

The Application of the Articles in the Multilateral Convention to HK's Tax Treaties

Scope of notifications

The purpose for a contracting jurisdiction (i.e. Hong Kong) to make notification to the OECD Depository is twofold: to ensure clarity and transparency about the application of the Multilateral Convention (the MLI); and acquire the legal validity of the action taken. Notification can be categorized as follows:

- The notification for a contracting jurisdiction to nominate CTAs, together with the list of reservations and notifications, at the time of signature or at the date of deposit of the Instrument of Ratification of the MLI (Article 29 (1)(a));
- At the time of signature or at the date of the deposit of Instrument of Ratification and thereafter, the notification made for opt-in provisions (Article 29(1)(a));
- After a contracting jurisdiction becomes a Party to the MLI, the notification given following an extension of the CTA list specifying that whether the new agreement falls within the scope of any of the reservations made pursuant to paragraph (8) of Article 28 (first and second sentences, Article 29(5));
- Notification of new reservation if the additional CTA as mentioned in the preceding bullet is first to fall within the scope of such a reservation (third sentence, Article 29(5)); and
- Notification required to be given under Article 29(1) to reflect the inclusion of the additional agreements (fourth sentence, Article 29(5)).

Interaction between Notifications and Compatibility Clauses

To achieve clarity and transparency about the modifications made by the MLI to the CTAs, the contracting jurisdictions are required to notify how the compatibility clause modifies a treaty provision in ways as set out below:

- a) The MLI provision applies “**in place of**” an existing provision of a Covered Tax Agreement i.e. the provision is intended to replace an existing provision if one exists;
- b) The MLI provision “**applies to**” or “**modifies**” an existing provision of a Covered Tax Agreement i.e. the MLI provision changes the application of an existing provision without replacing it;
- c) The MLI provision applies “**in the absence of**” an existing provision in a Covered Tax Agreement i.e. the MLI provision is, in effect, added to the bilateral treaty if there is no existing provision; or
- d) The MLI provision applies “**in place of or in the absence of**” an existing provision of a Covered Tax Agreement i.e. the MLI provision either replaces an existing provision or is, in effect, added to the CTA if there is no existing provision.

The operation of the compatibility clauses described above is linked to notifications provided by the contracting jurisdictions to the CTA. In cases of a), b) and c) as described above, the operation of the MLI provision requires the notification by both contracting jurisdictions of the existence (cases a and b) or the absence (case c) of an existing provision. In case d), the MLI provision will apply in all cases regardless of whether there is an existing provision and regardless of the notification made by the contracting jurisdictions. If both contracting jurisdictions notify the existence of a provision, the MLI provision will replace it. If the contracting jurisdictions do not notify the existence of a provision, the MLI provision will be added to the bilateral treaty. In the unlikely event that, in case d), there were to be an existing provision that has not been notified by both contracting jurisdictions, the MLI provision will supersede the existing provision to the extent that the two are incompatible.¹

In case of a notification mismatch, the MLI provision does not apply in cases a), b) and c). In case d), the MLI provision applies and supersedes the existing provision to the extent of incompatibility.

Application of the MLI Provisions to Hong Kong’s Tax Treaties

It is observed that Hong Kong has made the Reservations in Articles 6, 7 and 17, but no reservation for Article 16. The MLI articles Hong Kong has adopted to modify its CTAs with a view to addressing the minimum standards in the BEPS package are listed below for comparison purposes:

Article 6 Purpose of a CTA	Article 7 Prevention of treaty abuse
Operative clause	
6(1) reproduces model preamble text in paragraph 72 of Action 6 report. ²	7(1) reproduces paragraph 7 of Article X (Entitlement to Benefits) of OECD model tax convention under paragraph 26 of the Action 6 Report ³
6(1) A CTA shall be modified to include the following preamble texts: “Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this	7(1) Notwithstanding any provisions of a CTA, a benefit under the CTA 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

¹ See paragraph 22, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting: Functioning under Public International Law, Note by the OECD Directorate for Legal Affairs.

² See paragraph 75 in the Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

³ See paragraph 88 in the Explanatory Statement.

agreement for the indirect benefit of residents of third jurisdictions)”	granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the CTA.
--	--

Compatibility clause	
6(2) Texts described in paragraph 1 shall be included in a CTA in place of or in the absence of preamble language.	7(2) Paragraph 1 shall apply in place of or in the absence of a CTA where the PPT ... was to obtain the tax benefits.
Notification is given under paragraph 6(5), pursuant to Article 29(1)(a)	Notification is given under paragraph 7(17)(a), pursuant to Article 29(1)(a)

Reservation clause	
6(4)	7(15)(b)
A Party may reserve the right for paragraph 1 not to apply for CTA already containing texts in paragraph 1.	A Party may reserve the right for paragraph 1... not to apply to its CTAs that already contain provisions that deny all of the benefits that would otherwise be provided under the CTA where the PPT... was to obtain those benefits;
A list of the CTAs falling within the scope of reservation has been provided under Article 28(8)	

Opt-in clause	
Pursuant to paragraph 6(3), a Party may also choose to include the following preamble text with respect to its Covered Tax Agreements that do not contain preamble language referring to a desire to develop an economic relationship or to enhance co-operation in tax matters: “Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,”.	N/A
(6) Notification of opt-in provision under paragraph (3)	N/A

[Note] Article 7 contains a default option for the adoption of the principal purpose test (PPT). Hong Kong allows the default option under Article 7(1) to apply to its CTAs.

Article 16	
Operative clause	
Article 16(1) through (3) are based on the text of Article 25(1) through (3) of the OECD Model Tax Convention, which incorporate the changes made to Article 25(1) of the 2014 version of the OECD Model Tax Convention under the work of Action 14 to reflect the	

treaty obligation under element 3.1 of the Action 14 minimum standard to allow a taxpayer to present a case to the competent authority of either Contracting Jurisdiction. ⁴		
Paragraph (1)	Paragraph (2)	Paragraph (3)
A person may present case to the CA of either contracting jurisdiction. The case must be presented within 3 years from 1 st notification of action not in accordance with CTA provision.	The CA shall resolve case by mutual agreement with the other CA. Agreement reached shall be implemented regardless of time limit in domestic law.	CA shall resolve by mutual agreement difficulties / doubts on interpretation / application of CA. They shall consult each other for double tax elimination not provided in CTA

Compatibility Clause					
(4)(a)(i) 1st sentence of para. 1 shall apply	(4)(a)(ii) 2nd sentence of para. 1 shall apply	(4)(b)(i) 1st sentence of para. 2 shall apply	(4)(b)(ii) 2nd sentence of para. 2 shall apply	(4)(c)(i) 1st sentence of para. 3 shall apply	(4)(c)(ii) 2nd sentence of para. 3 shall apply
in place of or in the absence of		in the absence of		in the absence of	
Notification is given to the Depository under paragraph 6, pursuant to Article 29(1)					
(6)(a)	(6)(b)(i); (6)(b)(ii) [note]	(6)(c)(i)	(6)(c)(ii)	(6)(d)(i)	(6)(d)(ii)

Reservation Clause					
(5)(a) not chosen	(5)(b) not chosen	N/A	(5)(c) not chosen	N/A	N/A
N/A		N/A		N/A	

Note :

(6)(b)(i)	Notify OECD Depository of list of CTAs containing provision that a case referred to in 1st sentence of paragraph 1 must be presented in a period shorter than 3 years.
	Where both contracting jurisdictions have notified same existing provision, the CTA provision is replaced by the 2 nd sentence of paragraph 1 (the MLI provision); in other case, the MLI provision applies and supersedes the existing CTA provision to the extent of incompatibility.
(6)(b)(ii)	Notify OECD Depository of list of CTAs containing provision that a case referred to in 1 st sentence of paragraph 1 must be presented in time period of at least 3 years
	Where any contracting jurisdiction has made a notification with respect to that CTA, the 2 nd sentence of paragraph 1 (the MLI provision) shall not apply.

⁴ See paragraph 193 in the Explanatory Statement.

Article 17
Corresponding adjustments
Operative clause
Paragraph 1 is based on the text of Article 9(2) of the OECD model tax convention. ⁵
17(1) Where a contracting jurisdiction includes in the profits of an enterprise of that contracting jurisdiction – and taxes accordingly – profits on which an enterprise of the other contracting jurisdiction has been charged to tax in that other contracting jurisdiction and the profits so included are profits which should have been accrued to the enterprise of the first-mentioned contracting jurisdiction if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other contracting jurisdiction shall make an appropriate adjustment to the amount of the tax charged on those profits...

Compatibility clause
17(2) Paragraph 1 shall apply in place of or in the absence of a CTA provision...
Notification is given to the Depository under paragraph 17(4), pursuant to Article 29(1)(a)

Reservation clause
17(3)(a)
A Party may reserve the right for the entirety of this Article not to apply to its CTAs that already contain a provision described in paragraph 17(2).
A list of the CTAs falling within the scope of reservation has been provided pursuant to Article 28(8)

Opt-in clause
N/A
N/A

China Tax & Investment Consultants Ltd

www.china-tax.net

September 13, 2018

⁵ See paragraph 209 in the Explanatory Statement.