Significant changes regarding double taxation relief

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In brief

Romania joined on 7 June the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting ("MLI").

The MLI brings a lot of changes that affect double tax treaties provisions. This alert seeks to clarify the future applicability of the MLI.

In detail

What is the MLI's purpose?

The MLI completes some of the double tax treaties with provisions regarding the prevention of the base erosion and profit shifting from the BEPS plan.

These changes can significantly affect how cross-border transactions are taxed.

What did Romania opt for?

Among the measures proposed by the MLI for which Romania opted, we mention:

- Focus on economic substance of transactions by: introducing a rule according to which the benefit of the double tax treaty cannot be granted if obtaining that benefit was one of the principle purposes of an arrangement or transaction.
- An extensive revision of the permanent establishment concept: (i) new provisions regarding dependent agent (e.g. with direct impact on commissionaire arrangements); (ii) assessing preparatory / auxiliary activities considering substance of transactions (i.e. we no longer rely on a specific list of activities provided by the double tax treaty); (iii) in assessing the existence of a permanent establishment, all activities performed by the same company or a closely related enterprise in a contracting state are considered (anti-fragmentation rule); (iv) new rules regarding the existence of a permanent establishment in the case of construction works.
- Review of tax residence concept for companies: the place of effective management no longer represents the tie-breaker rule on which the tax residence is automatically set. From now on, resolution of residency conflicts will be made by mutual agreement procedure. In practice, this rule can have a dramatic effect for companies by creating double taxation.
- Dispute resolution:
  - Expanding the applicability of the mutual agreement procedure (e.g. for setting the tax residence, or in the case of transfer pricing adjustments).
  - NB. Romania did not opt for applying the arbitration procedure if no agreement has been reached after two

years through a mutual agreement procedure. This aspect can enhance the uncertainty in cases of conflicts regarding the application / treaty interpretation (leading to double taxation).

- Elimination of exemption method: regarding the avoidance of double taxation, only the credit method will be applied, with the exemption method no longer available in Romania's case.
- Dividend taxation: a new condition on the minimum 365-day holding period has been introduced for application of the more favourable provisions regarding dividends.

A list can be found on the *OECD website* containing the Romania double tax treaties covered by the MLI and the proposed changes (Romania included in this list all its double tax treaties in force).

When does MLI become effective?

- In practice, the MLI will only produce effects if the following conditions are all met:
  - Both countries party to a double tax treaty have signed the MLI;
  - Both countries included the other state in the MLI list of treaties. To date, only 47 countries from the preliminary list of 91 transmitted by Romania have signed the MLI and included the treaty with Romania on their list sent to the OECD, but the list is still open;
  - Both countries have ratified in Parliament the covered tax agreements and MLI amendments.
- The OECD is to centralise the information provided by each country through an online tool, which will most likely be available by the end of this year.

How does it become effective?

1. When reciprocated (i.e. both jurisdictions opt for the same changes), the adopted provisions of the MLI prevail over the text of the double tax treaty.
2. Where there is no reciprocity regarding the amendments ratified by the two states, the MLI does not produce any effect (with some exceptions). Those jurisdictions have the opportunity to engage in bilateral negotiations, however, in order to reach a consensus or to make amendments to the MLI, even after ratification.

[Source: OECD press release issued on 7 June 2017]

The takeaway

The MLI is an instrument that allows coordinated and effective amendment of double tax treaties, thereby eliminating bilateral negotiations. The changes are many and they impact on a wide range of provisions in the double tax treaties. Companies should analyse these changes in detail in order to assess the impact on their transactions and business models.

Let's talk:

For a more detailed discussion of the impact that these provisions may have on your specific situation, you can contact the following people:

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