THE OECD'S MULTILATERAL INSTRUMENT — WILL IT BE AN EFFECTIVE SOLUTION FOR NEW ZEALAND TO COUNTER MULTINATIONAL TAX AVOIDANCE?

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ABSTRACT

A key part of the OECD's base erosion and profit shifting ('BEPS') is the multilateral instrument ('MLI') that is designed to simultaneously amend many of world's double tax agreements ('DTAs'), to deal with the problem of multinational tax avoidance. The MLI can be regarded as modular, in that signatory states can enter reservations to parts of it. This paper analyses the reservations that all New Zealand's DTA partners (as at 1 June 2019) have entered in respect to the MLI. It is concluded that the MLI is unlikely to be effective for New Zealand to deal with BEPS, and that this has led New Zealand to enact changes to its domestic law unilaterally.

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I Introduction

Tax avoidance by major multinational enterprises ('MNEs') has been very topical since the global 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 other parts of the world, and calls for something to be 'done' about it. These pressures have resulted in the OECD undertaking a major project to develop a multilateral consensus on acceptable solutions to this problem. This project, which commenced in 2013, is known as the base erosion and profit shifting ('BEPS') project.[1]

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 multilateral convention — known as the multilateral instrument ('MLI') — which is intended to simultaneously modify the application of a great number of the world's bilateral double tax agreements ('DTAs').[2] Many of the modifications under the MLI are necessary if states are to deal with MNE tax avoidance, as many of the arrangements adopted by MNEs rely upon provisions in existing DTAs, or stand in the way of states making domestic law changes to counter them.

The MLI can be viewed as modular, in that signatory states do not have to adopt all parts of it. With respect to many of its provisions, signatory states have scope to enter reservations. This paper analyses the responses of all New Zealand's 40 DTA partners (as at 1 June 2019) in respect to the MLI. The analysis in this paper suggests that the MLI is unlikely on its own to be effective for New Zealand to deal with BEPS, nor particularly effective internationally. Tax disputes between countries may become more common in the future if the MLI proves as ineffective as the analysis in this paper suggests.

II The BEPS Project and the MLI

The BEPS project was organised by the OECD in response to pressure raised by, mainly European, members concerning perceived substantial levels of tax avoidance by US MNEs around the time of the global 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 also 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 Convention.[3] As the OECD largely comprises developed Western countries, its recommendations and

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[1] For an overview of the whole BEPS project, see OECD, *Background Brief — Inclusive Framework on BEPS* (OECD Publishing, January 2017); 'International Collaboration to End Tax Avoidance', *OECD, Inclusive Framework on Base Erosion and Profit Shifting* (Web Page, 2019) <http://www.oecd.org/tax/beps>.

[2] OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing, 24 November 2016) ('MLI').

[3] OECD, *Model Tax Convention on Income and on Capital* (OECD Publishing, December 2017).

measures (as exemplified in the OECD Model Tax Convention) have sometimes been criticised as favouring wealthy countries over the developing 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 that would be widely supported beyond just OECD member states.

The key part of the BEPS project was the identification and analysis of the range of methods by which MNEs were avoiding 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:[4]

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 the MNE tax avoidance problem was the worldwide

[4] OECD, *OECD/G20 Base Erosion and Profit Shifting Project — Executive Summaries 2015 Final Reports* (OECD Publishing, 2015).

network of DTAs, comprising currently over 3,000 agreements.[5] Existing provisions in nearly all of these DTAs are likely to constrain states 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 ('PE') in a DTA (based on the OECD Model Tax Convention) was defined, which had been drafted well before the emergence of electronic commerce (for example, as carried on by Google) allowing MNEs to avoid paying any tax in the jurisdictions where their customers 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 — the MLI — in Action 15, which will sit alongside (or on top) a state's existing DTAs to modify their application to implement the BEPS measures, rather than a state needing to negotiate amending protocols to each of their existing DTAs.

First, while on paper such a comprehensive multilateral convention could deal with the issue of simultaneous revision of many hundreds (if not thousands) of DTAs, the reality is that no state could be forced to sign such a convention. Second, there would surely be almost insurmountable difficulties in arriving at a consensus on what articles such a multilateral convention should contain, especially considering that nearly 100 countries had participated in the BEPS project, from wealthy developed countries to poor underdeveloped countries. Third, some states (mainly small ones, such as Singapore, Luxembourg and the Netherlands) had become very wealthy developing their economies as 'international financial centres', which relied upon an extensive network of DTAs to attract (mainly mobile) foreign investment. While publicly such states may have expressed concern about BEPS and MNE tax avoidance, their economies were often the beneficiary of BEPS and the current international tax order, and it was unrealistic to expect these states to agree voluntarily to undermine highly successful sectors of their economies. Consequently, the MLI is largely modular, and signatory states can enter reservations to significant parts of it.[6] There are very few provisions of the MLI that are mandatory.[7] It should be noted at this point that the MLI only applies to modify

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[5] Govind and Pistone refer to the International Bureau of Fiscal Documentation DTA database having 3,115 tax treaties in force in the English language in September 2017. Sriram Govind and Pasquale Pistone, 'The Relationship between Tax Treaties and the Multilateral Instrument: Compatibility Clauses in the Multilateral Instrument' in Michael Lang et al (eds), *The OECD Multilateral Instrument for Tax Treaties: Analysis and Effects* (Kluwer Law International, 2018) ch 6, 111, fn 1.

[6] For a discussion on these reservations, see Benjamin Walker, 'Reservations to the Multilateral Instrument' in Lang et al (eds) (n 5) ch 8.

[7] MLI (n 2). The mandatory provisions are found in arts 6(1)–(2), 7 and 16. While these provisions are mandatory to signatories, there is some limited scope for states to choose how they will meet these minimum standards, which are found in arts 6(4) and (6), and 7(15)–(17). States can actually enter reservations to both articles if a covered tax agreement already contains provisions that meet the minimum standards (see arts 6(4) and 7(15)(b)). Additionally, art 7(15)(a) allows a state to meet the prevention of treaty abuse standard using their own measures not specified in the MLI.

comprehensive DTAs and not more limited bilateral tax treaties, such as the more recent tax information exchange agreements.

III Inside the MLI

Given the breadth of matters covered by the MLI and the almost impossibility of obtaining 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 that signatory states must adopt even though there is some choice within these provisions. These are termed 'minimum standards', which are:

- the requirement for the preamble to a DTA to state, as well as the aim to eliminate double taxation, that the parties intend to prevent opportunities for non-taxation or reduced taxation[8]
- the introduction of anti-abuse rules[9]
- amendments to the DTA dispute resolution provisions to make them more efficient and effective.[10]

Additionally, there is ongoing monitoring and peer review between signatory states as to their compliance with the MLI and other BEPS provisions, but these are outside the MLI itself. At this stage, it should be noted that these 'minimum standards' do not on their own 'go very far towards preventing BEPS'.[11]

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 to which signatory states can enter reservations. Thus, these articles can be regarded as elective (or optional), the only condition being that if a state enters a reservation to them, then that reservation applies to all the DTAs to which that state is a party that they have specified are covered by the MLI (known as 'covered tax agreements'). However, states do not have an unfettered right to enter reservations to any part of the MLI. The ability to do so is limited by the provisions of art 28 of the MLI, which are very complex.

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:[12]

(1) The contracting states to that DTA must both be signatories to the MLI. As at 1 June 2019, 88 states have signed, the US being a major gap.[13] Some key Asian countries

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[8] Ibid arts 6(1) and (2).
[9] Ibid art 7.
[10] Ibid pt V arts 16 and 17.
[11] See James Keate, 'Venturing beyond the OECD: An Analysis of New Zealand's Response to Multinational Corporate Tax Avoidance' (Student/Alumni Paper No 28/2018, Legal Research Papers, Victoria University of Wellington, 4 April 2018) 8.
[12] See OECD, *Applying the Multilateral Instrument: Step-by-Step* (OECD Publishing, June 2017) <https://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf>.
[13] The reason for the US not signing has been given as the MLI largely following 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

(for example, the Philippines, Thailand and Vietnam) have also not yet signed, although Thailand has expressed interest in doing so.[14]

(2) If (1) is met, 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 the 36 will in fact be modified or subject to the provisions of the MLI.[15]

(3) If (2) is met, both countries must then agree to be bound by a particular article of the MLI. If one of the states has entered a reservation to a particular article, then that article will not apply to modify that covered tax agreement.

Thus, even though a large number of states have 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 agreement by the two states on reservations (or lack of them) to the key parts of the MLI.[16]

The optional parts of the MLI are:[17]

- Part II (arts 3, 4 and 5), which deals with hybrid mismatches arising from fiscally transparent and dual-resident entities as well as hybrid securities.
- Part III (arts 6, 7, 8, 9, 10 and 11), which deals with treaty abuse. While arts 6 and 7 form part of the 'minimum standards', the remaining articles are elective. Of these elective provisions, art 8 applies to dividend transfer transactions, art 9 is designed to deal with 'land-rich' companies, art 10 contains an anti-abuse rule to deal with PEs in third jurisdictions, and art 11 explains in what situations the MLI can limit a resident state in taxing its own residents.
- Part IV (arts 12, 13, 14 and 15), which deals with PE avoidance techniques.
- Part VI (arts 18, 19, 20, 21, 22, 23, 24, 25 and 26), which contains articles pertaining to arbitration if a state elects to adopt the arbitration provisions under art 18.

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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 as saying '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. Alston & Bird LLP, *International Tax Advisory* (14 July 2017).

[14] See OECD, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (29 May 2019) <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

[15] New Zealand Government, *New Zealand — Status of List of Reservations and Notifications at the Time of Signature* (8 June 2017) art 2, 2–6 <http://www.oecd.org/tax/treaties/beps-mli-position-new-zealand.pdf>.

[16] As at 1 June 2019, the OECD has reported that there are 2,712 'notified agreements', leading to 1,527 'matched agreements': see OECD, *Signatories and Parties to the Multilateral Convention* (n 14). These figures suggest that around half of the world's DTAs will fall within the ambit of the MLI, although the effect of falling within the 'matched' category will be limited by the reservations entered into by states.

[17] MLI (n 2).

IV NEW ZEALAND AND THE MLI[18]

On 7 June 2017, New Zealand signed the MLI and released a provisional list of its reservations and notifications. Of the 40 DTAs New Zealand has negotiated and that are currently in force, 36 have been designated by New Zealand as covered tax agreements for the purposes of the MLI. These are outlined in Table 1.

Table 1: New Zealand's covered tax agreements, as at 1 June 2019

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

*Note: Jurisdictions marked * above are OECD member states. The remaining jurisdictions are either developing countries, those that have not sought OECD membership (Singapore, United Arab Emirates), or those not recognised as sovereign entities (Hong Kong, Taiwan).*
 # The 1986 China–New Zealand DTA is a covered tax agreement under the MLI, however, the newly negotiated 2019 DTA with China will not be a covered tax agreement.

There are four DTAs that New Zealand has not included as covered tax agreements, with Fiji, Samoa, Taiwan and the US. Samoa, Taiwan and the US 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 chosen not to do so. This appears to reflect New Zealand's intention to renegotiate the Fijian DTA in the near future, although it has not yet occurred to date.[19]

Of the 36 DTAs that New Zealand has specified as covered tax agreements, the MLI cannot apply to three of them as the other contracting states (the Philippines, Thailand and Vietnam) have not yet signed the MLI. Of these three, it is understood that only Thailand has expressed an intention to sign the MLI, but has not yet done so. As a result of these various exclusions, the MLI applies to only 33 of New Zealand's 40 current DTAs.

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[18] This analysis is current to 1 June 2019.

[19] At 1 April 2019 it was disclosed that negotiations are in progress for a DTA with Luxembourg and a replacement DTA with the UK. In both cases, negotiations have been in progress over a long period of time. See 'Double Tax Agreements', *Ministry of Foreign Affairs and Trade, New Zealand Government* (Web Page) <https://www.treaties.mfat.govt.nz//search/details/p/63>. It is notable that other countries (for example, Portugal) have appeared on this list in earlier times, but have been removed, suggesting that negotiations have broken down. A new DTA was negotiated with China in April 2019, being the first DTA to be concluded by New Zealand since the MLI was signed, which incorporates anti-BEPS measures. The author has been informed that it will not be a covered tax agreement for the purposes of the MLI.

The remaining 33 covered tax agreements are 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, that are either tax havens or low-tax jurisdictions, commonly utilised by many MNEs as part of their tax avoidance arrangements.

V 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 New Zealand wishes to protect its revenue base from erosion by MNEs who have adopted BEPS techniques, and also sees the solution to the BEPS problem through adopting solutions formulated in a multilateral forum such as the OECD. New Zealand's lack of reservations to any major part of the MLI suggests that New Zealand sees the MLI as a way of amending a substantial number of its DTAs quickly. The alternative path would be to undertake piecemeal revision of each DTA by bilateral renegotiation, which would be incredibly resource intensive and take a long time, especially given New Zealand's small size and lack of economic importance to most of its DTA partners.[20]

But for the MLI to provide effective protection to its revenue base, it is not sufficient that 33 of New Zealand's 40 DTAs are designated as covered tax agreements, but it is also necessary that the other parties to those 33 agreements have not entered reservations to the key parts of the MLI when they adopted it. The following sections of this article will examine the reservations the other states have entered to the MLI to see if there is alignment between what New Zealand has agreed to under the MLI and the other parties to New Zealand's covered tax agreements.

A *Part II: Hybrid mismatches — arts 3–5*

Part II containing arts 3, 4 and 5 of the MLI deals with hybrid mismatches. Article 3 deals with fiscally transparent entities that are not explicitly dealt with in the existing *OECD Model Tax Convention on Income and on Capital* ('OECD Model').[21]

Article 4 of the MLI deals with dual-resident corporate entities (being entities other than individuals). While art 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 that 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 aims to address situations where there is double non-taxation, which may arise with cross-border holdings of hybrid securities. This article aims to modify existing provisions in covered tax agreements that deal with the methods to relieve double

[20] See C Peters, *National Interest Analysis: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (4 August 2017) paras 27–8.
[21] See OECD, *Model Tax Convention on Income and on Capital* (n 3).

taxation — being either a foreign tax credit or an exemption. New Zealand has previously dealt with tax avoidance involving hybrid security mismatches by using the general anti-avoidance rule (*Income Tax Act 2007* ('ITA 2007') s BG 1), as illustrated in *Alesco New Zealand Limited v. CIR*.[22] The provisions in art 5 of the MLI authorise a departure from a tax credit or exemption being required where it will facilitate tax avoidance using hybrids.

Table 2 shows the position on arts 3–5 of the contracting states to New Zealand's 33 covered tax agreements.[23]

Table 2: Position of New Zealand's contracting states: MLI arts 3–5

	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
Finland	√	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	√	√	√
Papua New Guinea	√	Reservation^	√
Poland	√	√	√
Russia	√	√	Reservation
Singapore	Reservation	Reservation	Reservation
South Africa	√	√	Reservation
Spain	√	√	√

[22] [2013] NZCA 40.

[23] Information in this and subsequent tables has been taken from 'MLI Database — Matrix of Options and Reservations', *OECD* (Web Page, 1 June 2019) <http://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm>. The limitations and restrictions upon the use of this database is explained in OECD, *Multilateral Instrument: Matching Database* <https://www.oecd.org/tax/treaties/MLI-database-disclaimer-and-manual.pdf>.

Sweden	Reservation	Reservation	Reservation
Switzerland	Reservation	Reservation	√
Turkey	√	√	Reservation
United Arab Emirates	Reservation	Reservation	Reservation
UK	Reservation*	√	√
Total no adopting out of 33 states	14 + 2 partial	14 + 1 partial	17

** Partial reservation entered to MLI art 3(2).*
^ Partial reservation entered to MLI art 4.

While New Zealand has adopted all three articles from the MLI in respect of its covered tax agreements, the above table shows that many other contracting states have entered reservations to them. Thus New Zealand's adoption of arts 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 pt 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, 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 that they may believe are adequate, and they may want to avoid the possible complications or confusion arising from applying the MLI provisions.

B *Part III: Treaty abuse — arts 6–11*

Part III of the MLI deals with treaty abuse. Articles 6 and 7 impose certain minimum standards upon signatory states and offer some limited options as to how states can meet these minimum standards.[24] The remaining articles in pt III (arts 8–11) are optional ones that 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 shareholding threshold being met, along with certain other 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 PEs 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 (that is, no active business income), where that income will receive

[24] See above n 7 and accompanying text.

concessional tax treatment and will be exempt from tax in the residence jurisdiction. Under art 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 per cent 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 tax their residents as they see fit is limited by a carve-out of 10 situations where treaty provisions would still apply.

New Zealand has not entered any reservations in respect to arts 8–11 of the MLI to its covered tax agreements. Table 3 shows whether the other contracting states to New Zealand's covered tax agreements have entered reservations to arts 8–11 of the MLI.

Table 3: Position of New Zealand's contracting states: MLI arts 8–11

	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	√
Papua New Guinea	Reservation	Reservation^^^	Reservation	Reservation
Poland	√	√	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
UK	Reservation	Reservation	Reservation	Reservation

Total no adopting out of 33 states	11 + 4 partial	11 + 6 partial	8 + 1 partial	8 + 2 partial

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

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 be almost 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.

C *Part IV: PE avoidance — arts 11–14*

Avoiding the creation of a PE in a state — to avoid any liability for income tax on profits derived from a business wholly or partly carried on in that state — is a tax avoidance strategy used by a number of MNEs in the electronic commerce area.[25] 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 (and most DTAs) to encompass certain preliminary or preparatory activities that 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 (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 division of activities so that they fall below certain time thresholds, above which a PE would be deemed to be created. Common examples of this are building construction or installation projects that exceed 12 months (sometimes six 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.[26] As part of the enactment of BEPS measures, New Zealand has also incorporated the term 'permanent establishment' into its domestic law from 1 July 2018.[27]

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[25] See Andrew Smith, 'Will BEPS Allow New Zealand to Finally Tax Google?' (Conference Paper, Conference of the Australasian Tax Teachers Association, 17–19 January 2018).
[26] MLI (n 2). For example, in the Australia–New Zealand DTA, a PE arises if a person performs independent services in a contracting state for more than 183 days in any 12-month period (art 5(4)(a)) or activities for the exploration or exploitation of natural resources for more than 90 days (art 5(4)(b)).
[27] Under ITA 2007 s YD 4B(2), where an enterprise resident in a jurisdiction with which New Zealand has concluded a DTA that includes a definition of a PE, the term has the meaning attributed to it in the DTA, or by ITA 2007 s GB 54, if the enterprise meets the requirements of that anti-avoidance provision. Otherwise the term is defined in ITA 2007 sch 23, where a DTA is not applicable.

New Zealand has adopted all three of these articles in respect to the MLI. Table 4 shows whether the other contracting states to New Zealand's covered tax agreements have also agreed to be bound by arts 12–14, or whether they have reserved their positions.

Table 4: Position of New Zealand's contracting states: MLI arts 12–14

	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
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	√	Reservation^
Norway	√	√	Reservation^
Papua New Guinea	√	√	√
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
UK	Reservation	√	√
Total no adopting out of 33 states	12	20 + 1 partial	6 + 5 partial

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

Table 4 indicates that very few of New Zealand's 33 DTAs 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 arts 12 and 13, and has introduced domestic law changes to address this gap.[28]

ITA 2007 s GB 54 is an anti-avoidance provision enacted in 2018, which applies to New Zealand's DTAs (including both covered tax agreements and those not covered) where the treaty does not incorporate art 12(1) of the MLI (or equivalent) and is part of a tax avoidance arrangement. If New Zealand does apply s GB 54 to enterprises resident from those states, it remains to be seen whether a New Zealand court will uphold s GB 54 as overriding the existing provisions in those states' DTAs with New Zealand. Furthermore, it is possible that these states will dispute the New Zealand application of s GB 54 on grounds that the taxpayer's arrangements do not constitute tax avoidance involving unintended abuse of DTAs.

The large number of reservations to art 14 possibly reflects that most of New Zealand's covered tax agreements already contain provisions dealing with artificial splitting of contracts to avoid PE creation. The other contracting states may well believe that these existing provisions are adequate and may not want the additional complexity of the MLI overlying them.

D *Part VI: Arbitration — arts 18–26*

New Zealand has adopted the arbitration option in pt 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.[29] 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 [the mutual agreement procedure]'.[30]

Table 5 shows the position on art 18 of the contracting states to New Zealand's covered tax agreements.

Table 5: Position of New Zealand's contracting states: MLI art 18

	Article 18		**Article 18**
New Zealand	√	Japan	Reservation
Australia	Reservation	Korea	√
Austria	Reservation	Malaysia	√
Belgium	Reservation	Mexico	√
Canada	Reservation	Netherlands	Reservation
Chile	√	Norway	√
China (People's Rep)	√	Papua New Guinea	√

[28] See above n 27 and accompanying text.
[29] *Double Tax Agreement*, Australia–New Zealand (2009) art 25(6) and (7); *Double Tax Agreement*, Japan–New Zealand (2012) art 26(5).
[30] See Peters (n 20) para 39.

Czech Republic	√	Poland	√
Denmark	√	Russia	√
Finland	Reservation	Singapore	Reservation
France	Reservation	South Africa	√
Germany	Reservation	Spain	Reservation
Hong Kong	√	Sweden	Reservation
India	√	Switzerland	Reservation
Indonesia	√	Turkey	√
Ireland	Reservation	United Arab Emirates	√
Italy	Reservation	UK	Reservation
		Total no adopting out of 33 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.

VI Analysis of Results

One very clear trend, apparent from Tables 2–5, 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 the MLI by not entering any significant reservations will be limited.

A number of New Zealand's DTA partners have entered into reservations to all the optional provisions to the MLI. The backgrounds of these states are quite varied. Three such states are Hong Kong, Singapore and the United Arab Emirates. These three states are low-tax jurisdictions, which are likely to have economically benefitted from the existing BEPS strategies adopted by many MNEs, and might understandably be reluctant to agree to measures that could 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 as 'partial' tax havens, as they have traditionally offered concessional taxing regimes to attract foreign mobile capital.

China is another state that has entered reservations to most (but not all) of the optional parts of the MLI, although it is not a tax haven. Li, in her analysis of the impact of the MLI in China,[31] does not specifically discuss the relatively large number of reservations China has entered to the MLI, but does note that China is not an OECD state and that the OECD Model (including commentaries)[32] has never been an official interpretive reference in China.[33] She further notes that the OECD commentaries have largely been drafted by a small group of OECD countries where China has no voting power and thus no obligation to follow.[34]

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

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[31] Na Li, 'The Impact of the Multilateral Instrument in China' (2018) 24(6) *Asia-Pacific Tax Bulletin*.
[32] See OECD, *Model Tax Convention on Income and on Capital* (n 3).
[33] Li (n 32) s 3.
[34] Ibid.

parts of the MLI. These include Austria, Canada, Czech Republic, Finland, Korea, Sweden and Switzerland, among others. These states are not low-tax jurisdictions 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 whole MLI, plus the lack of flexibility that would arise from its complete adoption, as they would have to apply it 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 as tipping the balance between source/resident states more towards source states, therefore undermining revenues gained by residence states. On the opposite side, Oguttu notes that the selective adoption of MLI parts could disadvantage developing countries,[35] as the MLI allows developed countries to 'cherry-pick' the parts that favour them, but create more gaps and mismatches between the tax rules of different countries.[36]

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, designed 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 a number of international commentators. Kleist discusses at length the resulting complexity and legal uncertainty from the application of the MLI.[37] Kleist also refers to issue of reservations being entered and the resulting effect that many covered tax agreements will not be modified by the MLI.[38] Oguttu, in analysing the interests of developing countries in the MLI, refers to the complexity and uncertainty that the MLI creates.[39] Antón discusses the problems arising from the reservations entered to the MLI, especially the partial reservations.[40] Avi-Yonah and Xu, while being more positive about the MLI than each of Kleist and Antón, conclude in their analysis of the MLI that

> [w]hether 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 set of provisions. On the other hand, the MLI may prove more appealing to developing countries because it enhances source-based taxation and limits treaty shopping.[41]

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[35] Annet W Oguttu, *Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty-Related Base Erosion and Profit Shifting Measures?* (Policy Paper, Center for Global Development, November 2018).
[36] Ibid 13.
[37] D Kleist, 'The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS — Some Thought on Complexity and Uncertainty' (2018) 1 *Nordic Tax Journal* 31, 41–2 and 44–7.
[38] Ibid 42–4.
[39] See Oguttu (n 36) 13–15.
[40] R García Antón, 'Untangling the Role of Reservations in the OECD Multilateral Instrument: The OECD Legal Hybrids' (August 2017) 71(10) *Bulletin for International Taxation*.
[41] Reuven S Avi-Yonah and Haiyan Xu, 'A Global Treaty Override? The New OECD Multilateral Tax Instrument and Its Limits' (2018) 39(2) *Michigan Journal of International Law* 155, 216.

If states have entered reservations to all of the optional parts of the MLI, it may well be because of these concerns over complexity, uncertainty and ambiguity, rather than ambivalence about the BEPS problem. New Zealand may be naïve in its adoption of the MLI without entering reservations, and is yet to encounter the problems that other states fear and are concerned about. This is perhaps compounded by the New Zealand Inland Revenue Department's reluctance to produce synthesised versions of its covered tax agreements modified by the MLI, despite other states already doing so, such as Australia. It may well be that, down the road, New Zealand will face more disputes about the application of its covered tax agreements, which might eventually be resolved when it renegotiates its existing DTAs and replaces them with updated ones that incorporate the new BEPS provisions. In this respect, the problems that might arise for New Zealand adopting the MLI so thoroughly may be temporary until its covered tax agreements are renegotiated with ones incorporating the BEPS provisions.

VII Conclusion

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 pt 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 can be difficult to get DTA partners to schedule negotiations when they have more important DTAs to negotiate.

Unfortunately for New Zealand, many of its key DTA partners have either not signed the MLI (for example, the US) or have entered into a large number of reservations in respect of the optional parts of the MLI. Thus, fewer 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 taken the additional step of enacting domestic law changes (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 MLI will substantially apply, considerable complexity will arise. For those DTAs that are either not covered tax agreements or ones where the other contracting state has entered significant numbers of reservations to the optional parts of the MLI, there is the uncertainty as to 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 33 existing DTAs.

In the longer term, it would be desirable if all of New Zealand's DTAs were renegotiated to incorporate the latest version of the OECD Model to deal with BEPS, and thus would no longer need to be classified as covered tax agreements. In this way the MLI, over several decades, would be of diminished relevance, and greater certainty and clarity would be regained with updated and revised DTAs using the latest versions of the OECD Model.

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