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THE OECD MULTILATERAL INSTRUMENT: NEW MOMENTUM IN THE INTERNATIONAL TAX LAW AND ITS IMPACT ON THE MACEDONIAN TAX LAW

Abstract

In the last decade, the international tax landscape, characterized by the interaction of more than 200 tax systems, limitation of countries` tax sovereign only in the national borders and difference in tax rules interpretation, has created numerous possibilities for taxpayers to maximize their income, capital and/or profit and minimize the tax they paid. These opportunities are much more available for large multinational companies that have a network of branches and subsidies worldwide. As a result of base erosion and profit shifting schemes, the outcome is a violation of the principle of taxation, problems in the functioning of tax systems and, at last but not at least, enormous loss of potential tax revenues. Countries and international organizations have recognized the importance of the problem and engaged in establishing standards to prevent tax evasion and tax avoidance. The BEPS Package is a symbol of these efforts, while the Multilateral Instruments, as Action 15 of this BEPS Inclusive Framework, only strengthens the countries` determination to combat tax evasion and tax avoidance by preventing abuse of bilateral tax treaties on elimination of double taxation on income and capital and introducing minimum standards. Surely, the Multilateral Instrument has changed the perspectives of the international tax law giving the countries a chance to amend their bilateral tax treaties without renegotiations which require time, finances and experts. The Republic of North Macedonia signed the MLI in January 2020 and the next step is its ratification. Although our country has a lot to do in the area of corporate taxation, signing MLI only confirms Macedonian endeavour to provide its assistance and to participate in the world`s fight against tax evasion and tax avoidance.

Keywords: *international taxation, aggressive tax planning, base erosion and profit shifting, MLI, bilateral tax treaties*

I. INTRODUCTION

International tax law and international tax rules and laws are a completely new paradigm. Their introduction and implementation have historical significance since national taxes and tax

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principles have been strongly connected to the countries for a long period of time. However, the intensive process of economic globalization has revealed the need to establish international tax rules. As a consequence of the internationalism of the economy, communications and technological development, new opportunities for earning income, capital and profit have been created. The key question that has arisen in this new tax landscape is whether the national tax systems have the power to cope with the rapid process of internationalization at every level? In the battle for economic growth, increased tax revenues and a better tax environment for doing business, countries are rapidly opening themselves for attracting new foreign taxpayer, primarily multinational companies. As a result, the process of globalization has caused erosion of the national tax systems. Multinational companies as global "players" and international investors are using market liberalization, deregulation, tax loopholes, and even tax haven to minimize their tax obligations. This surely leads to a situation where economically powerful entities are paying less and lower taxes, while tax liabilities of taxpayers with medium and lower-income are increasing. Such circumstances generate constant structural crisis in public finances, violation of key principles of taxation and improper income redistribution "from bottom to top". Moreover, there is an urgent need to tackle this crisis, given the fact that tax conflicts between countries that arise because profitable activities are undertaken beyond national borders are becoming more common and a great reality.

It seems to be an unsolvable problem, largely due to the lack of a supranational body that would be responsible for regulating and creating cohesive tax rules. Of course, the need for such a body is enormous, but its establishment seems utopian. However, no one can deny the fact that worldwide efforts are made to deal with such complex tax situations. Although we cannot discuss the presence of "international taxes", the reality is that, nowadays, countries are implementing similar tax rules introduced by bilateral and multilateral agreements. In principle, bilateral tax treaties and multilateral conventions are aimed to prevent and/or reduce the possibility of double taxation, double non-taxation, tax evasion and tax avoidance. These agreements are accepted worldwide as a "safe zone" because, by signing these types of treaties, countries do not lose their tax sovereignty, just sacrifice part of their tax powers, for a greater cause.

As a result of all these factors and the inevitable internationalization, in November 2016, more than 100 legislatures completed the negotiations on the new instrument within the OECD Model Tax Convention on Income and Capital called *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (hereinafter: MLI). The main goal of the MLI is to implement a series of measures to avoid international double taxation, which would supplement and renew existing tax rules, as well as reduce the possibility of tax evasion and tax avoidance by multinational corporations. MLI already covers 94 legislations and entered into force on July 1st 2018. Signatories come from different continents, including either developed and developing countries. Also, a number of countries have expressed interest in signing this Convention as soon as possible, and some of them are already working on it.

The importance of the MLI, its basic principles and requirements and the method of implementation are just some of the topics that will be analyzed in this paper. Given the fact that this is a completely new instrument in the area of international taxation, still anonymous for many, but with enormous value, it is necessary to give a proper evaluation of its key elements. What changes will the MLI impose for the signatory countries, including the Republic of North Macedonia, but also for those who will decide not to take that step? Will the MLI finally succeed to decrease the chances of double taxation, double non-taxation, tax evasion and tax avoidance to a minimum? Time will show.

II. NEW PROBLEMS IN THE AREA OF INTERNATIONAL TAX LAW

International tax law`s problems have existed since the beginning of international transactions. In the period between 2015 and 2016, many multinational corporations (mostly Americans) have engaged in tax disputes with the European Commission. From a historical point of view, these disputes are not overrated because they have resulted in enormous amounts of tax penalties. The most famous one is the Apple case for 13 billion Euros of nonpaid corporate taxes (Barker et al, 2016). Increased global technological development certainly causes new problems in the tax law – as new types of transactions appear (as electronic transactions) that raise the question which country has the right to tax the income, capital and/or profit earned worldwide. However, there is one fundamental problem in the area of international tax law - the lack of consensus on how the tax base of the world economy should be distributed among the approximately 200 tax jurisdictions. Currently, every country independently makes an effort to reach a proper solution for this difficulty, mainly by signing double tax treaties, multilateral conventions or introducing unilateral methods in domestic tax laws to prevent double (non) taxation on income and capital. Although there is evident progress in solving problems of international double taxation and double non-taxation, the expansion of multinational enterprises through establishing subsidiaries and branches all around the world has created new modern problems of international tax law (Lebovitz et al., 2001). These problems are often resulting in manipulation and abuse of tax systems in order to minimize costs and increase profit. Therefore, governments and international organizations are determinate to combat taxpayers` activities that erode national tax systems, such as aggressive tax planning, tax avoidance, transfer pricing, thin capitalization and base erosion and profit shifting.

Aggressive tax planning is most closely linked to multinational companies. It is not a secret that multinational companies endeavour to reduce the tax burden in every possible way, and surely they have a better chance than other taxpayers. The term “aggressive tax planning” refers to the abuse of tax systems or the exploitation of differences between two or more tax jurisdictions. According to the European Commission (2012), aggressive tax planning can be described as excessive efforts of multinational companies to reduce the taxes they have to pay. For the countries, aggressive tax planning implies less tax revenues in the budget and leads to unfair treatment of taxpayers, reduced level of tax ethics and creates distortion between companies. Interestingly, aggressive tax planning is seen differently in the United States and Europe and the United Kingdom. In the United States, the term “aggressive” has no significant negative connotation. Only if the activities are offensive and abusive and the reputation of the authorities involved is violated, then such actions are treated more severely. Different to the American position, in Europe and the United Kingdom, the term “aggressive” has a completely negative implication. Although not formally illegal, “aggressive tax planning” is seen more as an activity contrary to the law.

Tax avoidance is another problem that affects the regulation of international tax relations. It usually means leaving the resident country and moving to other countries with more convenient tax environment. Tax avoidance could cause double non-taxation, i.e. due to different tax rules the taxpayer might not fulfil his tax obligation in any of the involved countries.

Transfer pricing is also an important issue in the international tax law since multinational companies use this method of profit allocation (earnings without interest and taxes) between multiple subsidiaries within the parent company. This type of action abuses the various tax regimes, as parent companies allocate huge revenues to countries with low tax rates or with no taxes.

Thin capitalization is directly related to the way companies finance themselves. In a situation where the company obtains its financial assets mostly from borrowing, it is a matter of thin capitalization. The way companies finance themselves has a huge impact on the total revenue they report for tax purposes. A higher level of borrowing and higher-paid interest imply lower tax base. For these reasons, companies often decide to borrow despite to increase their shares (OECD, 2012). As a result, countries include provisions in tax laws that set a limit on the amount of interest that can be deducted when calculating a company's income for tax purposes. These types of provisions are used to intercept the cross-border "relocation" of income or overdue debt, thus protecting the budget revenues.

And finally, there is the problem of base erosion and profit shifting (hereinafter: BEPS). It mainly refers to the practice of multinational companies to avoid paying taxes by reducing the tax base in different ways (for example, paying high-interest rates to reduce the amount of profit for taxation), or by transferring taxable income, capital and profit from countries with high tax rates to countries with lower taxes rates or to "tax havens".

III. THE OECD MULTILATERAL INSTRUMENT AGAINST INTERNATIONAL TAX EVASION

i. Birth of the MLI

In order to give an appropriate response to the new challenges in the international taxation, the first initiative came from OECD, on February 12, 2013, when a report that examined the size of the problem of tax erosion and changes in profit and the global trends in the field of profit and capital tax within multinational companies was first published. Following this initiative, the so-called "BEPS Project" was introduced by the OECD on July 19, 2013. This Project contains guidelines that directly address the weaknesses of the applicable international tax principles. As the project progressed, the non-OECD member states and representatives from developing countries also joined the discussions on the BEPS impact. The Final Reports on all 15 Actions taken in the BEPS were printed in October 2015 on more than 1,600 pages.

Since 2015 a number of initiatives have been launched to address and combat the BEPS problem. As a result, new policies have been created on the world tax scene that is currently being implemented in every single country. It is important to note that BEPS rarely refers to the way multinational companies operate, but rather to the solution of this problem by international organizations such as OECD and EU (Hines, 2014).

This BEPS package, in the form of Explanatory Statement for all 15 Actions, provides the countries with instruments and minimum standards that will ensure that generated revenues are taxed in the country where economic activities are performed. At the same time, the Package guarantees greater protection of the businesses by reducing possible disputes over the applied international tax rules, and by assuring certain standards of compliance. The final version of the BEPS Package also included deadlines for implementation of the Actions it contains.

Action 15 of the BEPS Plan referred to an analysis of the possible development of a multilateral instrument that, in the words of the creators, "will enable the countries to introduce measures aimed at dealing with BEPS problem and to change the bilateral treaties for the elimination of double taxation on income and capital and fight against tax evasion." The report on Action 15 was developed with the assistance of a group of experts in the field of international public law and international tax law. Additionally, in February 2015, an ad hoc group for the development of a multilateral agreement that would modify the current bilateral agreements on the prevention of double taxation was established. Negotiations in the group mostly focused on how the Convention would have to change the conditions, i.e. the standards of bilateral agreements and multilateral conventions, in order to implement the measures against BEPS problem. The deadline for completion of all actions of this group was 31.12.2016.

A Report for Action 15, entitled "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties" concludes that such a multilateral instrument will provide an innovative approach by which countries can modify their bilateral tax treaties with additionally developed measures quickly and with no difficulties (OECD, 2016). In order to prevent BEPS, it was desirable that negotiations on such an instrument would be carried as fast as possible. Action 15 also includes the development of a Commentary on the Convention in order to facilitate the understanding of the Convention and its interpretation.

The text of the Convention and its Commentary was voted and accepted on November 24, 2016. The grand ceremony for joining the Convention was held on June 7, 2017, in Paris, where representatives of 68 countries signed the Convention. Signing MLI only indicates the obligation and commitment to implement, but not to ratify the instrument. According to the rules, the Multilateral Instrument enters into force 3 months after being signed and ratified by 5 jurisdictions.

The Multilateral Convention, also known as the Multilateral Instrument, is aimed to establish standards that detect and regulate omissions in tax rules, laws and agreements that allow the transfer of taxpayers` income to countries with low corporate tax rates or countries considered as "tax havens". MLI covers more than just preventing the misuse of bilateral tax treaties. This instrument also addresses the effectiveness of the resolution of tax disputes among countries, regulates the status of the permanent establishments and neutralizes the effects of so-called hybrid mismatch arrangements.

ii. Legal Analysis of the MLI

The MLI is characterized by universality, but also flexibility. The idea of creating an MLI is based on universality because the ultimate goal of the creators was to make this instrument applicable to as many bilateral tax treaties as possible, regardless of the economic situation of the signatory countries. Accepting the instrument shows a new global awareness of the differences that exist between countries and their tax systems. The MLI will help the countries to reduce the barriers and approach the same goal - preventing excessive taxation of taxpayers but also preventing tax evasion and tax avoidance due to differences in the national tax legislation. The universality of the instrument does not mean that all signatory countries will regulate bilateral tax relations in the same way. The purpose of MLI as an instrument is to apply according to the needs, tax goals and economic policy of the signatory countries.

This flexibility of MLI allows the instrument to be applicable in different tax systems and different tax policies, but to maintain the basic postulates and objectives of the measures provided by the BEPS Project. Certain tax legislation may choose different alternatives to apply the MLI, i.e. to accept or reject the application of various provisions that are part of the Convention (for example, to decide not to apply an article). However, this does not mean that

countries have the opportunity to decide which MLI provisions and rules will apply to each bilateral tax treaties. On the contrary, the acceptance of MLI means that the countries will determinate a framework that will include all so-called “Covered Tax Agreements” and all the provisions and measures that the specific state has chosen from the alternatives. Therefore, the conditions under which countries will sign the MLI and the provisions of the Convention which will be accepted as applicable shall apply to all listed bilateral tax treaties and they must be reported to the OECD within the MLI position.
The MLI instrument also marked transparency. OECD published MLI's text, along with the Commentary on the official website, in order to make it available to the public. In this way, individuals and legal entities are informed with the current situation, the effects and objectives of MLI, mostly due to the fact that they are directly affected by its application. All the news, changes and updates to the instrument, the signatory states, the method of implementation and the scope of the instrument are also available on the OECD website.
It is important to emphasize that in terms of its effectiveness, the MLI is an alternative to renegotiating over 3,000 bilateral tax treaties, which would require significant resources and time, but more notably, such bilateral negotiations between states would lead to inconsistent application of BEPS measures.
The MLI has a Preamble and seven sections covering 39 articles. The first part (article 1 and article 2) provides instruction on the scope and meaning of the terms. Sections 2-6 (article 3-26) contain the modifications that will be applied to the bilateral treaties for the prevention of double taxation that are covered by the instrument. The measures that were defined as part of the final BEPS Package are explained in the Sections 1-5. Section 6 regulates the mandatory and binding arbitration as a method for resolving tax disputes which is a result of the work of the Arbitration Subgroup. The last Section, Section 7 (article 27 - 39) includes the transitional and final provisions for the implementation of the MLI, the process of signing and ratification, possible alternative provisions, entry into force and application of MLI. Some of the provisions are obligatory, the so-called minimum standards that have to be accepted by all signatory countries, while some are optional and these provisions symbolize the individuality of the instrument.

iii. Tax Implication of the MLI on the International Tax Law

Minimum standards are incorporated in article 6 and article 14 of the MLI. The measures that are contained in these articles are also included in Section 3 and Section 5, and the signatory countries have the right to deviate only in certain circumstances. The two minimum standards for preventing abuse of bilateral tax treaties, first established in the Final Report on Action 6 of the BEPS Project, entitled “Prevention of Tax Treaty Abuse”, state that:

- the signatory countries must include a statement in their bilateral tax treaties that their common interest is to eliminate double taxation without creating opportunities for non-taxation or incorrect taxation through tax evasion and tax avoidance, including treaty shopping agreements (article 6, paragraph 1) (OECD, 1998), an
- It is necessary to incorporate a mechanism for prevention of tax treaty abuse by implementing “principle purpose test” for the main purpose (article 7).

Optional provisions of the MLI ensure flexibility in its implementation, so there is an appropriate mechanism if one country decides not to apply these provisions.
Articles 3-5 refer to the so-called hybrid mismatch arrangements. These provisions give a solution to the problem of incompatibility in tax systems and divergent interpretation of tax terms in different countries.

The provisions of Article 8 to Article 11 regulate the measures on how to prevent the abuse of bilateral tax treaties that are not covered by the Report on Action 6.

The provisions of Article 12 to Article 15 contain measures relating to the status of a permanent establishment, which are a result of the Report of Action 7. The intention behind these provisions is to amend the existing bilateral tax treaties in order to prevent the avoidance of recognition of the status of permanent establishment permanent status by using various mechanisms (Silberztein et al., 2017). Article 15 contains a new definition of "company-related persons".

Article 17 of Section 5 contains a mechanism for implementing adjustments in the dispute resolution procedure.

The provisions of Article 18 to Article 26 refer to mandatory arbitration in cases where the signatory states cannot reach an agreement in a dispute within the prescribed period. The provisions of this article are a product of the work of the Arbitration Subgroup.

According to OECD, in times of multitude of tax policies, the flexibility as a key feature of MLI allows the effectiveness of BEPS measures. Therefore, in addition to the mandatory and optional standards, MLI provides other mechanisms, such as:

(a) reservation - the right of a signatory country to decide not to apply a specific article of the MLI, which would otherwise apply automatically (reservation is allowed for provisions contained in Article 28 of the MLI);

(b) optional provisions - the possibility of the signatory countries to choose to apply provisions that would not otherwise be applied;

(c) alternative provisions - some provisions contain the possibility of the country to choose one from several alternatives.

In principle, the reservations and optional provisions are not allowed for non-compulsory standards, though alternative provisions may be contained in both mandatory and non-compulsory standards.

iv. Future and Challenges of the MLI

The MLI was originally created to address the challenge of amending more than 3,000 bilateral treaties for the elimination of double taxation. The need to incorporate MLI into national tax legislation arises from the increased activities of multinational companies – taxpayers. The characteristics of MLI enable, in addition to several mandatory conditions, a large range of alternative provisions that each country has the right to determine independently upon accession. This set-up of the instrument is certainly important for the signatory countries because it allows individuality in accessing a multilateral convention of this kind, which has been a rarity until adoption of the MLI.

Many experts have repeatedly debated about the MLI importance and its impact on future actions and international transactions of multinational companies. The application of the MLI will bring many changes in the current practices of the countries in terms of taxation of income, capital and profit. Thus, in terms of regulation of the permanent establishment as a key element in the operation of multinational companies, MLI introduces a broader definition of what is considered as a PE, which will certainly affect the determination of the right to taxation but will also help to prevent taxation only due to insufficient regulation of such an important issue.

An important question posed by the final adoption of the MLI was about its possible impact on other types of bilateral agreements, in terms of using the instrument as a kind of framework or basis. Bilateral investment treaties, for example, have come under fire, especially in terms of resolving disputes arising from the investor-state relationship. These disputes have so far been resolved through arbitrators elected by each party and a third, neutral authority. Most of all, there was a problem with the arbitrariness of the arbitrators towards the party that appointed them. Therefore, the UN Commission on International Trade Law (UNCITRAL) considered this issue for the first time in November 2017, and the view is that MLI with all its characteristics can serve as a model for the basic framework of a multilateral instrument that will cover also the bilateral investment treaties, especially in the area of dispute resolution (Ratner, 2017).

When it comes to possible problems in the MLI application, it is a fact that not all countries around the world have accepted the instrument. This means that each country will have to pay much more attention when signing bilateral tax treaties than ever before. This mostly refers to the MLI position that has been accepted by the other Contracting State and the conditions under which the MLI has been ratified. For multinational companies` point of view, in addition to increased control, the instrument will mean greater administrative activity and more work for the financial and tax advisers.

IV. THE REPUBLIC OF NORTH MACEDONIA AND THE MLI

In January 2020, Republic of North Macedonia signed the MLI on the 8th BEPS Meeting. Signing MLI will strengthen the existing bilateral treaties on elimination of double taxation on income and capital in order to combat tax evasion and tax avoidance and will help the Republic of North Macedonia to implement all actions of the BEPS Inclusive Framework.

Practically, in the first instance, our country has to ratify the MLI according to the Macedonian laws and then to amend the bilateral tax treaties. Specifically, Republic of North Macedonia will have to determine which treaties will want to amend and list them as “covered tax treaties" since signing and ratifying the MLI does not mean an automatic change of all bilateral treaties on elimination of double taxation. Covered tax treaties are the bilateral treaties for the elimination of double taxation on income and capital between our country and another contracting state that are in force and for which both parties have submitted a notification that they want to change the treaty using MLI. The temporary MLI position of each signatory country indicates the bilateral treaties that the country intends to cover, the chosen options and the reservations that the country has made.

Macedonian minister of finance announced that all 49 bilateral tax treaties that have been signed since country`s independence will be covered tax agreements. This only emphasizes the equal treatment of all contracting states by the Republic of North Macedonia.

V. FINAL REMARKS AND POLICY RECOMMENDATIONS

It is certain that the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting will bring a wave of change in the signatory countries, but as well as in the other countries from their mutual relations. Given the fact that MLI entered into force two years ago, at this moment it is not possible to create a complete picture of the effect of the MLI on the international tax law. However, it is certain that it has an impact on the bilateral treaties on the elimination of double taxation on income and capital and will also affect national tax legislations.

Few possible changes within the Multilateral Instrument are expected in 2020. It is planned to prepare an analysis and revision for the achieved effect so far, as well as the next steps for MLI upgrade. Potential amendments are possible in terms of introduction of more mandatory accession requirements, which might mean that signatory countries that have already approached MLI would have to withdraw their concessions from MLI positions if they would be introduced as mandatory in near future.

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