# The OECD's Multilateral Instrument (MLI) – Will It Save New Zealand From Multinationals' Tax Avoidance?

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## 1.0 Introduction

Tax avoidance by major multinational enterprises (MNEs) has been extremely topical since the great financial crisis of 2008. Regular disclosures throughout this decade of major US multinationals paying very low or nil tax on their substantial foreign earnings has led to considerable debate particularly in Europe and parts of the developing world for something to be "done" about it. These pressures have resulted in the Organisation for Economic Cooperation and Development (OECD) undertaking a major project to develop a multilateral consensus on acceptable solutions to this problem. This project, commenced in 2013, is known as the "base erosion and profit shifting" (BEPS) project.

The BEPS project resulted in a list of 15 agreed "actions" for states to deal with the BEPS problem. The last of these is a major multilateral convention (known as the "multilateral instrument" or "MLI") which is intended to simultaneously modify the application of a great number of the world's bilateral double tax agreements (DTAs). Many of the modifications under the MLI are necessarily if states are to deal with MNE tax avoidance as many of the arrangements adopted by MNEs utilise provisions in existing DTAs.

The MLI is modular in that signatory states do not have to adopt all parts of it. This paper analyses the responses of all New Zealand's forty DTA partners in respect to the MLI. The analysis in this paper will support a conclusion that the MLI is unlikely to be effective for New Zealand to deal with BEPS and that this has forced New Zealand to enact changes to its domestic law unilaterally in 2018 which may raise the issue of domestic override of existing DTA obligations and bring it into conflict with its treaty partners. The results obtained provide grounds for concluding that the MLI may not be as effective internationally as it was initially planned to deal with BEPS issue. Tax disputes between countries may become more common in the future if the MLI proves as ineffective as the analysis in this paper suggests.

## 2. The BEPS Project and the MLI

The BEPS project was organised by the OECD in response to pressure raised by mainly European members of the OECD concerning perceived substantial levels of tax avoidance by US MNEs around the time of the great financial crisis in 2008. On the streets of Europe there

was considerable outrage about austerity measures brought about by collapses of major financial institutions requiring taxpayer bailouts and pressure from the EU over member states who were running large deficits. Thus public disclosures of major tax avoidance by foreign MNEs made it politically imperative that something be done in response. There were major concerns that some countries might adopt unilateral measures in response to these disclosures which would create an unstable international tax environment, undermine greater global economic integration and undo an international tax consensus which the OECD had forged mainly through its Model Tax Agreement. As the OECD is largely comprised of developed Western countries, its recommendations and measures (as exemplified in the OECD Model Tax Convention) have sometimes be criticised as favouring wealthy countries over the developed world, so with the BEPS project a dialogue was established with many countries outside the OECD membership. This has led to many non-OECD states directly adopting some (or all) of the BEPS measures possibly leading to a revised international tax consensus which would be widely supported beyond just OECD member states.

The key part of the BEPS project was the identification and analysis of a range of methods by which MNEs were using to avoid tax. This analysis led the OECD to formulate 15 “actions” (in better English they would be “action points” or “action plans”) to deal with the BEPS issue. The 15 “actions” are as follows:

| | |
|---|---|
| Action 1 | Addressing the Tax Challenges of the Digital Economy |
| Action 2 | Neutralising the Effects of Hybrid Mismatch Arrangements |
| Action 3 | Designing Effective Controlled Foreign Company Rules |
| Action 4 | Limiting Base Erosion Involving Interest Deductions and Other Financial Payments |
| Action 5 | Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance |
| Action 6 | Preventing the Granting of Treaty Benefits in Inappropriate Circumstances |
| Action 7 | Preventing the Artificial Avoidance of Permanent Establishment Status |
| Actions 8-10 | Aligning Transfer Pricing Outcomes with Value Creation |
| Action 11 | Measuring and Monitoring BEPS |
| Action 12 | Mandatory Disclosure Rules |
| Action 13 | Transfer Pricing Documentation and Country-by-Country Reporting |
| Action 14 | Making Dispute Resolution Mechanisms More Effective |

Action 15 Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

None of the 15 "actions" require any state to adopt a particular course of action as the BEPS measures are not mandatory on any state. Some represent the OECD consensus on how certain matters should be dealt with (for example, Action 2 on dealing with hybrid security mismatches and Action 4 dealing with thin capitalisation) while others merely outline best practice (for example Action 3 on designing effective CFC rules).

One of the major issues the OECD had to address with the BEPS project in formulating appropriate strategies to deal with MNE tax avoidance problem was the worldwide network of double tax agreements (DTAs), comprising currently over 3,000 agreements. Existing provisions in nearly all of these DTAs are likely to constrain a state in how they deal with the BEPS issue. Furthermore, some of the provisions found in many existing DTAs underpinned some of the methods adopted by MNEs to shift profits. A good example of this (but not the sole instance) was the way that a "permanent establishment" in a DTA was defined which had been drafted well before the emergence of electronic commerce allowing MNEs in electronic commerce (such as Google) avoid paying any tax in the jurisdictions where advertisers were resident.

In some states international treaties such as a DTA are not always paramount to their domestic law, while in other countries such superiority is entrenched under constitutional law. If a state does have scope to override international treaties by domestic enactments, such overrides are likely to create friction with other treaty partners and also undermine a state's reputation in its international dealings. On the other hand, there are major difficulties for a state to renegotiate each of their DTAs on one-by-one basis. These constraints and limitations led the OECD to arrive at a multilateral convention (known as the "multilateral instrument" or "MLI") in Action 15 which will sit alongside (maybe on top?) a state's existing DTAs to modify their application to implement the BEPS measures rather for a state to negotiate amending protocols to each of their existing DTAs.

While on paper such a comprehensive multilateral convention could deal with the issue of simultaneous revision of many hundreds (if not thousands) of DTAs, reality is that no state could be forced to sign such a convention. Secondly, there would surely be almost insurmountable difficulties in arriving at a consensus as what articles the such a multilateral convention should

contain especially in light that nearly 100 countries had to some extent participated in the BEPS project from highly wealthy developed countries to very poor underdeveloped countries. Thirdly, some states (mainly small ones such as Singapore, Luxembourg, the Netherlands) had become very wealthy developing their economies as “international financial centres” which relied upon an extensive network of DTAs to attract foreign (mainly mobile) investment. However publicly such states may have expressed concern about BEPS and MNE tax avoidance, their treasuries and economies were often the beneficiary of BEPS and current international tax order and it was unrealistic to expect these states to voluntarily agree to undermine or destroy highly successful sectors of their economies. Consequently, the multilateral convention drafted by the OECD (known as the “multilateral instrument” or “MLI”) is largely modular containing a range of parts which signatory states can elect to access to or not. There are very few provisions of the MLI which are mandatory.

**3. Inside the MLI**

Given the breadth of matters covered by the MLI and almost impossibility to obtain a full consensus on all BEPS measures from nearly 100 states, the MLI is a complex convention upon which signatory states have considerable leeway as to how far they adopt the various parts of it. There are, however, some provisions which signatory states must adopt even though there are some choice within these provisions which are termed “minimum standards”. These minimum standards are:

- The preamble to a DTA should include that as well as aiming to eliminate double taxation, the parties to the DTA also intend to prevent opportunities for non-taxation or reduced taxation. (Article 6, MLI)
- Introduction of anti-abuse rules. (Article 7, MLI)
- Amendments to the DTA dispute resolution provisions to make them more efficient and effective. (Part V, MLI, Articles 16 and 17)
- Facilitation of ongoing monitoring and peer review between signatory states.

The remainder of the MLI contains a number of articles designed to deal with certain BEPS techniques (for example avoidance of creation of a PE) but are not mandatory upon a signatory state to adopt. These articles can be regarded as elective, the only condition being that if a state agrees to adopt them, then they apply to all the DTAs that state is a party to which they have specified are covered by the MLI (known as “covered tax agreements”).

Thus in summary for a provision of the MLI to apply to modify an existing DTA, there are a series of steps that need to be met:

(1) The contracting states to that DTA must both be signatories to the MLI. Around 80 states have signed so far, the US being a major gap.[1] Some key Asian countries (e.g. Thailand) have also not signed.

(2) If (1) is met, then both states must then agree that the particular DTA is a "covered tax agreement" for the purposes of the MLI. New Zealand has specified that 36 of its 40 DTAs are covered tax agreements but interestingly some of those "covered tax agreements" are with countries that have yet to sign the MLI so not all of these 36 covered tax agreements will in fact be modified or subject to the provisions of the MLI.

(3) If (2) is met, both countries must have agreed to be bound by a particular article of the MLI. If there is no alignment between the positions of the two contracting states to a particular article of the MLI, then that article will not apply to modify that covered tax agreement.

Thus despite a large number of states having signed the MLI, that on its own has little significance in terms of the MLI achieving its goal of modifying a large number of the world's DTAs and hence reducing MNE tax avoidance. The MLI can only achieve its intended outcome if there is a careful alignment of the relevant DTAs being "covered tax agreements" and alignment of the two states' position in regard to the optional parts.

#### 3.1.1 What do the optional parts of the MLI cover?

The optional parts of the MLI are found Parts II, III, IV and VI. They are as follows:

- Part II (Articles 3, 4 and 5) deals with hybrid mismatches arising from fiscally transparent and dual resident entities as well as hybrid securities.
- Part III (Articles 6, 7, 8, 9, 10 and 11) deals with treaty abuse. While Articles 6 and 7 form part of the "minimum standards", the remaining articles are elective. These articles apply Article 8 applying to dividend transfer transactions is elective.
- Part IV (Articles 12, 13, 14 and 15) deals with permanent establishment avoidance.

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[1] The reasons for the US not signing have been given as the MLI largely follows existing US DTA policy which does have strict provisions against treaty shopping arrangements for example. Henry Louie (Deputy International Tax Counsel at the US Department of the Treasury) is noted as saying that the US treaty network is already robust to prevent treaty shopping and already has a low degree of exposure to base erosion and profit shifting. He is quoted "the bulk of the multilateral instrument is consistent with US tax treaty policy that the Treasury Department has followed for decades". He is also mentioned as citing the complexity of getting necessary approvals from the US Department of State and from the Senate. *International Tax Advisory*, dated 14 July 2017 from Alston & Bird LLP.

- Part VI (Articles 18, 19, 20, 21, 22, 23, 24, 25 and 26) contain articles pertaining to arbitration if a state elects to adopt the arbitration provisions under Article 18.

## 4.0 New Zealand and the MLI

On 7 June 2017, New Zealand signed the MLI and released a provisional list of its reservations and notifications in respect of the MLI. Of the 40 DTAs New Zealand has negotiated and which are currently in force, 36 of them have been designate by New Zealand as "covered tax agreements" for the purposes of the MLI. These 36 "covered tax agreements" are the DTAs with:

| Australia; | Indonesia; | Singapore; |
|---|---|---|
| Austria; | Ireland; | South Africa; |
| Belgium; | Italy; | Spain; |
| Canada; | Japan; | Sweden; |
| Chile; | Korea; | Switzerland; |
| China (People's Rep.); | Malaysia; | Thailand; |
| Czech Republic; | Mexico; | Turkey; |
| Denmark; | Netherlands; | United Arab Emirates; |
| Finland; | Norway; | United Kingdom |
| France; | Papua New Guinea; | Vietnam |
| Germany; | Philippines; | |
| Hong Kong; | Poland; | |
| India; | Russia; | |

There are four DTAs New Zealand have not specified as "covered tax agreements" being the ones with Fiji, Samoa, Taiwan and the United States. Samoa, Taiwan and the United States have not signed the MLI although Fiji has. Fiji has specified its DTA with New Zealand as a "covered tax agreement" but New Zealand has not chosen to do so which appears to reflect the New Zealand intention to renegotiate the Fijian DTA shortly.

Of the 36 DTAs which New Zealand has specified as "covered tax agreements", the MLI cannot apply to four of them as the other contracting states in each case (Papua New Guinea, the Philippines, Thailand and Vietnam) have not signed the MLI. Of these four it is understood that

only Thailand has expressed an intent to sign the MLI but has not yet done so. As a result of these various exclusions, the MLI applies to only 32 of New Zealand's 40 current DTAs.

The remaining 32 "covered tax agreements" are concluded with an interesting range of countries. While most are with other OECD states, among them are several jurisdictions such as Singapore, Hong Kong and United Arab Emirates which are either complete or partial tax havens or low tax jurisdictions commonly utilised by many MNEs as part of their tax avoidance arrangements.

### 5.0 Optional Parts of the MLI and New Zealand's Covered tax Agreements

New Zealand has adopted a large proportion of the MLI. It has entered no reservations to the optional parts of the MLI. This is explicit evidence that wishes to protect its revenue base from erosion by MNEs who have adopted BEPS techniques and also that it sees the solution to the BEPS problem through adopting solutions formulated in a multilateral forum such as the OECD. Its almost complete adoption of all optional parts of the MLI reflects a perception that the MLI allows New Zealand to amend a substantial number of its DTAs quickly when the reality of piecemeal revision by bilateral renegotiation of the same number of DTAs would be incredibly resource intensive and take an very long period of time, especially given New Zealand's small size and lack of economic importance to most of its DTA partners.[2]

But for the MLI to provide effective protection to its revenue base, it not sufficient that 32 of its 40 DTAs are designated as covered tax agreements, but also that the other parties to those 32 agreements have also elected to adopt the same optional provisions in their accession to the MLI. The following sections will examine each of the optional parts of the MLI to see if there is alignment between what New Zealand has elected under the MLI and the other signatory states to its "covered tax agreements".

### 5.1 Part II MLI Hybrid Mismatches – Articles 3 to 5

Part II containing Articles 3, 4 and 5 of the MLI deal with hybrid mismatches. Article 3 deals with fiscally transparent entities which are not explicitly dealt with in the existing OECD Model Agreement.

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[2] Refer Peters, C; *National Interest Analysis: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, 4 August 2017, Wellington, paragraphs 27-28.

Article 4 of the MLI deals with dual resident corporate entities (being entities other than individuals). While Article 4 of the OECD Model contains a comprehensive residence tie-breaker clause, not all DTAs negotiated from the OECD Model necessarily contain provisions to deal with dual-resident corporate entities. Article 4(1) of the MLI extends an anti-avoidance provision that a dual resident corporate entity which has not had its residence resolved by mutual agreement under the MLI will not be able to obtain any relief or exemption from tax arising under a covered tax agreement until agreed by the competent authorities of two contracting states.

Article 5 of the MLI aims to modify existing provisions in covered tax agreements which deal with the methods to relieve double taxation – being either a foreign tax credit or an exemption. Article 5 aims to address situations where there is double non-taxation which may arise with cross-border holdings of hybrid securities. New Zealand has previously dealt with tax avoidance involving hybrid security mismatches by using the general anti-avoidance rule (GAAR) section BG 1 ITA 2007 as illustrated in *Alesco New Zealand Limited v. CIR* [2013] NZCA 40. The provisions in Article 5 of the MLI authorise a departure from a tax credit or exemption being required where it will facilitate tax avoidance using hybrids.

The following table shows the position of the contracting states to New Zealand's 32 covered tax agreements:[3]

| | Article 3 | Article 4 | Article 5 |
|---|---|---|---|
| *New Zealand* | √ | √ | √ |
| Australia | √ | √ | √ |
| Austria | Reservation | Reservation | √ |
| Belgium | √ | Reservation | √ |
| Canada | Reservation | Reservation | Reservation |
| Chile | √ | Reservation | √ |
| China (People's Rep.) | Reservation | Reservation | Reservation |
| Czech Republic | Reservation | Reservation | Reservation |
| Denmark | Reservation | Reservation | Reservation |

3 Information in this table has been taken from the spreadsheet prepared by the OECD MLI Database - Matrix of Options and Reservations at: http://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm.

| | | | |
|---|---|---|---|
| Finland | Reservation | Reservation | √ |
| France | Reservation | Reservation | Reservation |
| Germany | Reservation | Reservation | √ |
| Hong Kong | Reservation | Reservation | Reservation |
| India | Reservation | √ | Reservation |
| Indonesia | Reservation | √ | Reservation |
| Ireland | Reservation* | √ | √ |
| Italy | Reservation | Reservation | √ |
| Japan | √ | √ | √ |
| Korea | Reservation | Reservation | Reservation |
| Malaysia | Reservation | Reservation | Reservation |
| Mexico | √ | √ | √ |
| Netherlands | √ | √ | √ |
| Norway | √ | √ | √ |
| Poland | √ | √ | √ |
| Russia | √ | √ | Reservation |
| Singapore | Reservation | Reservation | Reservation |
| South Africa | √ | √ | Reservation |
| Spain | √ | √ | √ |
| Sweden | Reservation | Reservation | Reservation |
| Switzerland | Reservation | Reservation | √ |
| Turkey | √ | √ | Reservation |
| United Arab Emirates | Reservation | Reservation | Reservation |
| United Kingdom | Reservation* | √ | √ |
| Total no. adopting out of 32 states | 12 + 2 partial | 14 | 16 |

** Partial reservation entered to Article 3(2) MLI.*

While New Zealand has adopted all three articles from the MLI in respect of its covered tax agreements, the above table shows that this is not reciprocated by many of the respective contracting states. Thus New Zealand's adoption of Articles 3, 4 and 5 will be of little consequence in modifying many of New Zealand's DTAs. The reservations entered to the three

articles in Part II of the MLI does not necessarily signify that New Zealand's DTA partners do not wish to address issues of hybrid entity and security mismatches. For many of them such methods of tax avoidance are likely to be of concern to them, it is just that they prefer to adopt other strategies to deal with this particular type of avoidance. This may include existing provisions in DTAs which they may believe are adequate and that they do not wish the possible complication of the MLI provisions applying over them.

**5.2 Part III MLI Treaty Abuse –Articles 6 to 11**

Part III of the MLI deals with treaty abuse and includes Articles 6 and 7 which impose certain minimum standards upon signatory states. The remaining articles in Part III (being Articles 8 to 11) are optional ones which states can adopt or enter a reservation to.

Article 8 of the MLI applies to situations where inter-company dividends are exempt due to a specified threshold of shareholding being met along with certain shareholding requirements. Article 8 imposes a minimum time period of 365 days for which such shareholdings must be in place to deal with avoidance facilitated by temporary changes in shareholding in order to secure an exempt inter-company dividend.

Article 9 applies to stem artificial arrangements to defeat the rules applying to "land rich" companies. Sale of shares in such companies can in economic substance effect the sale of land. If companies' assets comprise land above a specified threshold, sale of shares in these companies can be taxed as a sale of the land itself. These provisions have been defeated by land rich companies temporarily acquiring non-land assets so that the threshold for the land rich company provisions is not breached. Article 9 of the MLI clarifies the time period the threshold test applies so that temporary arrangements to defeat the test will not be effective.

Article 10 introduces an anti-abuse rule for permanent establishments in third jurisdictions. It is designed to address tax avoidance where an enterprise sets up a PE in a jurisdiction to derive mainly passive income (i.e. no active business income) where that income will receive concessional tax treatment and that PE income is exempt from tax in the residence jurisdiction. Under Article 10 of the MLI, the source state will not be obliged to grant treaty benefits to such income derived by PEs in third countries where the tax imposed is less than 60% of the tax that would be imposed in the state where the enterprise is resident.

Article 11 is a "savings" clause which seeks to prevent a covered tax agreement from restricting how a contracting state may tax its own residents. However, this right for a contracting state to retain the right to tax their residents as they see fit is limited by a carve-out of 10 situations where treaty provisions would still apply which could affect how a state might tax its residents.

New Zealand has not entered into any reservations in respect to Articles 8 to 11 of the MLI to its covered tax agreements. The following table shows whether the other contracting states to New Zealand's covered tax agreements have entered reservations Articles 8 to 11 of the MLI:

| | Article 8 | Article 9 | Article 10 | Article 11 |
|---|---|---|---|---|
| *New Zealand* | √ | √ | √ | √ |
| Australia | √ | Reservation^^ | Reservation | √ |
| Austria | Reservation | Reservation | √ | Reservation |
| Belgium | √ | Reservation~ | Reservation | √ |
| Canada | Reservation | Reservation | Reservation | Reservation |
| Chile | Reservation | √ | Reservation** | Reservation*^ |
| China (People's Rep.) | √ | Reservation~ | Reservation | √ |
| Czech Republic | Reservation | Reservation | Reservation | Reservation |
| Denmark | Reservation | Reservation | Reservation | Reservation |
| Finland | Reservation | Reservation | Reservation | Reservation |
| France | √ | √ | Reservation | Reservation |
| Germany | Reservation* | √ | √ | Reservation |
| Hong Kong | Reservation | Reservation | Reservation | Reservation |
| India | Reservation^ | √ | √ | √ |
| Indonesia | √ | √ | Reservation | √ |
| Ireland | √ | √ | Reservation | Reservation |
| Italy | Reservation | Reservation | Reservation | Reservation |
| Japan | Reservation | √ | √ | Reservation |
| Korea | Reservation | Reservation | Reservation | Reservation |
| Malaysia | Reservation | Reservation | Reservation | Reservation |
| Mexico | √ | √ | √ | Reservation*^ |
| Netherlands | √ | √ | √ | Reservation |

| | | | | |
|---|---|---|---|---|
| Norway | Reservation* | Reservation | Reservation | √ |
| Poland | Reservation* | √ | Reservation | √ |
| Russia | Reservation* | Reservation^^ | √ | √ |
| Singapore | Reservation | Reservation | Reservation | Reservation |
| South Africa | √ | Reservation | Reservation | Reservation |
| Spain | √ | √ | √ | Reservation |
| Sweden | Reservation | Reservation | Reservation | Reservation |
| Switzerland | Reservation | Reservation | Reservation | Reservation |
| Turkey | Reservation | Reservation^* | Reservation | Reservation |
| United Arab Emirates | Reservation | Reservation | Reservation | Reservation |
| United Kingdom | Reservation | Reservation | Reservation | Reservation |
| Total no. adopting out of 32 states | 10 + 5 partial | 11 + 5 partial | 8 + 1 partial | 8 + 2 partial |

** Partial reservation entered to Article 8(b)(i) MLI.*
*^ Partial reservation entered to Article 8(b)(iii) MLI.*
*^^ Partial reservation entered to Article 9(6)(e) MLI.*
*~ Partial reservation entered to Article 9(6)(b) MLI.*
*^* Partial reservation entered to Article 9(6)(f) MLI.*
*** Partial reservation entered to Article 10(5)(b) MLI.*
**^ Partial reservation entered to Article 11(3)(b) MLI.*

Again many of New Zealand's DTA partners have entered reservations to the four articles designed to deal with four specific types of treaty abuse. Many of the partial reservations are not particularly significant in scope and can almost be regarded as acceptance of the particular article rather than a reservation to an article in its entirety. However, the large number of reservations does mean that New Zealand's wide ranging acceptance of nearly all of the optional provisions of the MLI will be of limited effect to its DTA network. The partial reservations will result in particularly complex analyses to determine exactly how much of one of those articles will apply to a covered tax agreement and may well result in disagreements as to what actually does apply.

**5.3 Part IV MLI PE Avoidance –Articles 12 to 14**

Avoiding the creation of a permanent establishment (PE) in a state to avoid any liability for income tax on profits derived from a business wholly or partly carried on in a state is a tax

avoidance strategy used by a number of MNEs in the electronic commerce area.[4] The MLI contains three articles that aim to deal with this mode of tax avoidance. Article 12 of the MLI modifies the existing definition of a PE found in the OECD Model Agreement (and most DTAs) to encompass certain preliminary or preparatory activities which habitually lead to the conclusion of contracts. Article 13 of the MLI will modify the existing exclusions of certain activities from constituting a PE found in the OECD Model Agreement (and most DTAs) which have enabled certain tax avoidance strategies. Article 14 of the MLI aims to modify existing DTAs where there has been artificial splitting up or division of activities so that that fall below certain time thresholds above which a PE would be deemed to be created. A common example of this are building construction or installation projects which exceed 12 months (sometimes 6 months under some of New Zealand's DTAs). Many of New Zealand's existing DTAs contain such time thresholds for the creation of a PE beyond just construction projects.[5]

New Zealand has adopted all three of these articles in respect to the MLI. The following table shows whether the other contracting state to New Zealand's covered tax agreements have also agreed to be bound by those three articles or whether they have reserved their positions:

| | Article 12 | Article 13 | Article 14 |
|---|---|---|---|
| *New Zealand* | √ | √ | √ |
| Australia | Reservation | Reservation* | Reservation^ |
| Austria | Reservation | √ | Reservation |
| Belgium | Reservation | √ | Reservation |
| Canada | Reservation | Reservation | Reservation |
| Chile | √ | √ | √ |
| China (People's Rep.) | Reservation | Reservation | Reservation |
| Czech Republic | Reservation | Reservation | Reservation |
| Denmark | Reservation | Reservation | Reservation |
| Finland | Reservation | Reservation | Reservation |
| France | √ | √ | Reservation |

4 Refer Smith, A, "Will BEPS Allow New Zealand to Finally Tax Google?", paper presented at the 30th annual conference of the Australasian Tax Teachers' Association, Monash University, Caulfield, 17-19 January 2018.

5 For example, in the Australia-New Zealand DTA a PE arises if a personal performs independent services in a contracting state for more than 183 days in any 12 month period (Article 5(4)(a) or activities for the exploration or exploitation of natural resources for more than 90 days (Article 5(4)(b)).

| | | | |
|---|---|---|---|
| Germany | Reservation | √ | Reservation |
| Hong Kong | Reservation | Reservation | Reservation |
| India | √ | √ | √ |
| Indonesia | √ | √ | √ |
| Ireland | Reservation | √ | Reservation^ |
| Italy | Reservation | √ | Reservation |
| Japan | √ | √ | Reservation |
| Korea | Reservation | Reservation | Reservation |
| Malaysia | √ | √ | Reservation |
| Mexico | √ | √ | Reservation |
| Netherlands | √ | √ | Reservation^ |
| Norway | √ | √ | Reservation^ |
| Poland | Reservation | Reservation | Reservation |
| Russia | √ | √ | Reservation^ |
| Singapore | Reservation | Reservation* | Reservation |
| South Africa | Reservation | √ | Reservation |
| Spain | √ | √ | √ |
| Sweden | Reservation | Reservation | Reservation |
| Switzerland | Reservation | Reservation | Reservation |
| Turkey | √ | √ | Reservation |
| United Arab Emirates | Reservation | Reservation | Reservation |
| United Kingdom | Reservation | √ | √ |
| Total no. adopting out of 32 states | 12 | 19 + 1 partial | 5 + 5 partial |

** Partial reservation entered to Article 13(2) MLI (Australia) and Article 13(4) (Singapore).*
*^ Partial reservation entered to Article 14 MLI in respect of contracts for natural resource exploration or exploitation.*

Thus the above table indicates that very few of New Zealand's 32 DTAs which are going to be modified by the MLI provisions applying to avoidance of the creation of PEs. This means that many of New Zealand's DTAs will potentially continue with unmodified definitions of "permanent establishment". New Zealand has recognised that many of its DTA partners entered reservations particularly to Articles 12 and 13 and has introduced domestic law changes to address this gap.

Section GB 54 ITA 2007 is an anti-avoidance provision enacted this year which applies to New Zealand's DTAs (including both covered tax agreements and those that are not) where the treaty does not incorporate Article 12(1) of the MLI (or equivalent) and is part of a tax avoidance arrangement. If New Zealand does apply section GB 54 to enterprises resident from those states, it remains to be seen whether a New Zealand court will uphold section GB 54 as overriding the existing provisions in those countries' DTAs with New Zealand or whether those states will dispute the New Zealand action under section GB 54 and disagree that the section is an acceptable anti-avoidance provision to prevent unintended abuse of DTAs.

**5.4 Part VI MLI Arbitration –Articles 18 to 26**

New Zealand has adopted the arbitration option in Part VI of the MLI. Until this adoption, New Zealand did not appear to favour arbitration to resolve problems arising from the application of a DTA, as arbitration provisions are only found in the DTAs with Australia and Japan.[6] New Zealand has taken this step because it wants the arbitration option as "an incentive for the competent authorities of two jurisdictions to come to an agreement within the required time period for MAP".[7]

The following table shows the position of the contracting states to New Zealand's covered tax agreements:

| | Article 18 |
|---|---|
| *New Zealand* | √ |
| Australia | Reservation |
| Austria | Reservation |
| Belgium | Reservation |
| Canada | Reservation |
| Chile | √ |
| China (People's Rep.) | √ |
| Czech Republic | √ |

6 Article 25 (6) and (7) Australia-New Zealand Double Tax Agreement 2009; Article 26(5) Japan-New Zealand Double Tax Agreement 2012.

7 Refer Peters, C; *National Interest Analysis: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, 4 August 2017, Wellington, paragraph 39.

| | |
|---|---|
| Denmark | √ |
| Finland | Reservation |
| France | Reservation |
| Germany | Reservation |
| Hong Kong | √ |
| India | √ |
| Indonesia | √ |
| Ireland | Reservation |
| Italy | Reservation |
| Japan | Reservation |
| Korea | √ |
| Malaysia | √ |
| Mexico | √ |
| Netherlands | Reservation |
| Norway | √ |
| Poland | √ |
| Russia | √ |
| Singapore | Reservation |
| South Africa | √ |
| Spain | Reservation |
| Sweden | Reservation |
| Switzerland | Reservation |
| Turkey | √ |
| United Arab Emirates | √ |
| United Kingdom | Reservation |
| Total no. adopting out of 32 states | 16 |

This provision will appear to have some significance for New Zealand's covered tax agreements as it will enable the arbitration option to apply for another 16 of New Zealand's DTAs in addition to the existing provisions in the Australian and Japanese DTAs.

**6.0 Analysis of Results**

One very clear trend apparent from the earlier tables is that many of New Zealand's DTA partners have entered a significant number of reservations to the optional provisions of the MLI. Therefore the results flowing from New Zealand's enthusiastic adoption of all of the optional parts of the MLI will be limited.

A number of New Zealand's DTA partners have entered into reservations to all the optional provisions to the MLI. The background of these states are quite varied. Three states which have entered reservations to all the optional provisions of the MLI are Hong Kong, Singapore and the United Arab Emirates. These three states are significant tax havens or low tax jurisdictions which are likely to have economically benefited from the existing BEPS strategies adopted by many MNEs and understandably be reluctant to agree to measures which might reduce their ability to gain from their existing DTA networks. Belgium and Switzerland have also entered a large number of reservations and they can be regarded a "partial" tax havens as they have traditionally offer concessional taxing regimes to attract foreign mobile capital. China has entered reservations to most (but not all) of the optional parts of the MLI although it is not a tax haven.

Along with these low tax jurisdictions and "partial" tax havens, a number of OECD states have also entered a large number (or complete number) of reservations to the optional parts of the MLI. These include states such as Austria, Canada, Czech Republic, Finland, Korea, Sweden and Switzerland among others. These states are not low tax ones and are likely to have been concerned about BEPS along with other OECD members. There are a variety of possible reasons why they may have taken this stance. Some may have been concerned about the potential confusion and complexity arising from adoption of the optional parts of the MLI plus the lack of flexibility that would arise by adopting the optional parts as they would have to apply to all their covered tax agreements. Possibly these states would prefer to deal with the BEPS issues on a state-by-state basis through bilateral DTA negotiations. Some of these states are also major capital exporters and may have perceived the MLI tipping the balance between source/resident states more towards source states therefore undermining revenues gained by residence states.

Cynics might also see the large number of reservations entered into by major OECD states as evidence that the BEPS project was political in nature to assure an angry (mainly European) populace that governments were reacting to the BEPS problem. Given the complexity of the

BEPS responses and the MLI in particular lay persons might well be convinced that their governments were reacting appropriately to the BEPS problem, when the real political will was much less.

The complexity arising from the application of the MLI to existing DTAs has been noted by number of international commentators. Kleist discusses at length on the resulting complexity and legal uncertainty from the application of the MLI.[8] Kleist also refers to issue of reservations being entered and resulting effect that many covered tax agreements will not be modified by the MLI.[9] Anton discusses at length about the problems arising from the reservations entered to the MLI, especially the partial reservations.[10] Avi-Yonah and Xu, while being more positive about the MLI than Kleist and Anton, conclude in their analysis of the MLI:

> *Whether the MLI will succeed remains to be seen. While its adoption by seventy countries (with more to come) is an achievement, the absence of the United States is important, and other OECD members have agreed to only a limited a set of provisions. On the other hand, the MLI may prove more appealing to developing countries because it enhances source-based taxation an limits treaty shopping.*[11]

If states have entered into reservations to all of the optional parts of the MLI, it may well because of these concerns over complexity, uncertainty and ambiguity rather than ambivalence about the BEPS problem.

## 7.0 Conclusions

New Zealand has been one of the more enthusiastic adopters of the MLI if judged by the very limited number of reservations it has entered to the MLI which are mainly in respect of the options arising under the arbitration provisions in Part VI. The apparent reason behind this approach is clearly valid in that it is very difficult and slow to renegotiate all of a state's existing DTAs and that given New Zealand's small size it often finds it difficult to get DTA partners to schedule negotiations with New Zealand when they have more important DTAs under negotiation.

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[8] Kleist, D; "The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – Some Thought on Complexity and Uncertainty", *Nordic Tax Journal*, Vol 1, pp 31-48 at pp 41-42 and pp 44-47.

[9] Refer above note at pp 42-44.

[10] Anton, R G; "Untangling the Role of Reservations in the OECD Multilateral Instrument: The OECD Legal Hybrids", *Bulletin for International Taxation*, Vol 71, # 10, August 2017.

[11] Avi-Yonah, R S and XU, H Y; "A Global Treaty Override? The New OECD Multilateral Tax Instrument and its Limits", *Michigan Journal of International Law*, Vol 39,155 (2018) at p 216.

Unfortunately for New Zealand, many of its key DTA partners have either not signed the MLI (e.g. the United States) or have entered into a large number of reservations in respect of the optional parts of the MLI. Thus less than half of New Zealand's 40 existing DTAs will be subject to any substantial modification or supplementation as a result of the MLI. At the same time New Zealand has also taken the additional step of enacting domestic law changes (often dressed up as anti-avoidance measures) which must reflect a conclusion that the MLI on its own may not be adequate to protect the New Zealand tax base.

The end outcome of these developments is considerable complexity and uncertainty for taxpayers applying New Zealand's existing DTAs. For those covered tax agreements to which the optional parts of the MLI will apply to modify existing DTAs, considerable complexity will arise. For those DTAs which are either not covered tax agreements or ones where the other contracting state has entered reservations to the optional parts of the MLI, there is the uncertainty how the domestic law changes will apply and whether they will be upheld by a future New Zealand court. Disputes about treaty overrides with other states may also arise. The adoption of the MLI by New Zealand has introduced a huge step up in complexity for taxpayers in applying any one of its 40 existing DTAs.

In the longer term it would desirable if all of New Zealand's DTAs were renegotiated to incorporate up to date provisions to deal with the issue of BEPS. Such updated DTAs could be not be classified as covered tax agreements to which the MLI applies.