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In this article, the author examines the structure of the OECD's multilateral instrument, including the compatibility clauses and the use of opt-in, opt-out, and alternative provisions, with a focus on the capital gains provisions in article 9.

The OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the multilateral instrument, or MLI) is arguably one of the most important documents in modern tax history. Its structure and the way it interacts with preexisting treaties makes it unique — and uniquely powerful. This article will look at how the MLI functions generally before moving to focus on the structure of the capital gains article and how it interacts with existing treaty rules.

Section I of this article will examine the structure of the MLI, in particular the interaction between its operative clauses and its compatibility clauses. It will also discuss the options the MLI offers, including opt-out, opt-in, and alternative provisions. Section II will look at article 9, titled "Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property." More specifically, it will compare the application of article 9 to the covered tax agreements (CTAs) with the application of other articles, such as the provisions dealing with the purpose of a CTA and the prevention of treaty abuse, to the CTAs. This examination will highlight both the similarities and the differences between opt-in and alternative provisions. Using the understanding of the MLI's legal logic developed in the previous sections, Section II.B will compare some of the different positions that contracting jurisdictions have taken on article 9.

I. The Operation of the MLI

A. Overview of the MLI's Structure

Articles 3 to 17 (that is, parts II through V) of the MLI are the substantive provisions addressing BEPS issues. The substantive provisions follow a common structure: operative clauses, compatibility clauses, reservation clauses, and notification clauses.

The MLI's compatibility clauses use four specified phrases — "shall apply in place of," "shall apply to," "shall apply in the absence of," and "shall apply in place of or in the absence of" — to adapt the MLI to those tax treaties that the parties have identified as CTAs. Understanding the structure of the MLI provisions is important because the phrases "shall apply," "shall not apply," and "shall apply with respect to" appear in a variety of places in the MLI with varying implications — that is, some of the same wording used in the compatibility clauses is also used for different purposes in different places throughout the MLI.

As noted, article 9 addresses capital gains from the alienation (transfer) of shares that derive their value principally from immovable property. Paragraph 1 of article 9 reads:

> Provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of

> participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction (or provided that more than a certain part of the property of the entity consists of such immovable property (real property)):
>
> a) *shall apply* if the relevant value threshold is met at any time during the 365 days preceding the alienation; and
>
> b) *shall apply* to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions. [Emphasis added.]

In this instance, "shall apply" is not being used to create a compatibility clause. Article 9(1) directly modifies — or is directly read into — the relevant texts of the CTAs of a contracting jurisdiction. The modified text becomes part of the treaty's operative clause, with the compatibility clause modifying its application. In contrast, compatibility clauses do not directly modify the CTAs. Instead, by using the four specified phrases identified above, compatibility clauses modify the application of the MLI to the CTAs.

"Shall not apply" and "shall apply" are also used in the notification clause — that is, article 9, paragraph 7 — which provides:

> Each Party that has not made the reservation described in subparagraph a) of paragraph 6 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 1, and if so, the article and paragraph number of each such provision. Paragraph 1 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision.

B. Compatibility Clauses

Paragraph 2 of article 9 is an example of a compatibility clause, which deals with how its own terms interact with article 9(1). Paragraph 5 of article 9 is another compatibility clause that addresses the interaction between itself and article 9(4). A compatibility clause comes into play if a contracting jurisdiction has not made any reservation for the operative clause — that is, it has not elected an opt-out provision — or a contracting jurisdiction has actively chosen to adopt a provision of the MLI, including opt-in or alternative provisions. Specifically, article 9(2) and 9(5) provide that:

> 9(2). The period provided in subparagraph a) of paragraph 1 *shall apply in place of or in the absence of* a time period for determining whether the relevant value threshold in provisions of a Covered Tax Agreement described in paragraph 1 was met. [Emphasis added.]
>
> 9(5). Paragraph 4 *shall apply in place of or in the absence of* provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction, or provided that more than a certain part of the property of the entity consists of such immovable property (real property). [Emphasis added.]

C. Options in the MLI

There are three classes of options in the MLI: opt-out provisions (reservations); opt-in provisions; and alternative provisions.

1. Opt-Out Provisions

In some cases, the MLI allows a party to the convention to reserve its right to opt out of all or part of a particular MLI provision. The MLI provisions that fall within the scope of the BEPS project's minimum standards do not permit a complete exclusion (or entire opt-out) unless:

- the contracting jurisdictions agree to endeavor to find a mutually satisfactory solution that fulfills the minimum standard, as in the reservation available in article 7(15)(a) on the prevention of treaty abuse; or
- the contracting jurisdictions have already committed to an equivalent provision in the existing CTA that satisfies the minimum standard, as in the reservations available in articles 6(4) and 7(15)(b).

For those MLI provisions that do not reflect minimum standards, article 28(1) explicitly permits full exclusion from the application of the MLI provisions. Paragraph 1 of article 9 is one example. Another example is paragraph 5 of article 10 (titled "Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions"). It provides that:

> 5. A Party may reserve the right:
>
> a) for the entirety of this Article not to apply to its Covered Tax Agreements;
>
> b) for the entirety of this Article not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 4;
>
> c) for this Article to apply only to its Covered Tax Agreements that already contain the provisions described in paragraph 4.

Thus, a contracting jurisdiction can reserve the right for the entirety of article 10 not to apply to its CTAs by electing subparagraph 5(a). If a contracting jurisdiction makes this reservation, then article 28(9) allows it to withdraw the reservation at any time or replace it at any time with a new reservation under either subparagraph 5(b) or 5(c), which are both more limited in scope than the complete exclusion in subparagraph 5(a). A contracting jurisdiction can also reserve its right not to apply article 10 on the strength of an equivalent provision that already exists in the CTAs in accordance with article 10(5)(b). The existence of an equivalent provision also provides an exception to the principle of reciprocity, which generally provides that a contracting jurisdiction cannot apply a particular MLI provision to only some of its CTAs.

2. Opt-In Provisions

Opt-in provisions supplement the application of a primary operative clause. One example is paragraph 3 of article 6 (titled "Purpose of a Covered Tax Agreement"). Paragraph 1 of that article modifies all CTAs to include basic preamble language about the desire "to eliminate double taxation . . . without creating opportunities for non-taxation or reduced taxation." Paragraph 3 allows contracting jurisdictions to also include the remaining part of the preamble of the OECD model tax convention: "Desiring to further develop their economic relationship and to enhance their co-operation in tax matters." Paragraph 3 notes that this preamble language should only be added if the preamble that is already in the CTA does not make such a statement. Also, as paragraphs 83 and 84 of the MLI's explanatory statement note, because including this portion of the preamble of the OECD model tax convention is not required to meet a minimum standard, it is an optional provision.

Another example of an opt-in provision is paragraph 4 of article 7 ("Prevention of Treaty Abuse"). Article 7(3) provides that a party that has not made the reservation for article 7(1) — that is, the party has not opted out of the principal purpose test (PPT) — may opt to apply paragraph 4 to supplement its application of paragraph 1 to its CTAs. A party to the MLI shall adopt the PPT in article 7(1) alone if it does not opt in for paragraph 4. If a party opts in for paragraph 4, article 7(1), as modified by article 7(4), shall apply in circumstances that a person that failed the PPT is still entitled to tax benefits on a specific item of income or capital provided that the competent authority of the contracting jurisdiction to which a request has been made by a resident of the other contracting jurisdiction shall consult with the competent authority of that other contracting jurisdiction before rejecting the request. Article 7(4) provides, in part:

> Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention)

> that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement.

Further, the MLI also gives contracting jurisdictions the option to adopt the entire Part VI ("Arbitration"), which spans articles 18 through 26.

In essence, an opt-in provision is the same as a non-default option — one type of option in the alternative provision category.

3. Alternative Provisions

The MLI includes alternative provisions to give the contracting jurisdiction flexibility by providing a choice between various measures that all lead to the same goal. From a technical perspective, there are two categories of alternative provisions: those with a default option[1] and those without.

If a contracting jurisdiction does not explicitly opt out of the default option, then the default option applies automatically. For example, paragraph 1 of article 7 provides for the principal purpose test as the default option. The paragraph provides that:

> Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

Paragraph 6 of article 7 offers an alternative (opt-in) to this provision. It allows a contracting jurisdiction to include a simplified limitation of benefit provision in its CTAs to supplement the principal purpose test (the default provision included under paragraph 1). A contracting jurisdiction that adopts only the principal purpose test provided in article 7(1) can satisfy the minimum standard for preventing treaty abuse under the BEPS package. In contrast, a party is not obligated to adopt article 9(1) because it is not part of a minimum standard under the BEPS project.

Article 9 provides another example of alternative provisions, offering paragraph 4 as an alternative to paragraph 1. Paragraph 4 of article 9 reads:

> For purposes of a Covered Tax Agreement, gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting Jurisdiction if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction.

4. Opt-In and Alternative Provisions

Both article 7(6) and article 9(4) are alternative provisions; however, there are important differences between the two. Article 7 provides a default option of a principal purpose test under paragraph 7(1). A contracting jurisdiction can apply the principal purpose test in article 7(1) to its CTAs without choosing to apply the simplified limitation of benefit provision in article 7(6). The latter is optional and supplementary. In contrast, as discussed below, article 9 does not provide a default option.

[1] *See* explanatory statement at para. 90.

II. Object and Purpose of Article 9

A. Overview of Article 9

The explanatory statement provides a useful overview of article 9(1), which is closely connected to the action 6 report:

> 128. Paragraph 1 addresses situations in which assets are contributed to an entity shortly before the sale of shares or comparable interests (such as interests in a partnership or trust) in that entity in order to dilute the proportion of the value of the entity that is derived from immovable property, based on Article 13(4) of the OECD Model Tax Convention as revised in paragraph 44 (page 72) of the Action 6 Report. . . .
>
> 129. The Action 6 Report provides two changes with respect to Article 13(4) of the 2014 version of the OECD Model Tax Convention: (i) to introduce a testing period for determining whether the condition on the value threshold is met; and (ii) to expand the scope of interests covered by that paragraph to include interests comparable to shares, such as interests in a partnership or trust. The provision in paragraph 1 has been divided into two subparagraphs. Subparagraph a) reflects the introduction of the testing period, and subparagraph b) reflects the expansion of the interests covered.

Instead of introducing a testing period and expanding the coverage of existing capital gains provisions to include additional types of interests, some parties to the MLI may prefer to apply article 13(4) of the OECD model to their CTAs. Paragraph 3 of article 9 permits parties to do so. Further, as paragraph 133 of the explanatory statement provides, "paragraph 3 also allows a Party to introduce a provision addressing gains derived from alienation of shares in entities deriving their value principally from immovable property (real property) into a Covered Tax Agreement that does not have such a rule."

Further, article 9(4) is an optional provision that offers an alternative way to address a particular BEPS issue. Article 9(8) provides some rules for its application:

> Each Party that chooses to apply paragraph 4 shall notify the Depositary of its choice. Paragraph 4 *shall apply* to a CTA only where all Contracting Jurisdictions have made such a notification. In such case, paragraph 1 *shall not apply* with respect to that CTA. [Emphasis added]

Note that, in this case, "shall apply" and "shall not apply" are not being used in the context of a compatibility clause. Rather they are meant to exclude paragraph 1 of article 9 in the MLI if all parties to the CTA have made matching notifications.[2]

B. The Differing MLI Positions on Article 9

To illustrate how article 9 works in practice, Table 1 shows some of the signatories and parties[3] to the MLI that have exercised options under article 9 as of September 27, using information from the MLI database's matrix of options and reservations, as provide by the OECD depositary.

Table 1. Article 9 Positions

Choose not to apply paragraph 9(1)	Reservation made under paragraph 6(a)	The U.K. and Isle of Man
Choose not to apply paragraph 9(1)(a)	Reservation made under paragraph 6(b)	China (provisional)
Choose not to apply paragraph 9(1)(b), and not to opt in for paragraph 4 (the alternative provision)	List of CTAs subject to reservation for 9(1)(b) given under paragraph 6(e), and notification given under paragraph 7	Australia

The United Kingdom and Isle of Man have opted out of paragraph 1 of article 9. Thus, unless they adopt the alternative provision in paragraph

[2] The term "all parties" covers the following cases: (i) if all the parties of a multilateral agreement have made matching notifications; or (ii) if both parties of a bilateral agreement have made matching notifications. One example of a multilateral agreement is the agreements between the Nordic countries to avoid double taxation regarding taxes on income and capital, which covers Denmark, the Faroe Islands, Finland, Iceland, Norway, and Sweden.

[3] A party is a contracting jurisdiction for which the MLI is now in force under article 34.

4, all of article 9 will not apply to CTAs involving these two contracting jurisdictions.

Australia provisionally chose to apply paragraph 9(1). Following Australia's deposit of its instrument of ratification on September 26, the reservations it made for paragraph 9(1)(b) and the notifications it gave regarding paragraph 1 have become definitive. To give legal relevance to the adoption of paragraph 1, Australia notified the OECD depositary under paragraph 9(7) that paragraph 1 shall apply in place of the previously existing provision in — or, in the absence of such a provision be added to — all its 42 CTAs, including the tax treaties with Austria, Ireland, Japan, New Zealand, Sweden, and the United Kingdom.

Out of Australia's 42 CTAs, 19 already contain a provision that expands the scope of shares to cover comparable interests in a land-rich entity such as an interest in a partnership or trust. Under article 9(6)(e) of the MLI, Australia has reserved its right not to apply article 9(1)(b) to these 19 CTAs, which include the tax treaties with Ireland, Japan, New Zealand, and the United Kingdom. These 19 CTAs — in an example of an exception to the reciprocity principle — will not be subject to being modified by the compatibility clause in paragraph 2. Notably, neither the tax treaty with Austria nor the treaty with Sweden contains the provision in article 9(1)(b) that expands the scope of shares to include interests comparable to shares such as interests in a partnership or trust. They also do not contain the 365-day testing period in paragraph 9(1)(a). Therefore, because Australia has not made a reservation under article 9(6)(e), these two treaties will be subject to modification by the compatibility clause under paragraph 9(2).

As Table 2 shows, a party or signatory can either choose to apply paragraph 4 of article 9 in addition to paragraph 1 or to the exclusion of paragraph 1.

Some of New Zealand's CTAs contain a specified value threshold in shares or comparable interests in the land-rich entity, but do not contain the 365-day testing period required under article 9(1)(a). Out of a total of 37 CTAs, 23 of New Zealand's CTAs do not satisfy the requirements of article 9(1)(a), including the tax treaties with Australia, Austria, Ireland, Japan, and Sweden. These 23 CTAs — for which New Zealand did not make any reservations under article 9(6)(a) — will be subject to modification by the compatibility clause under paragraph 9(2). The 365-day testing period will apply in the absence of another testing period. In short, the time period will be added to those CTAs.

Table 2. The Article 9(4) Option

Choose to apply paragraph 9(4), in addition to paragraph 1	Notification given under paragraph 7	Japan, New Zealand
Choose not to apply (opt out of) paragraph 1 *and* choose to apply (opt in for) paragraph 9(4)	Reservation made under paragraph 6(a) *and* notification given under paragraph 8	Israel, Italy (provisional), and Malta (provisional)

Contracting jurisdictions introduce alternative provisions to update older CTAs that, having been concluded decades ago, do not follow the latest version of the model tax convention. For that reason, some of New Zealand's CTAs do not meet both the 365-day testing period and the specified value threshold for shares (or comparable interest) in land-rich entity requirements. Examples include the Belgium-New Zealand and the Korea-New Zealand tax treaties. New Zealand is renegotiating both and expects to bring them in line with the current OECD Model Tax Convention, including article 13(4). However, New Zealand has covered this group of CTAs by opting in to article 9(4), which provides for both the 365-day testing period and a specified value threshold in shares or comparable interests. New Zealand did not give notification under paragraph 8 at the time it ratified the MLI, but it can give notification later under article 29(6) of the MLI.

A contracting jurisdiction can also choose to apply paragraph 9(4) but reserve its right not to apply paragraph 9(1). Israel, Italy (provisional), and Malta (provisional) have adopted this position.

III. Concluding Comment

As the OECD frames it in the action 15 final report, the MLI is intended to be one agreement with one uniform text concluded by a multitude of parties. While it is a uniform text, the MLI includes provisions that offer the parties alternatives for how to apply its provisions to their CTAs.

It is important to distinguish between opt-in provisions and alternative provisions when applying the MLI, including article 9.

Understanding the concept and logic in legal texts is a prerequisite to properly interpreting and applying them, and it serves as a tool to guide authorities and observers through the technicalities of the MLI, including article 9. ■