Analysis

The multilateral instrument: a timetable

Speed read

On 23 May 2018, the UK issued a statutory instrument (SI 2018/630) ratifying the multilateral instrument (MLI), which had been produced as part of the OECD/G20 BEPS project. On 29 June 2018, the UK deposited its instrument of ratification with the OECD depository. These two acts set the MLI on course to amend many of the UK's double taxation treaties, in some respects, from later this year.

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What is the MLI?

The multilateral instrument (MLI) was designed to implement those parts of the OECD/G20 BEPS recommendations that required (or recommended) changes to the double taxation treaties of participating states.

Changes to treaty provisions were included as part of the recommendations in each of: Action 2 (hybrid instruments); Action 6 (treaty abuse); Action 7 (permanent establishment status); and Action 14 (effective dispute resolution).

The aim of the MLI is to provide an efficient mechanism for making the numerous changes that could need to be made to the network of bilateral treaties between participating states without requiring the separate negotiation and ratification of the amendments to each of those treaties. It is a complex document and, no doubt in an attempt to ensure that as many states as possible remained committed to the process, provides participating countries with a significant degree of flexibility in the amendments that are made to their treaties.

First, the MLI allows a participating state to determine which of its double taxation treaties may be affected by changes made by the MLI. These are referred to as 'covered tax agreements'.

Second, a state can, in very broad terms, and subject to certain minimum requirements, determine which elements of the MLI will apply to each of its covered tax agreements through a complex series of notifications and reservations. However, a change will only be made to the double taxation treaty between two participating states where both states have opted to make the same change. If both states select a particular amendment, it is included in the revised version of the treaty between them. If *either* state does not select it, it is not included and the original provisions of that treaty continue to apply.

The UK's approach

The UK has elected for most of its treaties (covering 121 jurisdictions) to be covered by tax agreements. (One notable exception is the UK/Germany treaty, where the necessary changes will be made by bilateral agreement.) However, the UK has taken a much more restrictive approach to those aspects of the MLI which should apply to them:

- The UK has not adopted any of the changes offered by the MLI with respect to Actions 2 and 7 (taking the view that current legislation and treaty provisions are sufficient to address these issues).
- It has adopted the change (recommended in Action 6) to treat dual resident companies as a resident in a contracting state only where there is agreement between the competent authorities under the mutual agreement procedure (MAP).
- Of the range of options on treaty abuse (Action 6), the UK has adopted the provision that denies treaty benefits to any arrangements where it is reasonable to conclude that obtaining the benefit of the treaty was one of the principal purposes of the arrangements (the 'principal purpose test' (PPT)).
- The UK has notified the depository that it will apply Part VI of the MLI, which incorporates the provisions for mandatory binding arbitration (MBA).

Entry into force

The MLI itself entered into force on the first day of the month following the date three months after the fifth signatory of the MLI had deposited its instrument of ratification with the OECD depository. Slovenia deposited the fifth ratification on 22 March 2018, and so the MLI entered into force on 1 July 2018.

For each state that ratifies the MLI, the MLI then enters into force in relation to that state on the first day of the month following the expiration of the period of three months beginning on the date of its own deposit of its instrument of ratification.

When does the MLI take effect?

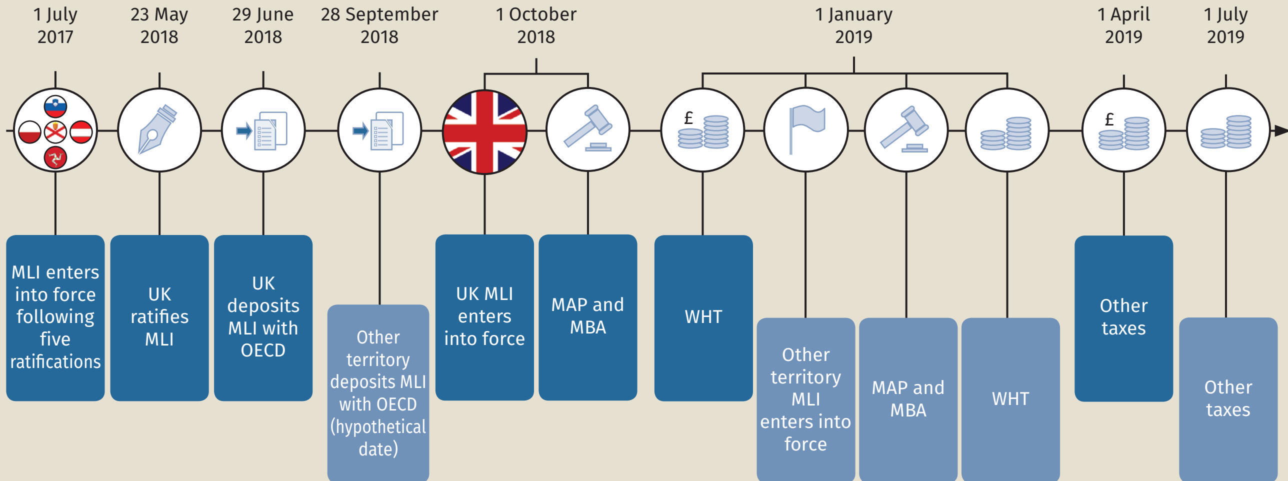
The MLI contains provisions which govern the time at which any given amendment to a particular double tax treaty will take effect. However, given the manner in which the MLI operates, these turn on the timing of each contracting state's ratification of the MLI.

The MLI contains different rules for provisions dealing with withholding taxes, direct taxes and administrative provisions such as those relating to the operation of the MAP and MBA. In summary, they are as follows:

- Withholding taxes are subject to the revised treaty rules where the event giving rise to the tax occurs on or after the first day of the next calendar year beginning on or after the latest of the dates on which the MLI enters into force for each counterparty.

The OECD multilateral instrument (MLI)

This timeline illustrates the date the MLI enters into force and takes effect for the UK and the covered tax agreements (where the territory has also deposited its MLI instrument on or before 30 June 2018). The timeline also illustrates the date the MLI could take effect for another territory, assuming a hypothetical deposit date of 28 September 2018. This is for illustrative purposes only.



- Other taxes are subject to the revised treaty rules for taxable periods beginning on or after the expiration of six calendar months (or a shorter period, if both counterparties to a covered tax agreement notify the depository of such shorter period) from the latest of the dates on which the MLI enters into force for each counterparty.
- The MAP applies to cases presented to the relevant tax authorities on the date of the latest entry into force of the MLI for each counterparty to the covered tax agreement, even if the case relates to tax an earlier taxable period. There are similar rules for MBA, but special additional rules can apply to allow old cases to be brought into the scope of MBA via the MAP.

How does this apply to the UK's treaties?

As we have mentioned above, the UK deposited its instrument of ratification on 29 June 2018, so the MLI will enter into force for the UK on 1 October 2018.

For treaties where the MLI had already come into force for the UK's counterparty, the UK's date of entry into force will be the 'latest date' referred to above and so the timeframes set out above will run from 1 October 2018.

The timeline above identifies the key dates for the entry into force of the MLI in relation to the UK and its covered tax agreements with counterparties which had already ratified the MLI as at 29 June 2018. For such counterparties, where the UK's MLI selections are matched with those of its counterparty:

- the MAP and MBA changes will apply to cases involving the UK and its treaty partners that have deposited with the OECD, which are presented to HMRC on or after 1 October 2018;
- in the case of withholding taxes, the changes will have effect for events on or after 1 January 2019; and
- in the case of other taxes, the changes will have effect for taxable periods beginning on or after 1 April 2019.

At the time at which the UK deposited its ratification instrument, only eight other states had ratified (Austria, Isle of Man, New Zealand, Jersey, Poland, Serbia, Slovenia and Sweden). This timetable will therefore apply to relatively few UK treaties.

For treaties where the MLI has yet to come into force for the UK's counterparty, the UK's date of entry into force will be the earlier date, and so the timeframe set out above will run from the date of entry into force of the relevant counterparty.

Just by way of example, the timeline also shows the key dates for the entry into force of the MLI in relation to a covered tax agreement between the UK and a hypothetical third state which deposits its ratification instrument on 28 September 2018. In this scenario, the MLI would enter into force for the third state on 1 January 2019. The effect on the application of the changes made by the MLI to the taxation treaty between the UK and that state would be as follows:

- any agreed MAP and MBA changes would apply to cases presented to the tax authorities from 1 January 2019;
- any agreed changes would apply to withholding taxes for events occurring on or after 1 January 2019 (being the first day of the calendar year that begins on or after the date of the entry into force of the MLI for the third state); and
- any agreed changes would apply to other taxes for taxable periods beginning on or after 1 July 2019 (being the date six calendar months after the entry into force of the MLI for the third state).

We are still waiting to see whether and when some of the UK's more significant treaty partners will ratify the MLI. The key dates will, however, shift depending upon the date on which the treaty partner deposits its ratification.

Added uncertainty...

As we have mentioned above, unless and until a counterparty state deposits its ratification instrument

with the OECD, any double taxation treaty between the UK and that state will remain in its current form. Once a counterparty has ratified the MLI, when determining the applicable terms of the relevant treaty to apply, it will be necessary to check:

- whether the counterparty has deposited its instrument with the OECD;
- whether the UK treaty is included in its covered tax agreements;
- which notifications and reservations it has made for each article of the treaty;
- whether those notifications and reservations correspond to the UK's notifications and reservations; and
- when any changes will apply.

For those looking at group structures which will need to stand the test of time, it will be necessary to keep a close eye on the approach to the MLI that is being taken by other treaty partners. In some cases, this will be more straightforward. The US, for example, has not, at this stage, signed the MLI. Unless and until it does so, the MLI will remain irrelevant to the interpretation of the UK/US double taxation treaty. In any event, the UK/US treaty already contains a provision under which the competent authorities are required to resolve questions regarding the residence of dual resident companies. In addition, in common with many US double taxation treaties, the US/UK treaty contains a detailed limitation on benefits clause (LOB), which seeks to ensure that a substantial commercial and economic connection exists between the taxpayer and the UK or the US before it will be entitled to treaty benefits, rather than a PPT. Even if it were to sign up to the MLI, the US seems even more unlikely to opt to replace its detailed LOB provisions with a more general PPT.

For other jurisdictions, it will be necessary to remain more watchful. It is likely, for example, that many EU jurisdictions will include notifications and reservations in their submissions to the OECD depositary which adopt the provisions requiring competent authority agreement for dual resident companies. With some exceptions – such as the UK treaty with the Netherlands – this could be a material change to the relevant treaty. It could cause many companies that would otherwise be dual resident, but which rely on a treaty tie-breaker rule based on 'place of effective management' (in the form of the existing article 4(3) of the OECD Model Convention), to lose treaty benefits in the absence of an agreement on residence between the competent authorities. Some such companies may also suffer restrictions on their abilities to benefit from certain reliefs under UK domestic provisions (e.g. group relief and tax neutral intra-group transfers of assets).

HMRC has suggested that it will create a library of updated treaties which incorporate the MLI amendments. This will be a welcome resource. However, it is likely that for some considerable time, we will all need to become very familiar with the workings of the OECD's online depository information service. ■

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