

Impact of BEPS Action 6 and Article 7 of MLI on India's tax treaties

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Key aspects of BEPS Action 6

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- Identified treaty abuse, and in particular tax treaty shopping, as one of the most important sources of BEPS concerns
- Three alternative rules to address tax treaty abuse
 - Principal purpose test (PPT) rule
 - PPT rule, supplemented with either simplified or detailed limitation of benefits (LOB) rule
 - Detailed LOB rule, supplemented by a mutually negotiated mechanism to deal with conduit arrangements not already dealt with in tax treaties

Key aspects of BEPS Action 15 / Multilateral instrument (MLI)

Key aspects of BEPS Action 15 / MLI

- MLI is an outcome of BEPS Action 15
- Specifically addresses the issue of how to modify existing bilateral tax treaties in order to implement BEPS tax treaty measures
- MLI is signed and has come into force from 1 July 2018
- MLI will modify an existing tax treaty only if both the countries have notified the tax treaty for the purposes of MLI (such a tax treaty is referred to as Covered Tax Agreement – CTA)
 - India has notified all its tax treaties (such as USA, UK, Singapore, Netherlands, Japan, etc.)
 - Some countries (such as Mauritius, Germany and China) have chosen not to notify their tax treaty with India
 - USA and Brazil are not signatories to the MLI itself

Structure of the MLI

Part	Title	Articles	BEPS Action Plans
I	Scope and interpretation of terms	1 and 2	-
II	Hybrid mismatches <ul style="list-style-type: none">• Transparent entities• Dual resident entities• Methods for elimination of double taxation	3 to 5	Action Plans 2 and 6
III	Treaty abuse <ul style="list-style-type: none">• Purpose of tax treaties (minimum standard)• Prevention of treaty abuse (minimum standard)• Dividend transfer transactions• Capital gains on interests in land rich entities• Third country PEs• Taxation of own residents	6 to 11	Action Plan 6
IV	Avoidance of PE status <ul style="list-style-type: none">• Commissionaires and similar arrangements• Specific activity exemptions• Splitting-up of contracts• Definition of a person closely related to an enterprise	12 to 15	Action Plan 7
V	Improving dispute resolution (minimum standard)	16 and 17	Action Plan 14
VI	Arbitration	18 to 26	
VII	Final provisions	27 to 36	-

MLI modifies the operation of existing tax treaties

- MLI modifies the operation of existing tax treaties between parties
- None of the bilateral tax treaties will actually be amended
- MLI and tax treaty have to be read together
- Each party to the MLI specifies which existing treaties the MLI applies to (Covered Tax Agreements - CTAs)

Term used	When applicable	Impact
“in place of”	There is an existing provision in the CTA	Existing CTA provision is replaced
“applies to” or “modifies”		Application of an existing provision is amended without replacing it
“in absence of”	The provision is absent in the CTA	The provision is added to the CTA
“in place of” or “in absence of”	The provision is present or absent in the CTA	The existing provision is replaced / superseded or MLI provision is added to CTA (in absence of existing provision)

Article 6 of the MLI

Article 6 of the MLI – purpose of a CTA

- Express statement to be mentioned in the preamble to every CTA (as part of the minimum standard):
 - that the intention is to eliminate double taxation with respect to taxes covered by the CTA;
 - 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 the CTA for the indirect benefit of residents of third jurisdictions)
- Optional provision which may also be included in the preamble:
 - desiring to further develop economic relationship and to enhance cooperation in tax matters
- Article 6 to apply to all India's CTAs – MLI preamble will be added to the existing preamble language in India's CTA
- India has not opted for the optional provision

Article 7 of the MLI

Article 7 of the MLI – prevention of treaty abuse

- As a minimum standard, jurisdictions should implement one of the following three:
 - Principal purpose test (PPT)
 - PPT plus limitations on benefits (LOB) provision – LOB can be either simplified or detailed
 - Detailed LOB provision plus anti-conduit arrangement
- Optional provision (PPT) – state to grant treaty benefits when PPT invoked, as would have been available in absence of transaction or arrangement
- India has opted for PPT plus simplified LOB provision
- India has opted not to grant treaty benefits when PPT invoked

Overview of PPT rule of the MLI

- Minimum standard
- Obtaining the benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit
- Exception – granting benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty
- Generally, PPT rule of the MLI will replace the existing anti-abuse provision in the tax treaty or will be inserted in the absence of anti-abuse provision in the tax treaty

Overview of PPT rule of the MLI

Article 7(1) of the MLI is reproduced as under:

“ 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.”

Overview of Simplified LOB of the MLI

- Optional
- Generally, simplified LOB rule of the MLI will be applicable to a tax treaty only if both the countries have opted for it
- India has chosen to apply the simplified LOB
- Very few other countries have chosen simplified LOB – Argentina, Armenia, Bulgaria, Chile, Colombia, Indonesia, Mexico, Russia, Senegal, the Slovak Republic and Uruguay
- Briefly, simplified LOB provisions limit the tax treaty benefit to Qualified Persons of a contracting jurisdiction – qualifying persons is defined / explained

Overview of Simplified LOB of the MLI

Qualified person

- Tax Treaty benefits (other than those relating to determination of residence of a dual resident non-individual person, corresponding adjustment and MAP) available only to 'qualified person' (QP), which covers:
 - Individual
 - Contracting jurisdiction / political subdivision/ local authority
 - Listed entity
 - Specified type of NGO / regulated retirement benefit entity
 - Entity in which atleast 50% shares are held, directly or indirectly, by any of the above persons who are residents of the State (on at least half of the days of 12 month period that includes time when benefit would otherwise be accorded)

Alternative condition 1

- 'Active conduct of business' and income 'emanates from' or 'is incidental to' that business
- Active conduct of business – not defined in MLI
 - Persons through whom the entity is acting, such as officers or employees of a company, should conduct substantial managerial and operational activities (OECD 2017 update)

Overview of Simplified LOB of the MLI

- Active conduct of business - exclusions
 - Operating as Holding Company
 - Supervision / administration of group companies
 - Group financing
 - Making / managing investments (except banks / insurance cos / registered security dealer)
- ‘Emanates from’
 - Factual connection between the actively conducted business and item of income
 - Important to compare lines of business – upstream or downstream
- “Derived in connection with” vs. “emanates from”
 - Item of income is ‘incidental to’ the business if production of the item facilitates the conduct of the business
 - Income derived from the temporary investment of working capital
- Condition of “substantial” business activity in certain cases
- Activities conducted by connected persons

Overview of Simplified LOB of the MLI

Alternative condition 2

- Treaty benefits to be available to a resident who is not a QP if:
 - ‘Equivalent Beneficiaries’ own, directly or indirectly, at least 75% of the beneficial interests of the resident on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded

Discretionary relief

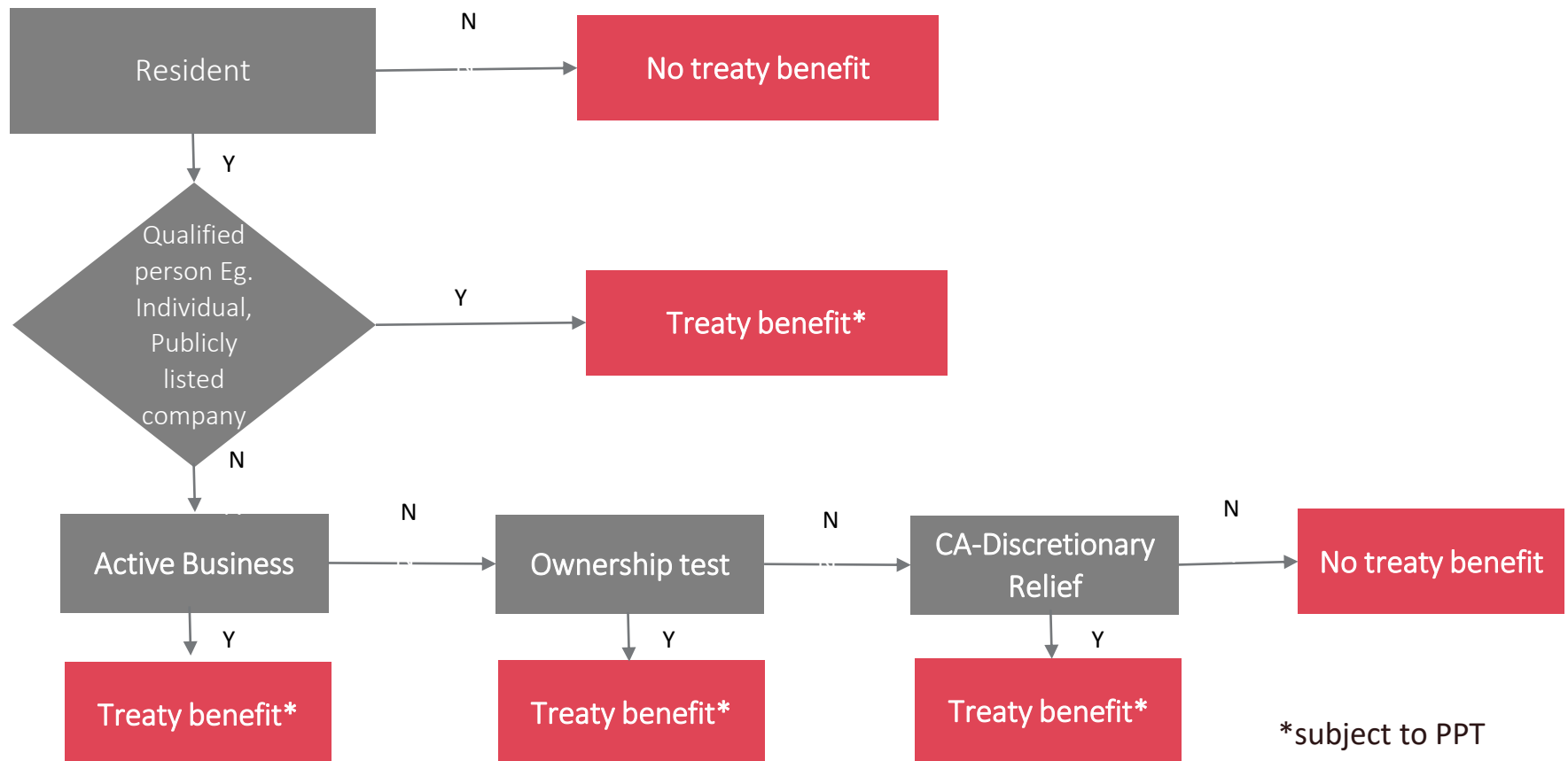
- Competent authorities to grant benefits in other cases if resident demonstrates that neither its establishment, acquisition or maintenance, nor conduct of its operation had as one of its principal purposes the obtaining of benefits under the CTA

Other aspects

- Simplified LOB is an optional provision – applicable only if both the parties opt for it
- Possible to apply Simplified LOB symmetrically or asymmetrically
- State choosing SLOB may opt out of Art. 7 entirely in some cases

Overview of Simplified LOB of the MLI

As per LOB measure, treaty benefits are available only if the following requirements are satisfied:



Overview of Detailed LOB provision

- Out of the scope of MLI
- Countries that prefer to address treaty abuse by adopting a detailed LOB provision are permitted to opt out of the PPT and agree instead to endeavor to reach a bilateral agreement that satisfies the minimum standard
- MLI does not provide for the text of the detailed LOB – both countries agree on the text of the detailed LOB

Impact on select India's tax treaties

Impact on select India's tax treaties

– India-UK tax treaty

Article	India	UK	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√	<p>Preamble language to be added to the existing preamble text.</p> <p>Optional provision relating to the desire to develop economic relationship and enhance cooperation in tax matters chosen by UK to not apply.</p>
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	<p>Currently, there are anti-abuse rules relating to dividend, interest and royalties and also a general anti-abuse rule.</p> <p>While UK has notified all the above, India has notified only the general anti-abuse rule. PPT to replace the general anti-abuse rule and to supersede the specific anti-abuse rules to the extent of incompatibility.</p> <p>Further, option chosen by UK to provide benefits when PPT is invoked (subject to determination by competent authority) not to apply.</p> <p>SLOB to not apply.</p>

Impact on select India's tax treaties

– Relevant extracts from India-UK tax treaty

Article 4 – Fiscal Domicile

1(b). in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

Article 11 – Dividend

6. No relief shall be available under this Article if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment.

Article 12 – Interest

11. The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.

Article 13 – Royalties and Fees for Technical Services

9. The provisions of this Article shall not apply if it was the main purposes or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment.

Article 28C – Limitation of Benefits

1. Benefits of this Convention shall not be available to a resident of a Contracting State, or with respect to any transaction undertaken by such a resident, if the main purpose or one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by him, was to obtain benefits under this Convention.

Impact on select India's tax treaties

– India-Netherlands tax treaty

Article	India	Netherlands	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√	<p>Preamble language will be added to the existing preamble text.</p> <p>Further, optional provisions chosen by Netherlands relating to the text “desiring to further develop economic relationship and to enhance their co-operation in tax matters” shall not apply (as India has not made notification in this regard).</p>
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	<p>No such provision in the existing treaty. PPT to apply to the tax treaty.</p> <p>Netherlands has also opted for treaty benefits to be granted when PPT invoked (subject to determination by competent authority). However, the same not to apply as India has not opted. SLOB to not apply.</p>

Impact on select India's tax treaties

– India-Singapore tax treaty

Article	India	Singapore	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√	<p>Preamble language will be added to the existing preamble text.</p> <p>Further, optional provisions chosen by Singapore relating to the text “desiring to further develop economic relationship and to enhance their co-operation in tax matters” shall not apply (as India has not made notification in this regard).</p>
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	<p>Currently, benefits provided to gains arising from shares acquired prior to 1 April 2017 and to shares acquired post 1 April 2017 but sold prior to 31 March 2019 are subject to primary purpose test and substance requirements (LOB provision).</p> <p>Existing provisions on primary purpose test not notified by India or Singapore. PPT under MLI to supersede these provisions to the extent of incompatibility (i.e. PPT to be invoked for claiming any benefit under the treaty and not just grandfathering / concessional rate benefit provisions for capital gains). Further, option chosen by Singapore to provide benefits when PPT is invoked (subject to determination by competent authority) not to apply. LOB provision of treaty to continue. SLOB to not apply.</p>

Impact on select India's tax treaties

– Relevant extracts from India-Singapore tax treaty

Article 13 – Capital gain

4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.

4B. Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.

4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State

Article 24A

1. A resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement if its affairs were arranged with the primary purpose to take advantage of the benefits in the said paragraph 4A or paragraph 4C of Article 13 of this Agreement, as the case may be.

2. A shell or conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement. A shell or conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

Explanation - The cases of legal entities not having bona fide business activities shall be covered by paragraph 1 of this Article.

Impact on select India's tax treaties

– India-Japan tax treaty

Article	India	Japan	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√ (India treaty notified)	Preamble language will be added to the existing preamble text. Further, optional provisions chosen by Japan relating to the text “desiring to further develop economic relationship and to enhance their co-operation in tax matters” shall not apply (as India has not made notification in this regard).
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	No such provision in the existing treaty. PPT to apply to the treaty. SLOB to not apply.

Impact on select India's tax treaties

– India-Canada tax treaty

Article	India	Canada	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√ (No treaty notified)	Preamble language will be added to the existing preamble text
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	India has chosen PPT plus simplified LOB. Canada has chosen PPT as an interim measure and intends where possible to adopt LOB in addition to or in replacement of PPT through bilateral negotiations. PPT to apply currently to the treaty. SLOB to not apply.

Impact on select India's tax treaties

– India-Australia tax treaty

Article	India	Australia	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√ (India treaty notified)	<p>Preamble language to be added to the existing preamble text.</p> <p>Further, optional provisions chosen by Australia relating to the text “desiring to further develop economic relationship and to enhance their co-operation in tax matters” shall not apply (as India has not made notification in this regard).</p>
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	<p>No such provision in the existing treaty. PPT to apply to the tax treaty.</p> <p>Australia has also opted for treaty benefits to be granted when PPT invoked (subject to determination by competent authority). However, the same not to apply as India has not opted.</p> <p>SLOB to not apply.</p>

Impact on select India's tax treaties

– India-Cyprus tax treaty

Article	India	Cyprus	Impact on the treaty
Article 6 – Purpose of Covered Tax Agreement	√ (No treaty notified)	√ (India treaty notified)	<p>Preamble language to be added to the existing preamble text.</p> <p>Further, optional provisions chosen by Cyprus relating to the text “desiring to further develop economic relationship and to enhance their co-operation in tax matters” shall not apply (as India has not made notification in this regard).</p>
Article 7 – Prevention of Treaty Abuse	√ (PPT + SLOB)	√ (PPT)	<p>No such provision in the existing treaty. PPT to apply to the tax treaty.</p> <p>Cyprus has also opted for treaty benefits to be granted when PPT invoked (subject to determination by competent authority). However, the same not to apply as India has not opted.</p> <p>SLOB to not apply.</p>

THANK YOU