How the OECD's Multilateral Instrument Will Affect The Nigeria-Spain Tax Treaty

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In this article, the author analyzes how, from a Nigerian perspective, both Nigeria and Spain signing the OECD's multilateral instrument will alter the existing tax treaty between the nations.

The OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (known as the multilateral instrument, or MLI) is one of the most significant contributions to improving the international tax system in tax treaty history. The MLI implements measures that strengthen existing tax treaties to protect governments against tax avoidance schemes that misuse treaties to shift profits to low- or no-tax locations.[1] Before the MLI, jurisdictions entered into bilateral tax agreements to avoid the double taxation of their residents. These agreements often took years to complete and bring into force. With the MLI, more than 1,100 bilateral tax treaties will be swiftly revised to close the gaps that enable tax avoidance. One of these tax treaties is that between Nigeria and Spain.

On August 17, 2017, Nigeria signed the MLI (which has yet to come into force in Nigeria). At the time, the avoidance of double taxation agreement between Nigeria and Spain (the treaty) was not enforceable in Nigeria. In Spain, the treaty had been in force since June 5, 2015. By signing a bill on January 26,[2] the Nigerian president made the treaty enforceable in Nigeria,[3] which is the 14th tax treaty in force in the country.[4]

The MLI only applies to covered tax agreements, a term that means that both treaty partners have agreed to apply the MLI to an existing double tax treaty. This is usually done through a notification to the OECD depositary. The notification details which articles of the MLI will apply to the covered tax agreement. The MLI will only take effect three months after five jurisdictions deposit their instrument of ratification with the OECD (a separate document from the notification).

Both Nigeria and Spain have designated the treaty as a covered tax agreement.[5] However, minimum standards of the BEPS project in the MLI are not optional. This means both parties must apply them to the treaty. The parties can decide to stick with the treaty language if it already meets the minimum standards. The parties must observe the following minimum standards: article 6 on purpose of a covered tax treaty, article 7 on preventing treaty abuse, and article 14 on improving dispute resolution. The minimum standards of the MLI will modify the treaty's preamble, and the antiabuse provision

[1] OECD, "Multilateral Instrument — Information Brochure" (Oct. 20, 2017).

[2] Avoidance of Double Taxation Agreement between the Federal Republic of Nigeria and the Kingdom of Spain (Domestication and Enforcement) Act, 2018.

[3] *See* Nigerian Constitution, section 12(3) (1999).

[4] Federal Inland Revenue Service, "Tax Treaties."

[5] OECD, "Nigeria: Status of List of Reservations and Notifications at the Time of Signature"; OECD, "Spain: Status of List of Reservations and Notifications at the Time of Signature."

(contained in the protocol to the treaty). The treaty's mutual agreement procedure already complies with the minimum standard. The non-mandatory provision of the MLI both parties agreed to will modify the treaty's provision on taxation of gains from the sale of shares deriving their value from immovable property, and the permanent establishment rules. How the MLI modifies the following treaty provisions are discussed in detail below.

The Preamble

The preamble underscores the purpose and philosophy of the treaty, namely to avoid double taxation and prevent fiscal evasion of taxes on income and capital. Article 6(1) of the MLI will expand this to include preventing double taxation without creating avenues that give rise to nontaxation or reduced taxation through tax evasion or avoidance, including preventing treaty-shopping arrangements aimed at providing treaty benefits to residents of third jurisdictions. Both Nigeria and Spain have also opted to apply article 6(3) of the MLI in the treaty's preamble. This will further encourage the parties to develop their economic relationships and enhance cooperation in tax matters. With the help of the Spanish tax authorities, Nigeria should be able to easily spot tax avoidance strategies.

One strategy frequently employed by multinational enterprises in Nigeria is the use of artificial operating costs, including management and technical fees, to avoid income tax.[6] These fees are paid to entities in jurisdictions that have bilateral treaties with Nigeria, but which tax little or none of the income in the hands of the recipient. Transactions of this sort contradict the purpose of tax treaties and would no longer be permitted. Together with other multilateral agreements signed by Nigeria, the MLI tackles this form of abuse. Other multilateral agreements include the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and the Common Reporting Standard Multilateral Competent Authority Agreement. Spain has also signed both of these instruments.[7] The former ensures that the Nigerian tax authorities can easily cooperate with the Spanish tax authorities to obtain tax information or perform a joint audit of a taxpayer. Under the latter agreement, the Spanish tax authorities can exchange financial information with the Nigerian tax authorities upon request. These agreements could help the Nigerian tax authorities identify MNEs' profit-shifting transactions by using financial data to compare the scale of business operations in both jurisdictions vis-à-vis profit reported.

The Antiabuse Provision

The MLI will also modify the antiabuse provision contained in the protocol to the treaty. Under the protocol, the competent authority of Spain and Nigeria can only deny a treaty benefit if the main purpose of the transaction was to obtain a treaty benefit without bona fide commercial reasons.

The language of this antiabuse provision will be modified by article 7(1) of the MLI to read as follows:

> 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.

This antiabuse provision (often called the principal purpose test, or PPT) is a minimum standard. The PPT was adopted from the OECD's action 6 report, the section of the BEPS project that addresses the need to prevent the granting of treaty benefits in inappropriate circumstances.

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[6] Emmanuel Mayah, "Investigation: How MTN Ships Billions Abroad, Paying Less Tax in Nigeria," *The Premium Times* (Oct. 26, 2015).

[7] OECD, "Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters Status" (Jan. 24, 2018); and OECD, "CRS by Jurisdiction" (Mar. 1, 2018).

The PPT has been criticized as being subjective. Discussing a draft of action 6, professor Michael Lang suggested that this subjective standard is problematic because it is impossible to prove the taxpayer's motive.[8] He believes that the standard draws a conclusion based on reasonableness and thus creates a bias in favor of the tax authority.

Professor Reinout Kok has offered an approach for interpreting the subjective standard of the PPT.[9] His approach is best explained using Example C in paragraph 14 of the commentary to Article X(7), the section of BEPS action 6 report focused on the PPT. Briefly, the example involves an enterprise in Country R that decides to build a factory in Country S because it has a beneficial tax treaty. According to Kok, the subjective test of the treaty should look at the motive for building the factory rather than the motive for choosing Country S.

Further, granting the treaty benefit should be in line with the object and purpose of the treaty. The purpose of tax treaties as explained by paragraph 6 of the commentary on Article X(7) of the action 6 report is "to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favorable tax treatment."

Paragraphs 10 and 11 continue, providing a guide for applying the PPT:

> To determine whether or not one of the principal purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention, it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it . . . . all of the evidence must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose.

Based on these provisions, commentators have concluded that the subjective test in the PPT rule is objectified by a reasonableness test.[10] This reading stems from the action 6 commentary, which provides that all relevant facts and circumstances must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken for the purpose of obtaining treaty benefits.

Consideration of the commentary on BEPS action 6 and scholarly opinions regarding the PPT rule gives the impression that more is expected of tax authorities before denying a treaty benefit. The Nigerian tax authorities should not get carried away by merely assuming that taxpayers sought to obtain treaty benefits when structuring their transactions. Are there legitimate business reasons for a transaction? If so, then it is possible that obtaining a treaty benefit was not one of the principal reasons for the transaction. Importantly, the emphasis here is on the word "principal."

Most taxpayers do take treaty benefits into consideration when structuring cross-border transactions. The application of the PPT test in Nigeria must focus on whether there was a commercial purpose for the transaction beyond obtaining a treaty benefit.

Right to Tax Capital Gains

The MLI also modifies the right of a contracting state to tax gains from the sale of shares (or comparable interest like a partnership or trust) by a resident of the other state if the shares derive more than 50 percent of their value directly or indirectly from immovable property. Under article 9(4) of the MLI, Nigeria will only have the right to tax a resident of Spain on those gains if the relevant shares met this condition at any time during the 365 days before the sale. If this threshold is not met, the right to tax those capital gains is reserved for Spain, the residence state.

Article 13(4), the equivalent provision in the original Nigeria-Spain treaty, did not contain this

[8] Michael Lang, "BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties," *Tax Notes Int'l*, May 19, 2014, p. 655.

[9] Reinout Kok, "The Principal Purpose Test in Tax Treaties Under BEPS 6," 44(5) *Intertax* 409, 412 (2016).

[10] Dennis Webber, "The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) Versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law," 1 *Erasmus Law Review* 49, 59 (Aug. 28, 2017).

time requirement, suggesting that the condition had to be met at the time of alienation.

Artificial Avoidance of PE Status

The MLI will also change the rules regarding the creation of a PE. Article 5(5) of the treaty's original text treated an enterprise as having a PE when a dependent agent had and habitually exercised the authority to conclude contracts in the name of the enterprise for activities that were not merely preparatory in nature. The scope of what constitutes a PE will be expanded by article 12(1) of the MLI to include the activities of a person who plays a principal role leading to the conclusion of contracts that are routinely concluded without material modification. The relevant contracts include those in the name of the enterprise, that transfer ownership of property, that grant the right to use property owned by an enterprise, or are for the provision of services by the enterprise.This provision implements the recommendations in the BEPS action 7 final report about preventing the artificial avoidance of PE status.

Determining whether a PE exists is important because the right of the Nigerian tax authorities to tax the business profits of a foreign enterprise depends on the existence of a PE under a tax treaty. Sometimes MNEs attempt to avoid creating a PE using commissionnaire arrangements and similar strategies. A commissionnaire arrangement, as described in the BEPS action 7 report, involves a person selling products in a jurisdiction in the person's own name but on behalf of an enterprise that owns the products. This arrangement makes it easier to avoid creating a PE by ensuring the commissionnaire agent does not conclude contracts that bind the enterprise. This loophole is addressed in the MLI. Thus, under the MLI, as long as the activities of the agent are sufficient to conclude that a Spanish company is engaging in business in Nigeria, the profits will be subject to Nigerian income tax.

Article 5(6) of the Nigeria-Spain treaty provides that the activities of an independent agent do not constitute a PE when conducted in the ordinary course of business and at arm's length. The MLI goes a step further by creating an exception in article 12(2), which would allow a supposedly independent agent to constitute a PE. This applies when "a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related." That person would not be considered independent.

The essence of this exception is explained in paragraph 38.7 of the revised commentary on article 5(6) of the BEPS action 7 final report. Accordingly:

> Independent status is less likely if the activities of the person are performed wholly or almost wholly on behalf of only one enterprise (or a group of enterprises that are closely related to each other) over the lifetime of that person's business or over a long period of time.

Article 15(1) of the MLI regards a person as closely related to an enterprise if, based on all the facts and circumstances, one has control over the other or both are controlled by the same persons or enterprises. This would be presumed if one directly or indirectly has more than 50 percent beneficial ownership in the other or, for a company, either holds more than 50 percent of the aggregate vote and value of the shares or of the beneficial equity interest in the other. This 50 percent ownership rule did not exist under the original text of the treaty. In view of this pending modification, it is likely that subsidiaries of Spanish companies in Nigeria could constitute PEs of their parent companies. This is in spite of article 5(7) of the treaty, which provides that control of a company by a resident of the other contracting state shall not itself constitute a PE for that resident.

Notably, the MLI will not eliminate the effect of article 5(7) of the treaty. Rather, the commentary to the article 7 report indicates that it is focused on situations in which the controlled subsidiary is not only responsible to its parent company for the results of its work, but is also subject to significant control regarding the manner in which the work is carried out.

If the bulk of a subsidiary's revenue is derived from acting for its parent company, that fact could negate independence. An example in the action 7 report is when more than 90 percent of a subsidiary's revenue is derived from acting for the parent company. When determining independence, another criterion the tax authorities can consider is who bears the entrepreneurial risk.

MNEs doing business with local subsidiaries should take note of the MLI's provisions and consider possible local tax exposures in the future.

Conclusion

As Nigeria expands its tax treaty network, the MLI can help protect the country's tax base, which has been continuously eroded by companies using various tax strategies involving the misuse of tax treaties. However, the desire to protect the tax base must be balanced against fulfilling the object and purpose of tax treaties. The tax authorities should be inclined to grant a treaty benefit when a transaction is legitimately motivated by business reasons. ■