

## Multilateral Instrument / potential impact on Dutch tax treaties

The OECD's project on Base Erosion and Profit Shifting ("BEPS"), among others, includes tax treaty-related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution. Recognizing the need for an effective mechanism to implement changes on these topics in a synchronized and efficient manner across the vast network of existing bilateral tax treaties, the OECD released the text of the "Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting" on 24 November 2016 as part of BEPS Action Plan 15.<sup>1</sup>

In anticipation of the publication of this "Multilateral Instrument" ("MLI") the Dutch State Secretary of Finance ("State Secretary") published a letter on 28 October 2016 with a summary of the items included in the MLI, the most relevant choices which this MLI allows countries to make with respect to certain items, and the intentions of the State Secretary in that respect.

*The MLI includes certain (mandatory) 'minimum standards' to counter tax avoidance and includes certain additional measures which are optional. Important to note is that any choices which the Netherlands would make will not automatically alter a (bilateral) Dutch tax treaty covered by the MLI. Consensus between both tax treaty partners and reciprocity are a condition. In other words: a bilateral tax treaty change via the MLI would occur only if both tax treaty partners accept the same adjustment to their bilateral tax treaty, and hence, their choices need to "match".*

The key observations in the State Secretary's letter of 28 October 2016 are as follows.

### 1. Scope

The State Secretary intends to bring as much of the Dutch tax treaties as possible within the scope of the MLI. Where new Dutch tax treaties are currently being negotiated the new OECD standards will be part of the negotiations.

### 2. 'Minimum standards' to prevent tax treaty abuse (BEPS Action Plan 6)

As a minimum standard the MLI prescribes that the preamble text of a (covered) tax treaty needs to reflect that, in addition to eliminating double taxation, one of the aims of the tax treaty is also not to create opportunities for non-taxation or reduced taxation. The State Secretary notes that such a preamble text is already part of Dutch tax treaty policy.

More elaborate are the minimum standards following from BEPS Action Plan 6 that are aimed at preventing treaty shopping via the introduction of:

- (i) A principal purpose test ("PPT"); OR
- (ii) A PPT in combination with a Limitation on Benefits clause ("LOB"); OR
- (iii) A (detailed) LOB in combination with an anti-conduit rule.

The State Secretary observes that a LOB clause is a complex measure which details which taxpayers under which circumstances are entitled to claim treaty benefits. This measure gives certainty to taxpayers, but is also based on certain (static) assumptions with respect to abusive situations which may result in "overkill". The State Secretary notes that the certainty offered by a LOB clause is also mitigated by the fact that the minimum standard can not be met by a LOB clause in itself. To meet the minimum standard a LOB clause would need to be combined with a PPT or an anti-conduit rule. In lack of sufficient guidance in BEPS Action Plan 6 with respect to the anti-conduit rule, also this rule does not have the State Secretary's preference.

With respect to the PPT the State Secretary notes that (i) this measure can in itself meet the minimum standard, (ii) this measure offers flexibility in countering abusive situations and allows for a

<sup>1</sup> Please refer to the following link to view the full text of this "Multilateral Instrument":  
<http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>.

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more tailor-made application to prevent “overkill” or “underkill” and (i) according to the State Secretary the majority of countries involved in the MLI has expressed a preference for this measure.

Based on the PPT “a 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 the Covered Tax Agreement”.

The MLI also leaves the option to include an ‘escape clause’ in case of application of the PPT. Subject to a request from the taxpayer, the competent authority of a Contracting State may in that case nevertheless give tax treaty benefits if it (after consideration of the relevant facts and circumstances) determines that such benefits would have been granted in absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made by a resident of the other Contracting Jurisdiction in that case also needs to consult with the competent authority of that other Contracting Jurisdiction before rejecting the request.

For completeness’ sake, please note that on 28 January 2016 the European Commission published a recommendation on Tax Treaty Abuse focusing on the PPT in BEPS Action Plan 6. To ensure compliance with EU case law with respect to abuse of law, this recommendation suggested to include additional wording in the PPT to exclude arrangements or transactions from the scope of the PPT which reflect genuine economic activity. The PPT in the MLI does not include any such wording.

### 3. Avoidance of Permanent Establishment Status (BEPS Action Plan 7)

The MLI includes optional measures for countering avoidance of a permanent establishment (“PE”) status, including:

- (i) Measures addressing commissionaire arrangements and similar strategies, among others, by expanding scope of the PE definition (permanent representative definition) to:
  - a. Include persons acting on behalf of an enterprise and, in doing so, habitually concluding contracts, or habitually playing a principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, if these contracts are in the name of the enterprise, or for the provision of services by that enterprise, or for the transfer of ownership or the granting of the right to use property owned or used by that enterprise;
  - b. Exclude from the qualification as ‘independent agent’ a person acting exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related.
- (ii) Measures involving modification of the specific activity exemptions. Tax treaties include specific exceptions in which case no PE is deemed to exist. The MLI proposes to explicitly make such exceptions conditional upon the activity being of a preparatory or auxiliary nature (also in combination with an anti-fragmentation rule).
- (iii) Measures addressing the splitting-up of contracts to avoid the specific PE exception for construction and installation projects which do not last for more than a specific period of time stipulated in the tax treaty.

Albeit that these are optional measures (no minimum standards) the State Secretary indicates that the Dutch government is in favor of the PE concept following from BEPS Action Plan 7 (in particular in relation to developing countries), which has become part of the Dutch tax treaty policy. The Netherlands may therefore also consider implementing the above (optional) measures via the MLI.

### 4. Other measures

Other relevant measures in the MLI, among others, include the following.

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- The introduction (minimum standard) of a dispute resolution mechanism (BEPS Action Plan 14). The State Secretary is in favor of rules improving dispute resolution.
- An optional 'hybrid mismatch' rule determining that "income derived by or through an entity or arrangement that is treated as wholly or partly 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 a resident of that Contracting Jurisdiction." Such 'hybrid mismatch' rule aims to prevent qualification differences resulting in double taxation or double non-taxation. The Netherlands already applies measures of this sort in a number of tax treaties.
- An optional measure to address 'dual resident entities' determining that Contracting Jurisdictions shall by mutual agreement determine the Contracting Jurisdiction of which such entity shall be deemed to be a resident for purposes of the tax treaty, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. A number of Dutch tax treaties already include a mutual agreement procedure in this respect, for instance, the Dutch tax treaties with Canada, the UK and the US.
- Optional measures preventing application of the exemption method for relief of double taxation in case the item of income is not subject to source State taxation as a result of a qualification difference.
- An optional ("anti-dividendstripping") measure to include a 365 day minimum holding / ownership period for exemption or reduction of the withholding tax rate applicable to dividend distributions (no account shall be taken of changes of ownership resulting from international reorganizations).
- An optional measure ensuring allocation of taxing rights to the State in which the immovable property ('situs State') is located in case of capital gains from alienation of shares or interests of entities deriving their value principally from immovable property. Based on the MLI measure such situs State taxation would apply if the relevant immovable property value threshold is met at any time during the 365 days preceding alienation. Aim is to avoid that otherwise in the year before the sale of the shares in the immovable property holding company this company's assets may be 'mixed' with non-immovable property assets to avoid application of situs State taxation.
- An optional measure which (subject to exceptions) limits eligibility to tax treaty benefits for items of income that are attributable to a low-taxed permanent establishment situated in a third jurisdiction.
- An optional measure determining that - subject to a list of specific exceptions - the tax treaty shall not affect the taxation by a Contracting Jurisdiction of its residents. The State Secretary notes that such so-called 'saving clause' is derived from treaties concluded by the US. The State Secretary does not intend to make use of the option to implement a saving clause in the Dutch tax treaty network via the MLI.
- The MLI also includes a measure addressing "corresponding adjustments" in case of transfer pricing corrections. Some 'older' Dutch tax treaties (e.g. the Netherlands - Ireland tax treaty and Netherlands - Spain tax treaty) do not yet include a corresponding adjustment clause.

### 5. Way forward

The State Secretary expects that the MLI will likely be signed in the first half of 2017. When signing a Contracting Jurisdiction also needs to indicate its preliminary choices and reservations. After signing the adoption of the MLI will be subject to parliamentary approval. During the parliamentary proceedings choices and reservations may still change. These will only become final upon ratification. The MLI will enter into force on the first day of the month following the expiration of a period of three calendar months after which the first five States have confirmed to have ratified the MLI. For each subsequent State the MLI will 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 State of its instrument of ratification.



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