The Multilateral Instrument - An overview of the MLI Action 6-choices made by the Netherlands and Luxembourg

On 7 June 2017, the OECD BEPS project reached its next milestone with the signing of the Multilateral Instrument ("MLI") by 68 countries in Paris. This newsletter provides a high-level summary of the MLI-choices made by the Netherlands and Luxembourg, regarding BEPS Action 6 on treaty abuse (most relevant for the private equity industry).

1. Background

The MLI is one of the outcomes of the OECD/G20 Project to tackle Base Erosion and Profit Shifting ("BEPS") and aims at enabling countries to swiftly modify bilateral tax treaties to include several anti-tax avoidance measures developed in the course of the BEPS work. Among other countries, the Netherlands and Luxembourg signed the MLI.

2. Effect bilateral tax treaties

The MLI will have effect for those bilateral tax treaties that are listed by both participating jurisdictions, after ratification of the MLI under their respective domestic rules and procedures. The date on which the MLI applies to a specific tax treaty depends on the two jurisdictions involved and when they will adopt the MLI. The OECD expects that the first modifications to tax treaties following the MLI will become effective in 2018. As jurisdictions will first have to complete domestic ratification procedures, we expect that the MLI will not become effective on a large scale until 2019.

3. Coverage of the MLI

The MLI covers the treaty-related minimum standards, including BEPS Action 6 on treaty abuse. Jurisdictions can choose to implement further provisions of the MLI. These optional provisions will come into force in bilateral relations, provided there is a 'match' in the choices made by the treaty partners. To what extent tax treaties will be amended by the MLI will therefore depend on the matches.

4. MLI Measure 7: Prevention of Treaty Abuse (BEPS Action 6)

As a BEPS minimum standard, countries must include one of the following measures in their tax treaties:

(i) a principal purpose test ("PPT"),
(ii) a PPT together with a simplified limited limitation on benefits ("LOB") test or
(iii) an extensive LOB together with an anti-conduit provision.

Both the Netherlands and Luxembourg will apply only the PPT. As set out in section 7(1) of the MLI, the PPT is worded as follows:

"Notwithstanding any provisions of a Covered Tax Agreement, 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."

In this respect, a Covered Tax Agreement ("CTA") means an agreement for the avoidance of double taxation with respect to taxes on income that is in force between two or more Parties.

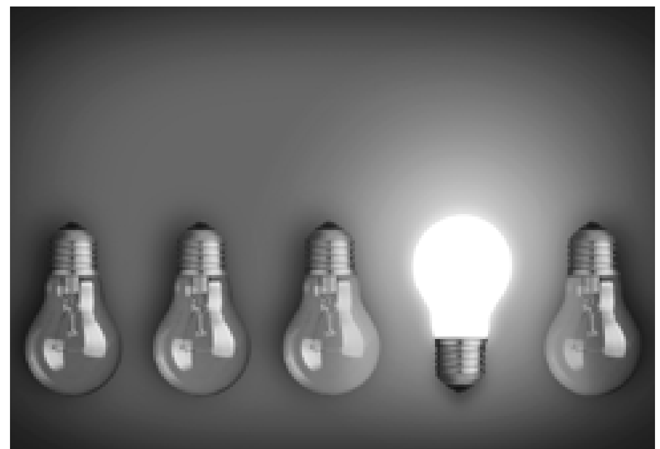
A PPT analysis will be very case-specific. The PPT refers to the purpose of an arrangement or transaction. Where treaty access is relevant, it will be important to document the purpose and intention of a transaction.

For some guidance concerning the functioning and the interpretation of the PPT, we refer to BEPS Action 6 Discussion Draft on non-CIV ("Collective Investment Vehicle") examples (http://biac.org/wp-content/uploads/2017/01/Discussion-draft-non-CIV-examples.pdf), which has been published by the OECD in January 2017. In particular, we refer to Example 1 on page 3. This example shows that in the context of a PPT analysis the following circumstances, amongst others, can be relevant for determining the purpose of an arrangement or transaction in case of an investment platform set up by a fund in another jurisdictions (such as the Netherlands or Luxembourg):

(i) whether the jurisdiction itself provides certain benefits to the fund (such as access to a common currency/market, multilingual workforce);
(ii) the type of investment functions and other activities which are carried out in the jurisdiction where the platform is established (treasury);
(iii) whether the investment platform has investments in multiple jurisdictions; and
(iv) whether the investment platform employs in the home jurisdiction an experienced management team/board of directors with expertise in investment management which team reviews and approves investment recommendations from the fund.

Considering the above, many private equity funds should re-consider the way they handle the investment approval process (involve in an early stage the local management team), they should furthermore consider to move senior management to the jurisdiction where the investment platform is located and they should consider merging their existing platforms (to create master holding companies).

In accordance with section 7(4) of the MLI, both the Netherlands and Luxembourg furthermore apply for a discretionary relief, under which a person that is denied the benefits of a CTA may still be granted the benefits of the CTA as a result of a decision by the competent authority, "if such competent authority [...] determines that such benefits would have been granted to that person in the absence of the transaction or arrangement." Granting treaty access in these circumstances requires consultation with the competent authority of the other Contracting State.



The explanatory statement to the MLI explains the discretionary relief as follows:

"Where a benefit under this Convention is denied to a person under paragraph 7, the competent authority of the Contracting State that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit [...] if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence

of the transaction or arrangement referred to in paragraph 7. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State."

Unlike the Netherlands, Luxembourg reserves the right, in accordance with section 7(15)(b) of the MLI, not to apply the PPT to CTAs that already contain a PPT. This would apply only with respect to a comprehensive PPT denying all treaty benefits, and would not apply to a PPT-type test that applies only with respect to benefits under specific articles such as dividends, interest, royalties, income from employment, other income and elimination of double taxation.

5. Entry into force/effect

The MLI will enter into force after five jurisdictions have deposited its instrument of ratification, acceptance or approval of the MLI.

With respect to a specific bilateral tax treaty, the measures will only enter into effect after both parties to the treaty have deposited its instrument of ratification, acceptance or approval of the MLI and a specified time has passed. The specified time differs for different provisions. As aforementioned, we expect that the MLI will not become effective on a large scale until 2019.

6. Contact

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