparties thereto). All above options apply in addition or in place of DTC provisions requiring exemption of certain income from taxation in the residence-jurisdiction; it follows that they do not affect DTCs providing for elimination of double taxation through credit/deduction mechanism. In any case, the option taken by each party to a DTC will be applicable to its residents only.

3.1.1 *Practical Example on Application to Italian DTCs*

From the four DTCs between Italy and Germany, China, the UK and the US to be examined hereunder,[32] only the one with Germany includes provision with respect to fiscal treatment of income earned by or through transparent entities (paragraph 2 of Protocol).[33] This could be replaced by the provisions of Article 3 of the MI, without there being however any substantial change in the practical implications. In the absence of a similar provision, the other Italian DTCs should be expected to be supplemented by Article 3 of the MI.

With respect to Article 4 of the MI, it should substitute Article 4 paragraph 3 of the DTCs with UK, Germany and China, which specify a criterion[34] for the determination of single tax residence for the application of the DTC. As a result dual resident companies would be stopped from enjoying benefits of the above DTCs until the conclusion of the agreement envisaged in this article between the DTC parties. The DTC with the US already provides determination of single residence by agreement. Consequently, it should only be affected through supplementation as to the effects of the absence of an agreement.

Moreover, taking into account that Article 5 of the MI targets DTCs providing for elimination of double taxation through exemption, among the four DTCs, only the one with Germany could be affected. In particular, it provides for conditional exemption of dividends paid between companies-residents in the two countries as well as for exemption in Germany of taxable income items in Italy.[35] It follows that such provision could (1) be supplemented according to Option B with an additional condition, that the dividend to be exempted is not treated as deductible in the other State, or (2) be replaced pursuant to Option C, to the effect that income taxable in Italy shall qualify for deduction of the tax actually paid and not for exemption (as originally provided); so far as a tax resident's income or capital[36] is exempted under the DTC, irrespective of being taxed in Italy, exemption should apply with progression. DTCs with the UK, US and China apply credit/deduction mechanisms for the elimination of double taxation and should not be affected.

3.2 Implementation of Action 6: Preventing the Granting of Treaty Benefits Under Inappropriate Circumstances[37]

Further on, the conclusions drawn by the OECD from its works on treaty shopping[38] are reflected in Part III of the MI, which provides instruments against arrangements

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[30] If instead of exemption in the source state, the taxpayer enjoys a limited tax rate on such item due to the same DTC, the residence State shall provide – instead of an exemption – a deduction for the tax paid.

[31] Any tax paid in the source-State shall however be deducted in the residence-State.

[32] Cf. Introduction to this article.

[33] It is noted that the DTC with the US includes criteria for the determination of the residence of a transparent entity, without however defining the tax treatment of the income derived by or through it.

[34] Such criterion is normally the place of effective management, while in the case of the DTC with China it can also be the head office.

[35] It is noted that certain income items are excluded from this rule and subject to credit mechanism, pursuant to Art. 24 para. 4 of the DTC between Italy and Germany.

[36] Applicable to dividends paid by Italian company, 10% of the capital of which is owned directly by German company.

[37] OECD, *Action 6: 2015 Final Report* (2015).

[38] Cf. T. Rosenbuj, *International Tax Arbitrage*, 4 Intertax 158–168 (2011).

through which it is attempted to obtain benefits under a targeted or desired DTC by non-residents[39] who establish companies with no/hardly any substance ('*letterbox*'/'*shell*' or '*conduits*'). Most importantly, Part III includes a preamble wording (Article 6) as well as a PPT clause (Article 7 paragraph 1) and a LOB clause (Article 7 paragraphs 6–14).

Article 6 provides the wording of a preamble clarifying that DTCs may not be (ab)used to create opportunities for no or reduced taxation through tax evasion. Parties to the MI cannot abstain from application of Article 6 unless and to the extent that their DTCs already contain a preamble with the same wording.

Moreover, PPT is introduced in Article 7 paragraph 1, providing that DTC benefits are denied to taxpayers where there is evidence that a given arrangement or transaction was put in place for the principal purpose of obtaining the benefit.[40] This provision is essential for the satisfaction of the minimum standard and for this reason, parties to the MI cannot abstain from its application unless they reach the minimum standard by (undertaking to apply or already) applying a LOB along with a rule to address conduits or another PPT. In addition to PPT, the MI parties can opt for the application of *Simplified Limitation of Benefits Provision* under Article 7 paragraphs 8–13. This clause is structured to allow the granting of treaty benefits only to persons that meet certain *categorical tests.* More extensively, very few DTC provisions are applicable to all residents of the relevant party-jurisdictions, such as rules on dual residence of legal entities and transfer pricing (TP) adjustments. The remaining provisions are in principle available to the so called '*qualified persons*', i.e. individuals, local authorities, non-profit organizations, investment or pension funds, listed entities. Apart from the above, DTC income related benefits are available to non-qualified persons provided that they meet certain criteria in relation to actual conduct of business activity in their State of residence or, in any case, provided that they did not engage in such activities from which the income arose in order to obtain the DTC benefit.[41] A LOB is in principle applicable only where all DTC parties have opted for it or if its application is agreed in relation to a specific DTC. It is worth noting that a party to the MI choosing to apply a LOB is entitled to prevent the application of whole of Article 7 to a DTC if the counterparties thereto do not make the same choice. This however would raise issues under the minimum standard, which should be addressed through negotiation.

In Part III, Article 8 refers to DTCs providing for favourable tax treatment of dividends in the source-jurisdiction where the beneficial owner/recipient company (1) resides in the counterparty – jurisdiction and (2) satisfies certain control criteria in relation to the payer. The benefit is made subject to the additional condition that control criteria are satisfied for a 365 – day period including the day of payment.

The case of capital gains from alienation of shares, which derive a major part of their value from immovable property, is treated under Article 9. In essence, it is clarified that for such capital gains to be taxed at the place of immovable property, it suffices that any value condition set by the DTC is satisfied any time within 365 days prior to alienation. The scope of any relevant clauses is extended to other interests comparable to shares, e.g. interests in partnership or trust. An alternative clause – applicable upon choice of all DTC parties – includes also definition of the value threshold (50%).

Cases where the income of an enterprise is considered by the residence-jurisdiction attributable to PE in a third country and is hence tax exempt (triangular cases involving PEs in third countries) are addressed under Article 10. If such income (1) is not connected with active business conduct by the PE and (2) is taxed at a very low rate in such third country,[42] DTC shall not apply and it will be taxed at source-jurisdiction.[43]

Article 11 seeks to safeguard states' taxing rights over their residents, which could be put at risk due to ineffective interaction of treaty clauses with domestic law provisions. Such rights may only be limited upon express statement to this effect in concluded DTCs. A list of the most common DTC clauses leading to such a restriction is provided.[44]

3.2.1 *Practical Example of Application to Italian DTCs*

To begin with, the preamble of all four DTCs under examination should be expected to be replaced by the new wording (Article 6 of the MI), since none of them includes the specific wording '*without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance*'[45].

In addition, all four DTCs should be supplemented with the PPT clause (Article 7 paragraph 1 of the MI). Although some of them do include PPT clauses with

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[39] DTC benefits are normally reserved for tax residents of the jurisdictions that are parties to such DTC.

[40] An MI party may reserve the right to grant the benefit in cases it would do so regardless of the existence of any arrangement/transaction.

[41] Valente, *supra* n. 4, at 325 et seq.

[42] Less than 60% of the tax that would be payable in the residence-State.

[43] However, the denial may be reversed if the source state so decides upon relevant application of the taxpayer, taking into account the reasons for the denial.

[44] It includes TP adjustments, individuals' income from supply of services, taxation of pensions under a State's social security laws etc.

[45] However all of them do include clarification of the intention of the parties to prevent tax evasion.

respect to specific DTC benefits, none of them includes a catch-all provision. Apart from PPT, the DTCs can be supplemented by the Simplified LOB clause if both parties so choose. The DTC with the US already includes a LOB clause[46]; hence Italy and the US might agree in its replacement by the wording of Article 7 paragraphs 8–13.

Under Article 10 and/or under the respective article on elimination of double taxation the Italian DTCs regulate tax treatment of dividends. All examined DTCs include holding requirements for the beneficial treatment of dividends. The introduction of the new provision can in fact have implications only for persons falling under the scope of the DTC with Germany, as it is the only one not conditioning the beneficial treatment from the twelve-month holding of the title.

Furthermore, Article 13 of all above DTCs regulates tax treatment of capital gains. DTCs with China and the US could be envisaged to be affected by Article 9 of the MI, through the additional requirement that the alienated shares derived, wholly or principally, their value from immovable property for 365 days prior to alienation. All other DTCs under examination do not include such provision.

3.3 Implementation of Action 7: Preventing Artificial Avoidance of PE Status[47]

The long awaited amendment of the PE definition, as envisaged in the Final Report on Action 7, is introduced in Part IV. An update of the definition was imperative in view of the widespread use of tax avoidance strategies to circumvent the existing definition in the MTC and in the majority of existing DTCs.[48] All three strategies identified in the Final Report on Action 7, i.e. commissionaire arrangements, specific activity exemptions and splitting-up of contracts, are addressed under Articles 12, 13 and 14 accordingly. Other strategies may be countered through the PPT detailed above.

More specifically, Article 12 targets the well-known issue of commissionaire arrangements, i.e. arrangements through which a person sells products in a state in its own name, but on behalf of a foreign enterprise that is the owner of the products.[49] It follows that, in fact, the foreign enterprise sells the products without being taxed on the sales' profits in the source-jurisdiction, since it does not have a PE there (but only a commissionaire) to which such profits are attributable. From now on, PE status is extended to cases with the following characteristics: (1) a person acts on behalf of an enterprise, (2) it does not act so in the ordinary course of its independent-agent business, (3) it habitually concludes contracts (or leads to their conclusion), (4) the contracts so concluded are 'standard', not requiring any significant review/negotiation on the part of the enterprise while, (5) in substance 'engaging' the enterprise, meaning that they are in the latter's name, or involving its services or property rights.[50] It is clarified that a company acting exclusively or almost exclusively on behalf of one or more related companies cannot be regarded as an 'independent agent'.

Article 13 addresses the abuse of '*specific activity exemptions*' for the circumvention of PE status. It refers to a list of activities that may be exercised at a fixed place of business without giving rise to PE status. In light of the major change in the conduct of business activity lately, especially with respect to new technology, the list is revisited and it is proposed to be limited to what constitutes today merely an activity of '*auxiliary or preparatory nature*'. Two options are provided. Under option A, any and all specific activity exemptions listed in a DTC shall be subject to an additional, substantial condition, that they are indeed of a '*preparatory or auxiliary nature*'. According to the OECD commentary, an activity is of a '*preparatory nature*' when '*it is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole*' while it is of '*auxiliary nature*' when '*it is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole*'. Option B is less ambitious; it provides for the denial of PE status on the basis of activities deemed to be of a preparatory or auxiliary nature but leaves a margin for a list of specific activity exemptions regardless of such nature. In any case the scope of specific activities exemption provision is limited with respect to fixed places of business in tax jurisdictions where the enterprise (or a related company) carries on also other activities forming a '*cohesive business operation*' with the activities of the fixed place of business, either through an existing PE or in an overall non-preparatory/non-auxiliary way.

The practice of splitting-up of contracts to circumvent DTC time limits for the granting of PE status falls under Article 14. As per the Final Report on Action 7, the twelve-month period provided in Article 5 paragraph 3 of the OECD MTC[51] and included in several DTCs, has

Notes

[46] Art. 2 of DTC Protocol.

[47] OECD, *Action 7: 2015 Final Report* (2015).

[48] Valente, *supra* n. 4, at 1103 et seq.

[49] OECD, *supra* n. 37.

[50] Exception applies for the case that the commissionaire's activities are of such nature that even if exercised by a fixed place of business they would not suffice for the granting of a PE status.

[51] OECD, *supra* n. 16.

been abused by enterprises through dividing a contract into several parts. Each contract does not last more than twelve months and it is attributed to a different legal entity of the same group. DTCs should include a provision to prevent such abuse, by enabling the aggregation of time periods during which (1) an enterprise conducts activities at a building site[52] for more than thirty days overall, even if at intervals, and (2) one or more related companies conduct connected activities at the same place for more than thirty days each.

3.3.1 *Practical Example of Application to Italian DTCs*

All four DTCs under examination include similar provisions on commissionaire arrangements under Article 5 paragraphs 4 & 5.[53] Such provision could be envisaged to be replaced by Article 12 of the MI, which has a wider scope than the existing DTC provisions. It is noteworthy, for example, that (1) weight is attached to the fact of habitual conclusion of contracts instead of the authority to do so, (2) that persons with a leading role in the conclusion of contracts, even if not taking part in the concluding act themselves, may from now on qualify as PEs, (3) that the contracts do not need to be concluded '*in the name*' of the enterprise, if they refer to its property or services, (4) that the independent-agent-exemption cannot apply where a person is acting exclusively or almost exclusively for one or more enterprises.

In addition, all four DTCs contain almost identical specific activity exemptions under their Article 5 paragraph 3. In all cases the scope of the clause could be amended to exclude fixed places of business in jurisdictions where the enterprise (or a related party[54]) already has other activities, as above detailed. The provisions could be further amended if both parties to each DTC take the same option under Article 13 of the MI. Under the first option, all existing exemptions, both of activities and regarding fixed places of business, would apply subject to the additional requirement that they are of '*preparatory or auxiliary nature*'. Under the second option, the exemptions in relation to activities would remain untouched. Fixed place of business clauses would be affected, where any and all activity conducted (even if a combination of exempted activities) must be preparatory/auxiliary to be exempted.

Article 5 paragraph 2 of all above DTCs, providing for a Twelve-month period for a building site or specific project to qualify as PE could be expected to be supplemented by the clarification under Article 14 of the MI, to the effect that this period shall be calculated as an aggregate of the activities conducted by the enterprise, or the group at the site for more than thirty days.

3.4 Implementation of Action 14: Making Dispute Resolution Mechanisms More Effective[55]

In the Final Report on Action 14 it was recognized that legal certainty and rapid procedures in the area of international taxation are of fundamental importance. They should be ensured through a MAP, at a first stage, and by arbitration, at a second stage, in case of MAP's failure to reach a settlement. MAPs shall be implemented through Part V, while arbitration through Part VI. Action 14 is reflected in two different parts to facilitate implementation: while MAP is part of the minimum standard that should be complied with in all cases, the differences among national laws and policies of the jurisdictions that are invited to join the MI require that arbitration shall only apply subject to choice.

As regards MAPs, in essence Article 16 of Part V seeks to update the existing DTCs[56] to the current version of the MTC, with some innovations. To this effect, (1) it upholds the right of every taxpayer, reasonably assuming that the provisions of a DTC are not complied with (or might not be in the future) in his case, to complain with any of the parties[57] to the respective DTC (2) within (at least) three years from notification of the act giving rise to non-compliance, (3) it provides for the launching of a MAP in three cases, i.e. (a) if an authority considers a complaint to be duly motivated but cannot solve the issue alone, (b) in case of '*difficulties or doubts*' with respect to a DTC, or (c) in case of any other issues in relation to double taxation even outside the scope of a DTC, and (4) it provides for implementation of any mutual agreement '*notwithstanding any national law time limits*'. Since the MAP is part of the minimum standard, its application cannot be denied by the parties to the MI, unless they opt for one of the alternative solutions under Article 16. In such case they shall have to ensure taxpayers' right to complain with residence-jurisdiction, which shall not reject such complaint before notifying the counterparty-jurisdiction.[58] The requirement that mutual agreements

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[52] The same applies for installation/construction/other specific projects as well as to supervisory or consultancy services rendered in connection with such a place.

[53] The DTC with China includes slightly more elaborated provisions and hence the impact of the amendment is more limited.

[54] Definition is provided under Art. 15 of the MI.

[55] OECD, *Action 14: 2015 Final Report* (2015).

[56] For a thorough overview of the current DTC provisions, Valente, *supra* n. 3.

[57] It is noted that the MTC provides for submission of complaint with the Authorities of the State of residence (or nationality – depending on the nature of the case) of the complainant.

[58] As regards the deadline for the submission of the complaint, parties to the MI must ensure that it is at least three years from first notification of the act giving rise to non-compliance.

apply notwithstanding any national law time limits is also part of the minimum standard. Parties to the MI cannot abstain therefrom unless they undertake not to make adjustments to profits of PEs or enterprises after a period mutually agreed with the counterparty to the DTC subject to examination.

TP adjustment cases are dealt with under Article 17 of Part V. In case of profit attribution proven not to be at arm's length, the jurisdictions involved shall make any necessary adjustments to ensure taxation of the profits at the hands of the entity to which they belong, at arm's length.

Upon a MAP's failure to settle the dispute, arbitration may be resorted to, pursuant to Part VI. Arbitration is not part of the minimum standard. Article 19 invites MI parties to use arbitration for the resolution of any issues not settled within two years from MAP's activation.[59] Opening of an arbitration procedure does not, however depend on the States themselves but on the taxpayer-complainant, who has to submit a request to this effect. Details of the arbitral procedure shall be defined by the parties to the DTC questioned. and any decision reached shall be implemented through the MAP. Such decision shall be final and binding on all States involved, unless it is not accepted by the taxpayer-complainant, who decides to continue or start litigation on the issues considered by the arbitrators,[60] or unless the arbitration is deemed to be null and void by the Courts of one of the jurisdictions involved. Strict deadlines are provided regarding notifications and requests by the States. There are also provisions on: (1) the appointment of arbitrators, (2) confidentiality of the proceedings, (3) the event of the resolution of a case submitted to arbitration prior to the delivery of the arbitral decision, (4) alternative types of arbitration processes,[61] (5) the States' margin to agree on a resolution of the issues different from the one concluded by the arbitrators, and (6) procedural costs.[62] With respect to the appointment of arbitrators and the type of the process as well as the scope of the issues that may be submitted to arbitration, the States involved may, at any time, consent to rules other than the ones under Part VI of the MI.

3.4.1 *Practical Example of Application to Italian DTCs*

All four DTCs already provide for MAPs. The respective provisions could be replaced by Article 16 of the MI. In detail, the DTC with the US could only be affected as regards the right to complaint with any of the parties (and not only with the residence-jurisdiction). The DTCs with Germany and China could be amended as regards: (1) the right of complaint with both parties, (2) the extension of the current second-year deadline for submission of the complaint to three years, (3) the specification that any mutual agreement will be applied '*notwithstanding any time limits of the domestic laws*', and (4) the right of the authorities of the parties to apply MAPs in any case involving double taxation issues, irrespective of the scope of the DTC. Implications for the DTC with the UK could be expected to be similar, except for (2) above, since no deadline is provided for the submission of a complaint. With respect to Article 17 of the MI, it could be added to all DTCs under examination. Although all of them include provisions on transfer pricing adjustments to the effect that each party must tax income calculated at arm's length, these refer to specific types of income, e.g. interests, royalties.[63]

Finally, subject to choice of both parties to each DTC, all four DTCs may be supplemented by an arbitration agreement as worded in part VI of the MI.

4 Conclusion

The MI aims at filling the gaps identified in the application of the existing DTCs and thus eliminating margins for tax planning and flows of tax revenue. It enables jurisdictions to demonstrate, upon ratification, their will to amend their DTCs in line with MI provisions. Upon ratification by all of its parties, a DTC is aligned with the MI and with all other DTCs thereby covered.[64] Thus, not only are the outrageous costs of renegotiating thousands of DTCs saved but this also helps to avoid misalignment risks that individual negotiations would involve. As regards its substantial provisions, in thirty-nine articles, the MI implements measures indicated in four BEPS Actions, and in particular Actions 2, 6, 7 and 14, to mitigate the effects of hybrid mismatches, treaty abuses and artificial avoidance of PE status as well as to ensure effective dispute resolution of international tax disputes. A key characteristic of the released instrument is that it also strikes a perfect balance between flexibility and minimum standards, to encourage large participation by different jurisdictions, while establishing the level of coherence necessary for a fruitful implementation.

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[59] MI parties that upon ratification did not opt for Part VI (Arbitration) may do so at any time.

[60] The competent authorities may not consider further any case, where an arbitral decision has been issued and has not been accepted by the taxpayer.

[61] Art. 23 with respect to types of arbitration, provides for the arbitrators either (1) selecting one of the resolution proposals submitted by the States involved in the arbitration, or (2) rendering a decision on the basis of information provided by the above States and in accordance with any rules indicated in the applicable DTC and domestic laws, or otherwise pursuant to the rules agreed in a mutual agreement between the States on the type of the arbitration procedure.

[62] Arts 20–25.

[63] E.g. Art. 11 para. 7, Art. 12 para. 7 of the DTCs with Germany and the US, or Art. 11 para. 8 and Art. 12 para. 6 of the DTC with the UK or Art. 11 para. 7 and 12 para. 6 of the DTC with China.

[64] This however is subject to any reservations that expressed by the parties to the MI.

The MI release turns what until today was *wishful thinking* into actual applicable rules able to inaugurate a new era in international taxation. In this regard, it may be said that the ad hoc Group assigned with the development of the MI fulfilled its purpose. The floor is now given to the States, which shall determine, through their choices, the extent to which '*the rules will be re-written*'. In other words, the MI's success depends on the number of jurisdictions that will actually ratify it as well as on the reservations they will put forth, the options that they will take, the number of DTCs they will notify. In any case, the important number of jurisdictions that are involved in the MI development and are committed to the BEPS Actions in general, allows optimism.[65]

New horizons seem to have been opened in international taxation; the happy ending is not quite here yet, though. Further steps need to be taken to develop standards on the remaining issues identified in the BEPS Actions Plan, e.g. with respect to the challenges of digital economy (Action 1), to provide further guidance for coherent implementation of BEPS measures and to monitor implementation. Most importantly, the moral of the story is that if States actually want to protect their tax bases, it is necessary to keep themselves constantly updated with developments in the business environment. These should be closely followed, and proactively – or at least – promptly tackled. In any case, the MI, within the general framework of the BEPS Project, provides evidence that a better tax world is a matter of willpower and cooperation, and is certainly closer than ever before.

Notes

[65] Cf. T. Gorgas, *The Times They Are A-Changin*', Intl. Tax Rev. (July 2016).