



BEPS multilateral instrument

A turning point or just more uncertainty?

The signing of the Organisation for Economic Co-operation and Development's (OECD's) multilateral instrument (MLI) in June was a significant achievement in the implementation of the Base Erosion and Profit Shifting (BEPS) Action Plan.

So what does the MLI really mean for your business? And with many of the updated treaty provisions set to come into force over the next 18 months, how can you make sure you're ready for the changes ahead?

At the stroke of a pen, some 1,100 bilateral tax treaties have been modified to reflect key elements of the BEPS Action Plan. The OECD has hailed the MLI as a move towards 'swift implementation' of BEPS measures and the 'closure of tax loopholes'.¹

Different national agendas are in operation as the aspects of BEPS that each of the 68 signatories have agreed vary quite markedly. Many haven't signed up at all, notably the United States. The result is a spider's web of tax arrangements worldwide, which can only add to the complexity and uncertainty within the international tax landscape.

If agreeing the BEPS Action Plan was difficult enough, implementation could be an even bigger challenge.

¹ [Ground-breaking multilateral BEPS convention signed at OECD will close loopholes in thousands of tax treaties worldwide, 7 June 2017.](#)



What is the MLI and how does it work?

When the finalised Action Plan launched in 2015, most observers' list of potential obstacles would have included how to modify all the countless bilateral tax treaties worldwide.

Agreeing these various protocols required complex and protracted negotiations. Surely, therefore, updating them to take account of BEPS would demand equally difficult and lengthy negotiations. The results would at the very least delay and even derail the planned changes. The coming together of 68 tax jurisdictions to sign 1,100 'matching agreements' under the MLI defies these sceptical expectations.

The MLI provides a quick and easy way to amend bilateral treaties without the need to negotiate protocols with each individual country.

In essence, each party sets out what aspects of BEPS it's prepared to accept within its tax treaties and then this is matched up with other signatories. The main aim is to make it harder for businesses to use tax treaties to circumvent tax registration or route taxable income through jurisdictions with limited 'substance'.

Specific areas covered include the definition of permanent establishments (PE), hybrid mismatches² and treaty abuse. The MLI touches many of the root causes of disputes with tax authorities and the differences between them that could lead to double taxation of your business. The MLI also provides a procedure to resolve protracted disagreements, either between businesses and tax authorities or between authorities. If authorities can't agree, the dispute would go to mandatory binding arbitration led by a third country representative – 25 countries have signed up for this.³

MLI agreements need to be incorporated into signatories' local legislation before they become effective. It's expected that most treaty modifications will go live from 2019 onwards. However, it's possible that some provisions could be effective in 2018.



² 'Hybrid mismatches' include double deductions for the same expense, deductions for an expense without the corresponding receipt being fully taxed or an entity that is look-through in one country but regarded as a separate entity in another such as the US 'check the box provision'.

³ [MLI status as of 7 June 2017 – includes country by country round up of agreements.](#)

‘Big challenges include changes in what constitutes a taxable presence under the updated PE rules.’

Implications

The “multilateral instrument marks a new turning point in tax treaty history,” said OECD Secretary-General, Angel Gurría.⁴ If judged on what has been agreed and how quickly, it’s hard to disagree. The changes will make ‘treaty shopping’ harder, limit treaty benefits and potentially affect where and how you conduct business.

Important pluses include greater certainty that disputes will eventually be resolved as a result of binding arbitration. If your business is caught up in a disagreement, arbitration could reduce the amount of time you need to hold reserves to pay disputed tax. The benefits shouldn’t be overstated, however, as existing arrangements (eg US and Canada) show that few disputes come up for settlement by arbitration. These usually take many years before they do, albeit the fear of binding arbitration should have an impact in ‘encouraging’ the tax authorities to reach agreement.

Not all areas potentially covered by the MLI will actually be changed in practice. Big challenges include changes in what constitutes a taxable presence under the updated PE rules. A telling example is the potential impact on so-called ‘commissionaire’ arrangements, through which agents sell goods and services in a number of different countries. In the past, a dependent agent could often operate in markets outside their home country without activating a PE designation, as long as they did not routinely conclude the contracts. Under the terms of the MLI, the trigger point for PE designation may be substantially lowered to include routinely playing the principal role in negotiating the contract.

Interested parties might hope that more PE designations will add up to an increased tax take. But the overall ‘cake’ is only so big, so the likely result could be more disputes between companies and tax authorities and between tax authorities themselves, over potentially very small amounts of tax, or even nil tax, if the transfer pricing is correct. However, the risk of double taxation is likely to increase significantly as countries take different views and argue over who has the primary right to taxation. This makes dispute resolution all the more important.

Actions

Key priorities include checking whether current PE analyses, along with the revenue flows, transfer pricing and the underlying operating model, are still viable. The potentially negative impact on commissionaire-type arrangements is a case in point of how operations may need changing because of the MLI.

Opportunities for business include accelerating dispute resolution and assessing how this could reduce reserving levels and hence enhance recorded financial returns.

⁴ [Multilateral Instrument Information Brochure, OECD, June 2017](#)

MLI only goes so far

While what's been agreed is clearly significant, the MLI only goes so far. Many treaties, and protocols within them, aren't included within the agreements.

Several countries who are signatories have nonetheless opted out of various provisions. These include the UK and Australia, which have not amended their PE rules. There is also little consensus or consistency so far in what's been agreed on transfer pricing.

The variance in the PE approach highlights the different agendas in play. In general, governments from countries that invest large amounts in IP development want the PE thresholds to be set at a high point to limit the number of designations that are triggered, because they believe the profits should flow to the home country that made the investments. These capital exporting countries include most developed economies. By contrast, generally less developed capital importing countries tend to prefer lower PE designation thresholds to enable them to capture more companies in their tax net. While some are keen to expand the definition of a PE and increase designations, others are reluctant to go down this route. They believe it will simply create many additional taxable presences with little attributable profit to tax, and the potential for fruitless disputes.

Quite a few countries haven't even signed up at all. Notable absentees include the US, though according to Henry Louie, Deputy international tax counsel, "the bulk of the multilateral instrument is consistent with the US tax treaty policy that the Treasury has followed for decades".⁵ The limitation on treaty benefits is one of the areas he cites.

⁵ [Treasury Official Explains Why U.S. Didn't Sign OECD Super-Treaty - Bloomberg, 8 June 2017](#)

‘...all the variations in what has and hasn’t been agreed as part of the MLI have created a complex web of treaty arrangements.’

Implications

Grant Thornton research shows that most businesses want greater certainty over tax liabilities, even if this means paying more.⁶ With all the upheaval that comes with BEPS, more certainty should follow. However, all the variations in what has and hasn’t been agreed as part of the MLI have created a complex web of treaty arrangements. The result is likely to be even more uncertainty rather than less.

The complexities grow the more markets you operate in and how integrated your business is. Sectors with arrangements that could be especially difficult to unravel include financial services. Companies with complex entity structures resulting from multiple acquisitions also face big challenges.

To increase certainty and alleviate the risk of double taxation an Advanced Pricing Agreement (APA) could help. You can directly present your case to one tax authority and negotiate terms for a unilateral APA. You might also seek bilateral and/or multilateral APAs, which provide additional protection. Recent developments under BEPS, and the need for a two-sided approach to transfer pricing, make bilateral and multilateral APAs a much more useful source of tax certainty than their unilateral counterparts do. However, it’s important to bear in mind the cost and effort needed to secure such an agreement. APAs also require a level of transparency that’s not far short of a tax audit, and are therefore not for the faint-hearted.

Actions

In the short-term, sifting through what’s been agreed between countries and monitoring legislative ratification in the various signatory jurisdictions will be a job in itself.

To identify the applicable provisions, there is no alternative to mapping where you do business, with whom and how, and then comparing this with the MLI changes. Whilst laborious, this will enable you to unravel all the different connections within this MLI web and how they affect your business. This evaluation will in turn inform your impact assessment and possible changes to operating structures ahead of MLI implementation in 2018 and beyond.

Given how much work is likely to be involved, it’s important to look for upsides and opportunities. The MLI could provide the catalyst for entity rationalisation, for example.

⁶ [Big shake-up in international tax rules - 4 October 2015](#).

Making the case for sensible implementation

The signing of the MLI by so many countries and the resulting acceleration of BEPS implementation underlines the political momentum behind the Action Plan, as well as the skill and determination of the OECD in making it a reality. The OECD has proved the doubters wrong and BEPS is now an unavoidable fact of life. Even the United States, which is not party to the MLI, tacitly accepts its importance by comparing its treaty provisions to the MLI ‘norms’.

In answer to whether the MLI is a turning point or a source of further uncertainty in an already complicated international tax landscape, both are partly true. The MLI will require your business to look at bilateral treaties through a new lens. And all the complications, exceptions and disparities mean that this is a fuzzier lens than many, including us at Grant Thornton, would have hoped. While little will change before 2019, it’s important to evaluate the implications now to allow sufficient time to adapt tax strategies and operations.

If you would like to discuss any of the areas raised in this article, please contact your own Grant Thornton adviser or one of the contacts listed.

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