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Global Tax Alert

UAE ratifies Multilateral Convention to implement tax treaty related measures

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Executive summary

On 29 May 2019, the United Arab Emirates (UAE) ratified the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (Multilateral Instrument or MLI), which will become effective for the UAE as of 1 September 2019. Fifteen UAE double tax treaties will be modified as of 1 September 2019 and three more as of 1 October 2019. As more jurisdictions are expected to proceed with ratification of the MLI, going forward, more UAE double tax treaties will be amended in line with the MLI. Businesses operating in the UAE should review the changes introduced by the MLI to determine if the changes will affect access to treaty benefits.

Detailed discussion

Background

The Organisation for Economic Co-operation and Development (OECD) and G20 Base Erosion and Profit Shifting (BEPS) Action Plan, established in 2013, represents a package of measures that governments should implement to address features of tax regimes that facilitate BEPS. The Plan has 15 actions, of which 4 are minimum standards that all Inclusive Framework members, including the UAE, have committed to implement: Action 5 (Harmful tax practices), Action 6 (Prevention of tax treaty abuses), Action 13 (Country-by-Country Reporting) and Action 14 (Mutual Agreement Procedures).

Building a better working world

The implementation of BEPS Actions 6 and 13 require the amendment of tax treaties. Currently, the global tax treaty network is comprised of more than 3,000 treaties, and amending these through bilateral negotiations would be a cumbersome and time-consuming process. The solution set forth by the OECD/G20 is in Action 15 of the BEPS Project: the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. The MLI allows governments to modify existing treaties in a synchronized and efficient manner to comply with the BEPS measures.

For a tax treaty to be amended by the MLI, both treaty counterparties must be signatories of the MLI and must indicate the tax treaty as a Covered Tax Agreement (CTA). If this is the case, the MLI provisions, limited by the jurisdictions' reservations and choices of optional provisions, will be applied alongside the provisions of the existing bilateral treaty once the MLI is ratified by both jurisdictions.

The UAE ratifies the MLI

After signing the MLI in June 2018,[1] the UAE deposited its instrument of ratification on 29 May 2019. This means that the MLI will enter into force for the UAE on 1 September 2019.

The UAE listed 114 treaties as CTAs. From this list, 67 jurisdictions are also signatories of the MLI. However, not all of them have deposited their instrument of ratification. As of the date of this Alert, the MLI is in force for 21 of these jurisdictions, of which only 18 jurisdictions listed their treaty with the UAE as a CTA.[2]

As of 1 September 2019, the UAE treaties with Finland, France, Ireland, Japan, Jersey, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Poland, Serbia, Singapore, Slovenia and the United Kingdom will be affected by the MLI. As of 1 October 2019, three additional treaties will be affected: the treaties concluded with Belgium, India and Russia.

The UAE's MLI positions

Many of the MLI provisions allow jurisdictions to opt out of their effect. However, some provisions, the minimum standards, must be applied by all signatories of the MLI. These include:

- Adoption of a new preamble that updates the objectives of tax treaties to state that a treaty should not be used to "create opportunities for non-taxation or reduced taxation through tax evasion or avoidance" (Article 6 of the MLI)
- Prevention of treaty abuse by including the principle purpose test (PPT) clause or the limitation of benefits (LOB) clause (Article 7 of the MLI)
- Inclusion of additional wording in the treaty to improve the dispute resolution process by allowing taxpayers to initiate the Mutual Agreement Procedure (MAP) to resolve treaty conflicts (Article 16 of the MLI)

The UAE published its official reservations and notifications to the MLI, substantially confirming the announced intention to implement only the BEPS minimum standards. Thus, the effect of the MLI on the UAE treaty network should be limited to these provisions.

Prevention of tax treaty abuse: PPT and LOB

The most significant change to the UAE tax treaties will be the inclusion of a default PPT clause in its CTAs.

The PPT is based on the principal purpose of transactions or arrangements. If it is reasonable to conclude, having regard to all relevant facts and circumstances, that one of the principal purposes of that transaction or arrangement is to obtain treaty benefits, these benefits may be denied unless it is established that granting these benefits is in accordance with the object and purpose of the provisions of the treaty.

Out of the 18 UAE tax treaties that will be affected by the MLI as of September and October 2019, 6 already contain a PPT or a similar provision.[3] The remaining treaties will be amended to include a default PPT. These are the treaties concluded with: Belgium, Finland, France, Ireland, Japan, Jersey, Luxembourg, Malta, New Zealand, Serbia, Singapore and Slovenia.

Implications

The UAE Government's decision to join the Inclusive Framework and commit to implementing the BEPS minimum standards will help to strengthen the UAE's business and investment reputation in the Middle East. Ratification of the MLI is an important step in the ongoing BEPS process.

Businesses operating in the UAE should review the potential changes to be introduced by the MLI in their tax treaty application and determine whether new business models should be adopted. It is important to review outbound foreign investment models where the UAE acts a holding and/or a hub location and monitor the approach of the UAE tax treaty partners to the application of the PPT.

Going forward, businesses should also monitor how broader BEPS concerns are addressed by other jurisdictions. The principal purpose of business structures should also be aligned with the functional profile of the legal entities claiming the tax treaty benefits. Therefore, the link to a group's transfer pricing policies and documentation should be considered, especially, since the UAE has recently implemented the Country-by-Country Reporting rules.[4] Lastly, local substance requirements recently implemented by several low-tax jurisdictions, including the UAE, should also be considered.

Endnotes

1. The UAE signed the MLI in June 2018. For details, see EY Global Tax Alert, *The UAE signs the BEPS Multilateral Instrument*, dated 8 August 2018.
2. Austria, Georgia and the Slovak Republic did not list the treaty with the UAE as a CTA.
3. The treaties that already contain a PPT or a similar provision are: India, Lithuania, Netherlands, Poland, Russia and the United Kingdom.
4. See EY Global Tax Alert, *UAE introduces Country-by-Country Reporting*, dated 17 July 2019.

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