



Tax Client Update

October 2018 | Israel Ratifies the MLI

Dear Clients, Colleagues and Friends,

Recently Israel informed the OECD that it has ratified the Multilateral Convention to Implement Tax Treaty Related measures to prevent Base Erosion and Profit Shifting (“**MLI**”), which was signed by the Minister of Finance on 7 June, 2017. The MLI is expected to come into force with respect to the relevant Israeli tax treaties (as explained below) on January 1, 2019.¹ The changes to the double tax treaties provided for in the MLI will apply to the Israeli bilateral tax treaties currently in effect but only with respect to the treaties with countries that have also ratified the MLI in their respective country, and furthermore only with respect to the provisions on which both countries have not submitted reservations to the OECD.

To date the MLI has been signed by over 75 countries around the world. Israel is the 11th country to ratify the MLI. The United States is not party to the MLI.

Countries will not be required to issue new treaties. Therefore, when checking the current version of a treaty in a country that has ratified the MLI, one would also need to check whether treaty provisions have changed due to the MLI.

For the reservations and notifications under the MLI of the state of Israel please click [here](#).

Background

The MLI is a consequence of action 15 of the base erosion and profit shifting project (“**BEPS**”). The BEPS project was initiated by the G20 to provide recommendations on how to reduce issues of base erosion and profit shifting mainly by multinational companies shifting their income to jurisdictions with low tax rates. Action 15 suggested a multilateral instrument that will amend existing treaties to lessen the opportunities for tax avoidance by multinational enterprises and to ensure the results of the BEPS project are transported into the existing tax treaties in a timely manner.

¹ Different sections have different start date. Therefore, not all the provisions will become effective as of 1 January, 2019. Generally, the withholding provision will be applicable from the first day of the calendar year following the ratification by both parties to the tax treaty. All other taxes will generally apply for any tax periods commencing 6 months after the second party to the tax treaty ratified the MLI.



The use of a multilateral convention to amend the treaties means that the changes will be implemented quickly without the need for individual negotiations on the over 1,200 treaties in place today (taking into account the treaties of all the countries who have signed the MLI). In the alternative each country would need to negotiate, agree on the wording of the provisions in question and lastly get the new and amended treaty signed and ratified. This would mean a lengthy process which would take the OECD countries years to complete.

The Provisions of the MLI

The MLI includes provisions that will be added to the existing treaties as well as replacement provisions for some of the existing provisions. Further to the ratification letter, each country is required to submit to the OECD a letter detailing its reservations and listing the treaties it would like the MLI to apply to.

The main provisions of the MLI are as follows:

1. Treaty abuse prevention – the MLI allows for two different methods to prevent the treaty abuse; (a) the principal purpose test (PPT) which will disallow treaty benefit if the principal purpose of the structure or arrangement was to gain treaty benefits, and (b) simplified limitation on benefits which will set out conditions that must be met by the ultimate owner for the treaty benefits to apply. Each jurisdiction must indicate which method they would like to apply (it is possible to apply both). Israel has chosen to apply the PPT approach.
2. Mutual Agreement Procedure (improving dispute resolution) – in the past in the event of a tie-breaker the residency of the entity was concluded based on the effective management of the entity. This test proved to be inefficient and subject to abuse. Therefore, under the MLI in the case of a tie-breaker the countries will mutually agree on the residency of the entity in question. For this change to be implemented both countries need to abstain from any reservation. Israel has not submitted any such reservation to this provision.
3. Permanent establishment – the MLI provides for a number of changes in this respect. The main change is with respect to the definition of a dependent agent and the restriction on the allocation of income to a jurisdiction where the tax rate is 60% lower than the tax rate in the country of residence of the managers of the PE. In accordance with the new definition, a dependent agent will establish a PE if he habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification. This is a deviation from the past where tax authorities usually just checked



where the contracts were signed.² For this change to be implemented both countries need to abstain from any reservation. Israel did not submit any reservation with respect to this provision.

4. Inter-Company Dividends – the MLI added a condition to the application of the lowest withholding rate provided for in the treaty dividend provision with respect to inter-company dividends. The lower withholding rate would only apply if the company receiving the dividend held the shares in the company distributing the dividend for a period of 365 days including the dividend payment date. For this change to be implemented both countries need to abstain from any reservation. Israel has not submitted any reservation in this respect.
5. Taxation of real estate companies – the MLI added the clarification that the provisions relating to the sale of a real estate company will apply if the relevant holding threshold is met at any time during the 365 days preceding the sale. In addition the section was expanded to include sales of rights in similar entities like partnerships and trusts. For this change to be implemented both countries need to abstain from any reservation. Israel has not submitted any such reservation.
6. Arbitration – in the event that the mutual agreement process is not concluded within two years from the date on which all the required documentation is submitted to the relevant authorities, the person requesting the mutual agreement can take the matter to arbitration. Israel objected to this provision and therefore it will not apply to any treaty with Israel.

MLI and Israel

Which treaties will the MLI apply to - except for the treaties with the UK, Germany and Switzerland with whom Israel will sign new bilateral treaties, Israel has chosen to implement the MLI on most of its existing treaties, as well as on the treaties with Armenia and Macedonia, two treaties which have been signed by Israel but have not yet been ratified.

Additionally, as noted above, Israel has submitted some reservations to the MLI provisions. The ITA is expected to issue a circular before the end of 2018 that summarises the implications of changes caused by the MLI. The circular is expected to explain the applicable date for each change in each one of the treaties to be effected by the MLI.

² Granted the ITA took a similar position with respect to when the actions of an independent agent will cause a PE in Israel even prior to the MLI.