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Japan Tax Bulletin

Ratification of Multilateral Instrument

June 2018

Multilateral Instrument (The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, or "MLI") are anti-BEPS measures amending existing bilateral tax treaties. On May 18, 2018, the Diet approved the ratification of the MLI and the government is going to deposit the instrument of ratification with the OECD.

1. *Entry into force*

The MLI comes into force after the fifth country has deposited an instrument of ratification with the OECD. On March 22, 2018, Slovenia deposited the instrument of ratification with the OECD, following Austria (22 September 2017), the Isle of Man (19 October 2017), Jersey (15 December 2017) and Poland (23 January 2018). After the fifth deposit of the instrument of ratification, the entry into force of the MLI on 1 July 2018 will bring it into legal existence in these five jurisdictions. In accordance with the rules of the Convention, its contents will start to have effect on existing tax treaties as from 2019.

2. *How the MLI modifies existing bilateral tax treaties*

(1) Bilateral tax treaties modified by the MLI

The MLI modifies the articles of existing bilateral tax treaties as long as both parties of the treaty select the relevant articles of the MLI. The Japan government notified the OECD to apply the MLI to its bilateral tax treaties with the following countries:

Ireland, Israel, Italy, India, Indonesia, UK, Australia, Netherlands, Canada, Korea, Kuwait, Saudi Arabia, Singapore, Sweden, Slovakia, Czech, China, Germany, Turkey, New Zealand, Norway, Pakistan, Hungary, Fiji, Finland, France, Bulgaria, Poland, Portugal, Hong Kong, Malaysia, South Africa, Mexico, Luxemburg and Romania

Apart from Saudi Arabia and Malaysia, the countries listed above have elected to apply the MLI to their bilateral tax treaties with Japan. As the US has not signed the MLI, the bilateral tax treaty with US is not modified by it.

(2) Japan's application of the MLI

Japan notified the OECD that it will apply the following Articles and Part of the MLI:
Article 3 - Transparent Entities
Article 4 - Dual Resident Entities
Article 6 - Purpose of a Covered Tax Agreement
Article 7 - Prevention of Treaty Abuse
Principal Purpose Test

Article 9 - Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property
Article 10 - Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions
Article 12 - Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies
Article 13 - Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions
Article 16 - Mutual Agreement Procedure
Article 17 - Corresponding Adjustments
PART VI. ARBITRATION

(3) Articles of the MLI that Japan will not to apply

Japan notified the OECD that it has chosen not to apply the following Articles of the MLI:
Article 5 - Application of Methods for Elimination of Double Taxation
Article 7 - Prevention of Treaty Abuse
Simplified Limitation on Benefits Provision
Article 8 - Dividend Transfer Transactions
Article 11 - Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents
Article 14 - Splitting-up of Contracts

The OECD MLI matching database, as linked below, is a tool designed to show how the MLI affects the Articles of the tax treaty between two chosen countries.
http://www.oecd.org/tax/treaties/mli-matching-database.htm

(4) Modification of bilateral tax treaties

The provisions of the MLI overlap in many cases with the provisions of a country's bilateral tax treaties and can be applied without any conflict to the treaties' provisions. However in cases where the MLI and treaty provisions conflict with each other, "compatibility clauses" need to be drafted to identify the how the provisions of the MLI will affect the treaty provision as well as the effect on other treaties that do not contain that particular provision. To ensure clarity and transparency about its application, the MLI requires parties to make a notification specifying which treaties are within the scope of the compatibility clauses. The contents and effect of these notifications depend on the type of compatibility clause that applies to the treaty provision i.e. whether the MLI provision is “in place of”; “applies to” or “modifies”; is “in the absence of” or is “in place of or in the absence of” provisions of a treaty (see also the MLI Explanatory Statement, para. 15-18).

3. *Effective date*

The MLI will apply to a specific treaty once both Japan and the other party have ratified and accepted the MLI. The effective date will differ depending on the type of income that modified provision applies to

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