
A Multilateral Tax Instrument Has Been Signed

Summary:

A multilateral tax instrument (“MLI”) was signed in Paris on 07 June 2017 by some jurisdictions including Turkey. As of 11 July 2017, 70 jurisdictions had signed the instrument. The instrument aims to implement precautions by making action plans related to the BEPS tax treaty practices prepared by the OECD. The instrument will become effective as per the OECD calendar after it has been approved as falling in line with Turkish domestic law. After the instrument becomes effective, it is expected that conditions for real or legal entities to benefit from multilateral tax instruments for cross border activities will become more difficult globally. It is also expected that cross border tax-related disputes resulting from international tax law agreements will be resolved more quickly and more efficiently.

Why Do We Need MLI?

The difficulty of renegotiating double taxation treaties (DTT), which number 3,000 globally, within the framework of BEPS action plans led the OECD to take a holistic approach. The idea of preparing a multilateral tax instrument was inspired by international agreements signed in the field of criminal law.

There are three main reasons multilateral agreements are preferred:

- i) they are a **faster** solution compared to DTTs, thanks to the one-time negotiation and signature process,
- ii) multiple changes can be made **simultaneously**,
- iii) changes can be made in a **consistent** way.

The MLI was prepared as a result of a negotiation in which 100 countries participated. It will affect nearly one-third of DTTs (1,105 in total) around the world. The number of DTTs affected is expected to increase in the coming days.

The first step toward a multilateral tax instrument was taken with the 15th Action Plan draft report, and the final report related to the plan was published on 05 October 2015. The signing ceremony took place on 07 June 2017 as per the calendar determined in the final report.

The two main purposes of the MLI are as follows:

- to transfer agreement-based suggestions within the scope of the BEPS project to current double taxation treaties or multilateral tax instruments,
- to determine fixed and binding new rules to solve double taxation disputes.

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The MLI's Effect on DTTs

- The MLI **does not replace** DTTs. It is an agreement which will apply **along with** DTTs.
- There **will be no** changes in **DTT** texts as a result of signing the MLI. If the contracting state prefers, it is possible to prepare a combined text to make things easier for taxpayers and administrations.
- The implementation of the MLI **does not** have a "**freezing**" effect on DTTs. Contracting States will continue to have the right to amend any articles of DTTs.

What Are The Action Plans Related To the MLI?

Here are the BEPS action plans within the scope of the MLI:

Action 2 - hybrid transfers: related to transparent companies, dual resident companies and applying exemptions to avoid double taxation. The precautions are optional and all countries are free to apply the precautions or not.

Action 6- treaty shopping: related to introducing special precautions to avoid treaty exchanges. The precautions simplify the "Limitation of Benefits", define the principal purposes test for gaining agreement benefits, define the minimum holding period, and pave the way for similar precautions. The minimum standard was proposed as the principal purposes test, and simplifying the provision of the Limitation of Benefits was also offered as an option.

Action 7 - workplace: strict rules about commissioners, similar structuring, strategies and creating a workplace are expected.

Action 14 - dispute resolution and mutual agreement method: the aim is for the mutual agreement method to be carried out efficiently and in good faith. All states must comply with the standards determined and arbitration is optional.



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MLI Content:

The instrument consists of 49 pages and seven sections.

First section: Interpretation of Scope and Terms (Articles 1-2)

Second section: Hybrid Mismatches (Articles 3-5)

Third section: Treaty Manipulation (Articles 6-11)

Fourth section: Avoiding Work Place Status (Articles 12-15)

Fifth section: Improvement of Dispute Resolution (Articles 16-17)

Sixth section: Arbitration (Articles 18-26)

Seventh section: Final Provisions (Articles 27-39)

Comprehensive language is used in the instrument and there is no direct reference to any article in the OECD or UN model.

The MLI Was Prepared to Offer Countries a "Flexible" Solution

The MLI was designed in such a way that it can be developed and is a flexible instrument.

DTTs falling within the scope of the MLI are determined using lists prepared by the contracting states. For a DTT to fall within the scope of the MLI, it must be included in the list of DTTs that fall within this scope by both contracting states.

If the "minimum standards" determined by the MLI are applied under DTTs signed by a contracting state or some by other instruments, the contracting state can exercise its right to apply the relevant articles.

Contracting states have the right not to apply (to have reservations for) MLI articles, with the exception of those articles predicting "minimum standards". The reservations of contracting states are applied symmetrically. Accordingly, a reservation a contracting state has on an article will be applied in all DTTs signed by the relevant contracting state without checking whether or not another contracting state has a reservation for it.

The articles of some MLIs have a set of alternative/optional regulations that will only be applied if the contracting states chose to do so. These alternative regulations will be only applied if both contracting states approve them. For example, 44 contracting states prefer the optional regulation in the field of "arbitration". To apply arbitration article between two Contracting States, both Contracting States must approve it.

Reservations a contracting state has can be changed within the period by way of that state approving the MLI. Only reservations can be eliminated after the MLI is approved. In other words, after the relevant State approves the MLI, a new reservation may not be added but the current reservations may be eliminated.

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The MLI is an "Open Offer"

Contracting states create an "open-offer" using the MLI. The States choose which MLI articles they want to apply and which DTTs fall within the scope of the MLI, and they present an offer to other contracting states based on this. Since only "**compatible regulations**" will be implemented, implementation of a choice by one state is only possible **to the extent to which the other state accepts** the same choice.

For example, Turkey stated that it would implement Article 12 entitled "Artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies". However, Ireland stated that it would not implement the same article. In this case, Article 12 will have no effect on the double taxation treaty signed between Turkey and Ireland.

The DTTs Turkey Included in the Scope and the Reservations Turkey Stated

Turkey included all the DTTs it signed within the scope of the MLI, including those that have not yet become effective.

Articles for which Turkey has reservations are as follows:

- Article 4, Dual Resident Entities,
- Article 5, Application of Methods for Elimination of Double Taxation,
- Article 6, Purpose of a Covered Tax Agreement,
- Article 8, Dividend Transfer Transactions,
- Article 9, Capital Gains From Alienation of the Shares or Interest of Entities Deriving Their Value Principally from Immovable Property,
- Article 10, Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions,
- Article 11, Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents,
- Article 14, Splitting-up of Contracts.

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How Can the Changes Caused By the MLI Be Made Visible During Implementation of a DTT Between Two Contracting States?

The OECD provided two implementation methods to ease the implementation of the MLI: the "Application Toolkit" and the "Matching Database".

The **Application Toolkit** aims to identify the arrangement which is required, considering both contracting states' choices for each MLI article. The Application Toolkit is an easy-to-use programme with schemes where the user pushes "yes" or "no" buttons indicating whether the contracting states made some specific choices or not.

The **Matching Database** is a tool providing information on the arrangements required after comparing information such as which articles of the MLI the two contracting states have reservations about and which optional articles the states chose. This comparison can be completed by simply entering the names of contracting states into the system. The finalisation of the Matching Database, which will inarguably be a useful resource, is still in progress, and the beta version has been released on the OECD website.



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When Will the MLI Become Effective?

The MLI will become effective after the first five countries approve it as per their domestic legal procedures. For these countries, the MLI will become effective three months after the approval process is complete in all five countries. For all other countries, it will become effective three months after the approval process is complete in line with domestic law.

The effective date will differ for withholding taxes and other taxes (taxes paid within the tax period).

Withholding taxes The MLI will become effective on the first day of the year following the latest approval date of the contracting states. For example, for the MLI between Turkey and Switzerland, if the MLI is approved in Switzerland on 01 November 2017 and in Turkey on 01 December 2017, the MLI will become effective on the first day of the year following the 01 December 2017 approval date. So, it will become effective on 01 January 2018.

Other taxes The latest approval date of the contracting states will be considered. The MLI will become effective on the first day of the month, after six months have elapsed. In the example above, Turkey's approval date of 01 December 2017 will be considered, and the 6-month period will be complete on 01 June 2018 and the MLI will become effective on 01 July 2018.

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