

Nathalie Bravo

A Multilateral Instrument for Updating the Tax Treaty Network

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52

A Multilateral Instrument for Updating the Tax Treaty Network

Why this book?

The Multilateral Instrument is changing the landscape of international tax law. It is modifying over 1,200 tax treaties with a view to coordinating the implementation of international tax rules to avoid base erosion and profit shifting (BEPS) and reducing the negative effects of harmful tax competition among states. Signatory countries can incorporate the rules from the OECD BEPS Project into their tax treaty network. These rules encompass hybrid mismatch arrangements, the abuse of treaties and the artificial avoidance of permanent establishment status and rules for improving dispute resolution mechanisms, including mandatory binding arbitration.

A Multilateral Instrument for Updating the Tax Treaty Network provides a systematic analysis of the Multilateral Instrument from a public international law and tax perspective. You'll learn how the Multilateral Instrument works, how it impacts tax treaties and the extent to which parties and signatories have committed to implementing the uniform tax treaty-related BEPS measures through this instrument.

You'll find this book to be a valuable resource, whether you're an academic, tax professional, international organization official, government official or tax judge.

Highlights:

- Gain a full-frame picture of the Multilateral Instrument through this detailed legal analysis
- Be guided through the key elements of the Multilateral Instrument from concept to interaction with other tax agreements and from the flexibility of the instrument to potential future changes

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Preface

Coming from Venezuela, a country that was a member of the Andean Community of Nations from 1971 to 2006, and that afterwards decided to withdraw from this group to join the Mercosur as of 2012, I was always interested in the integration process of nations. Noticing that the Andean Community has a treaty to avoid double taxation, but Mercosur does not, I became interested in multilateralism in international taxation. My interest in this topic increased even more after learning about European tax law and, especially, after the OECD published its deliverable on BEPS Action 15 in September 2014. From the moment I started my research on a multilateral instrument to update the tax treaty network, I realized that there was a significant lack of fundamental research into many important questions. This book is the result of my research lasting almost four years into this topic.

When I began my PhD, I could not imagine that this would turn into a journey that would take me to the most diverse countries and provide me with the most culturally enriching experience I have had thus far. Contrary to all expectations, it did just that: I had the opportunity to participate in congresses, conferences, summer schools as well as conduct internships in Europe, Asia and the Americas. Moreover, I met many dear colleagues coming from different countries whom today I consider my friends.

I would like to express my gratitude to Prof. Michael Lang and Prof. Alexander Rust for welcoming me at the Institute for Austrian and International Tax Law and supervising my PhD thesis.

I owe many thanks to Prof. Jeffrey Owens, Prof. Pasquale Pistone and Scott Wilkie for their support while I was writing my PhD thesis and for believing at all stages that my work was not only original but also enriching.

During my PhD, I had the opportunity to conduct two very constructive internships, one at the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development (OECD) and one at the United Nations Department of Economic and Social Affairs. While at the first I learnt about the design and functioning of the Multilateral Instrument, at the second I learnt about the needs and interests of developing countries. I would like to thank Jesse Eggert and Michael Lennard for trusting me with these opportunities.

I do not have enough words to thank Kasper Dziurdz for the time he invested in discussing and helping me to test new ideas, for reading my thesis and supporting me in all possible ways.

I would also like to thank the collegiate of the Doctoral Program in International Business Taxation (DIBT) and members of the DIBT faculty that read and discussed parts of my PhD thesis. The DIBT research seminars are amongst the most constructive and inspiring fora for presenting new ideas and I very much enjoyed being part of them every time.

I will be eternally grateful to my parents, Felix and Magaly, for teaching me resilience, showing me by example how to look on the bright side of things, and inspiring me to be the best person I can possibly be.

Finally, I would like to thank all the team of IBFD involved in the publication of my thesis for their support. Likewise, I would like to thank the Austrian Academy of Sciences for granting me a DOC Fellowship to conduct my research for 2 years.

This study was completed in April 2018, officially accepted as a PhD thesis in January 2019, and updated thereafter. It was written at the Institute for Austrian and International Tax Law of the Vienna University of Economics and Business (WU Vienna) while receiving a DOC Fellowship from the Austrian Academy of Sciences.

Vienna,
September 2019

Introduction

Aim of the book and research methodology

The strong desire and willingness of states to counter base erosion and profit shifting (BEPS) practices has manifested in the form of an initiative already suggested in the 1930s but until now not achieved: concluding a worldwide multilateral tax treaty. Designed to modify tax treaties, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (hereinafter the Multilateral Instrument)¹ is the first worldwide multilateral tax treaty and, as such, it may end up reshaping the tax treaty network.

To receive support from states with different tax policies and economic interests, the Multilateral Instrument uses unconventional techniques. It modifies numerous tax treaties without replacing them. Additionally, it provides parties with a high level of flexibility allowing them to shape their commitments differently. Even though simultaneously applying treaties dealing with the same subject matter or using mechanisms to provide parties with flexibility is not new in treaty practice, it is new for tax treaties. The tax treaty network comprises more than 3,000 bilateral tax treaties and a small number of regional multilateral tax treaties. The tax treaty network has grown mainly on a bilateral basis to allow states to adapt treaty provisions to their tax policies and mutual economic interests. Moreover, the techniques used by the treaty makers of the Multilateral Instrument have not been used before to modify such an extensive treaty network and to implement such complex and comprehensive changes as those introduced through the Multilateral Instrument. All this raises uncertainty about how the Multilateral Instrument works and how it modifies tax treaties.

This book aims at being an in-depth and comprehensive legal analysis of the Multilateral Instrument and to provide the reader with a full-frame picture of the Multilateral Instrument. For this purpose, it examines the foundations of the Multilateral Instrument and, after assessing precedents and literature in public international law and international tax law, it answers the research question how the Multilateral Instrument impacts the tax treaty network. The analysis contained in this book considers the options available to the treaty makers in designing the Multilateral Instrument, the treaty changes that can be implemented through the Instrument to counter BEPS practices

1. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (7 June 2017), Treaties & Models IBFD.

and the positions notified to the depositary by the parties and signatories of the Instrument as at 26 November 2019. In this sense, compatibility clauses, notification clauses, opting-in mechanisms, alternative provisions and opting-out mechanisms in the form of reservations used in the Multilateral Instrument are systematically scrutinized. Finally, the possibility to produce subsequent modifications and amendments to the Multilateral Instrument are also explored, as future changes to tax treaties may be produced by further modifying the Instrument.

The purpose of this research, however, goes beyond simply understanding how the tax treaty-related BEPS measures may be implemented through the Multilateral Instrument. In fact, it analyses whether through the Multilateral Instrument parties have committed themselves to coordinate the tax treaty network in such a way as to achieve the collective goal of eliminating BEPS practices. Previous attempts at coordination of the tax treaty network through multilateral initiatives has often been seen as nothing but wishful thinking. The Multilateral Instrument, however, seems to have changed this tendency.

The following research questions will subsequently be addressed in this book:

- Why do states prefer concluding bilateral tax treaties over a worldwide multilateral tax treaty? Why have worldwide multilateral initiatives always failed in international tax law before? Why, in spite of this, has the Multilateral Instrument been a fairly successful experience until now? (*See* chapter 1.)
- How should the Multilateral Instrument and the Covered Tax Agreements be applied? What is the nature of the provisions of the Multilateral Instrument? What is the nature of the Multilateral Instrument itself? What implications does the nature of the Multilateral Instrument have for the implementation of the tax treaty-related BEPS measures across the tax treaty network? (*See* chapter 2.)
- How do the provisions of the Multilateral Instrument interact with the provisions of existing tax treaties and how can potential conflicts between the provisions of these treaties be resolved? (*See* chapter 3.)
- Why was it important to provide for a high level of flexibility in the Multilateral Instrument? How is this high level of flexibility reflected in the Multilateral Instrument? (*See* chapter 4.)

- How can parties to the Multilateral Instrument further modify their tax treaty relations? Can parties through future changes contract out from the goal of eliminating BEPS? What are the implications derived from a withdrawal from the Multilateral Instrument or the termination of a Covered Tax Agreement? (*See* chapter 5.)

When appropriate, two other questions relevant for the understanding and interpretation of the Multilateral Instrument are answered:

- Does the Multilateral Instrument deviate from the Vienna Convention and treaty practice?
- In such a case, what consequences and/or implications do the deviations have for the interpretation and application of the Multilateral Instrument?

Finally, the book analyses whether a systematic application of the Multilateral Instrument is possible.

Although not all of the parties to the Multilateral Instrument may also be parties to the Vienna Convention on the Law of Treaties (hereinafter the Vienna Convention),² the research analyses the Instrument from the perspective of the Vienna Convention. Four reasons explain why the Vienna Convention has been used as a basis for this analysis of the Multilateral Instrument. First, many provisions of the Vienna Convention codify customary international law. Second, where the provisions of the Vienna Convention do not codify customary international law, the Vienna Convention sets out concepts and rules that are commonly followed when treaties are drafted. Third, as the legal community is familiar with the concepts and rules set out in the Vienna Convention, departing from the Vienna Convention makes it easier to explain how the Multilateral Instrument works. Fourth, for the parties to the Vienna Convention, its rules have a residual character. As a consequence, if the Multilateral Instrument does not contract out from the Vienna Convention or does not deal with a particular matter, the Vienna Convention may apply. If the Multilateral Instrument deviates from the Vienna Convention, the research analyses the differences between the

2. *Vienna Convention on the Law of Treaties* (22 May 1969), *Treaties & Models IBFD*. From the parties and signatories of the Multilateral Instrument, at least the following ones have not ratified the Vienna Convention: Belize, Curaçao, Fiji, France, Iceland, India, Indonesia, Israel, the Ivory Coast, Kenya, Monaco, Norway, Pakistan, Papua New Guinea, Qatar, Romania, San Marino, Seychelles, Singapore, South Africa, Turkey and the United Arab Emirates.

provisions of both international agreements and explains the consequences and implications of the deviations adopted by the treaty makers for the application and interpretation of the Multilateral Instrument.

Moreover, the book has recourse to articles 31 and 32 of the Vienna Convention for the interpretation of the provisions of the Multilateral Instrument. Both articles of the Vienna Convention codify pre-existing customary international law.³ Thus, it is generally accepted that the interpretative rules of the Vienna Convention also apply to treaties of states that have not ratified such a convention. Article 31 of the Vienna Convention establishes the general rule of interpretation of treaties. According to this article, treaties must be interpreted in good faith and give to terms their ordinary meaning, unless parties have given a special meaning to some of the terms. Likewise, article 31 of the Vienna Convention establishes that the context and the object and purpose of a treaty must be taken into account for treaty interpretation. Article 32 of the Vienna Convention allows the use of supplementary means of interpretation for the interpretation of treaties (e.g. the preparatory work of the treaty and the circumstances of its conclusion) if the supplementary materials confirm the results of an interpretation made in accordance with article 31 of the Vienna Convention or if they help to determine the meaning when an interpretation made in accordance with article 31 leaves it ambiguous or leads to a manifestly absurd or unreasonable result. Thus, the interpretation of the provisions of the Multilateral Instrument is based not only on the text of the Instrument (grammatical interpretation) but also on its context (systematic interpretation), its object and purpose (teleological interpretation) and its supplementary means of interpretation (historical interpretation).

The book reviews an extensive number of multilateral treaties and literature in public international law with the purpose of further understanding how the rules of the Vienna Convention work and how they have been generally implemented in practice. An in-depth understanding of multilateral treaties, whether they follow or deviate from the rules of the Vienna Convention, was useful to evaluate the Multilateral Instrument. The comparison of the Multilateral Instrument with other multilateral treaties permitted reaching conclusions on whether the Multilateral Instrument deviates from the Vienna Convention and common treaty practice as well as understanding the potential reasons for such deviations, and the consequences and implications of such deviations.

3. A. Aust, *Modern Treaty Law and Practice* p. 232 (2nd ed., Cambridge University Press 2007).

Structure of the book

The book consists of five chapters and of conclusions. The order of the different chapters of the book is relevant, as each of them builds on the conclusions previously presented. The book starts with the presentation of the background of the Multilateral Instrument (chapter 1). Subsequently, it focuses on the nature of the Multilateral Instrument (chapter 2) and all of the elements relevant for its application (chapters 3 and 4). It finishes with an analysis of the forms in which the Multilateral Instrument may be modified, amended or terminated by one or more parties (chapter 5). As explained in more detail below, each chapter answers a number of research questions. All of these research questions need to be answered to understand how the Multilateral Instrument works, how it impacts the tax treaty network and whether, through the Multilateral Instrument, parties have committed themselves to coordinate the tax treaty network to achieve the collective goal of eliminating BEPS practices.

The first chapter answers why previous worldwide multilateral initiatives have always failed in international tax law but the Multilateral Instrument has proved fairly successful until now, with more than 90 states and non-state jurisdictions concluding it. For this purpose, the first chapter explores the sovereignty of the states and their legal capacity to conclude tax treaties. It also includes a historical review of the tax treaty network. This explains why states prefer concluding bilateral tax treaties based on model conventions instead of adopting a worldwide multilateral tax treaty. The chapter then moves on to review regional multilateral tax treaties. The review shows the advantages and disadvantages of multilateral tax treaties over bilateral tax treaties. The provisions of the Vienna Convention on the amendment of treaties and previous proposals of tax scholars for amending tax treaties in a multilateral framework are also studied in this chapter. The first chapter finalizes with an introduction to the OECD/G20 BEPS Project and the proposal of developing a multilateral convention to modify bilateral tax treaties contained in the BEPS Action 15 Final Report.⁴

The second chapter analyses how the Multilateral Instrument applies, as well as the legal nature of its provisions and of the Instrument itself. Furthermore, the implications that the nature of the Multilateral Instrument might produce in the implementation of the tax treaty-related BEPS measures across the tax treaty network is scrutinized. Thus, this chapter reviews the concept of the Multilateral Instrument and how it builds on the current

4. OECD/G20, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15: 2015 Final Report* (OECD 2015), Primary Sources IBFD.

tax treaty network. The Multilateral Instrument modifies tax treaties without replacing them. For this reason, determining which tax treaties may be modified through the Multilateral Instrument is essential. The treaty makers of the Multilateral Instrument have used the term “Covered Tax Agreement” to refer to the tax treaties that will be under the scope of the Instrument. The definition of “Covered Tax Agreement” is, thus, subsequently explored. Then, the nature of the provisions of the Multilateral Instrument is analysed. Additionally, considering the features of the Multilateral Instrument, the nature of the Instrument itself is discussed. The nature of the Multilateral Instrument is reflected in several of the measures implemented by the treaty makers. Finally, this chapter discusses the structure of the Multilateral Instrument and the structure of its substantive provisions.

The third chapter discusses the relationship between the provisions of the Multilateral Instrument and the provisions of the Covered Tax Agreements. It answers the questions on how the provisions of the Multilateral Instrument interact with the provisions of the Covered Tax Agreements and how potential conflicts between the provisions of the Multilateral Instrument and the provisions of the Covered Tax Agreements can be resolved. For this purpose, the third chapter starts by discussing when the provisions of treaties dealing with the same subject matter accumulate and when the provisions of treaties dealing with the same subject matter conflict. As conflicts of treaty provisions may be common in cases of treaties dealing with the same subject matter, it is explored how these conflicts may be resolved. To resolve conflicts of treaty provisions, a third provision (different to the ones that conflict) or a principle of interpretation is needed. The third provision may be a compatibility clause provided in one of the conflicting treaties, the *lex posterior* principle or the *lex specialis* principle. After setting this theoretical background, the third chapter illustrates with examples that the provisions of the Multilateral Instrument and the Covered Tax Agreements may accumulate or conflict. Subsequently, it discusses the use of compatibility clauses and notification clauses in the Multilateral Instrument to resolve conflicts between its provisions and the provisions of the Covered Tax Agreements. The third chapter ends by examining the potential use of the *lex specialis* principle for resolving conflicts between the provisions of the Multilateral Instrument and the provisions of the Covered Tax Agreements. It also introduces the potential effects from the non-inclusion of an obedience clause in the Multilateral Instrument.

The fourth chapter deals with the mechanisms to create flexibility in the Multilateral Instrument. It thus explains the reasons for providing for a high level of flexibility in the Multilateral Instrument and analyses in depth the

different mechanisms implemented by the treaty makers of the Multilateral Instrument to provide flexibility as well as how each of these mechanisms work. As the Multilateral Instrument looks for universal participation to eliminate BEPS practices, it was necessary to provide a high level of flexibility to the parties so that states could join despite their different tax policies and economic interests. The fourth chapter includes an in-depth analysis of the opting-in mechanisms, alternative provisions and opting-out mechanisms in the form of reservations provided in the Multilateral Instrument. Attention is particularly paid to reservations since each of the substantive provisions of the Multilateral Instrument provides for a list of permitted reservations. Thus, it is the most used mechanism to create flexibility in the Multilateral Instrument. Moreover, the Multilateral Instrument provides for very detailed rules on reservations. Finally, the fourth chapter discusses how the different mechanisms used in the Multilateral Instrument to create flexibility interact with the compatibility clauses and the notification clauses.

The fifth chapter explores how changes to the Multilateral Instrument and to the Covered Tax Agreements may be put into place. For this purpose, this chapter studies the forms in which parties to the Multilateral Instrument can further modify their tax treaty relations, whether parties through future changes can contract out from the collective goal of eliminating BEPS practices, and the effects derived from a withdrawal from the Multilateral Instrument or the termination of a Covered Tax Agreement. Once the Multilateral Instrument modifies the Covered Tax Agreements, parties may produce subsequent modifications to both types of international agreements. The changes may be produced through the withdrawal or replacement of reservations made to the provisions of the Multilateral Instrument, through subsequent modifications to the Covered Tax Agreements and through amendments of the Multilateral Instrument. Therefore, all of these mechanisms are analysed in depth. Moreover, in this chapter, it is discussed whether parties to the Multilateral Instrument may withdraw objections and opting-ins, and withdraw or replace alternative provisions, matters that have not been dealt with in the Instrument itself or in its Explanatory Statement. The fifth chapter concludes with the review of the potential effects of the withdrawal of a party from the Multilateral Instrument, the termination of the Multilateral Instrument and the termination of a Covered Tax Agreement. Thus, this chapter goes deeper into the interaction between the Multilateral Instrument and the Covered Tax Agreements.

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