

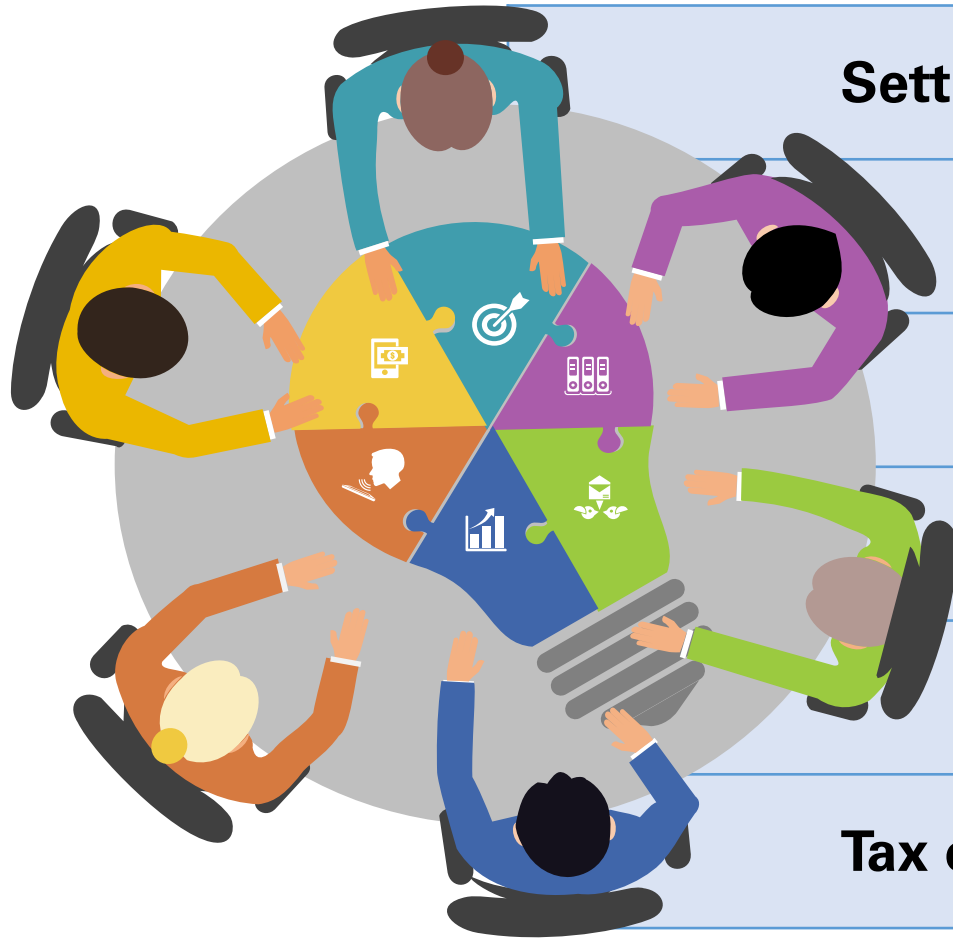
Multilateral Instruments - Indian Perspective

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15 December 2018



Agenda



Setting the Context

Introduction to MLI

India's Positions on MLI

Denial of Treaty Benefits

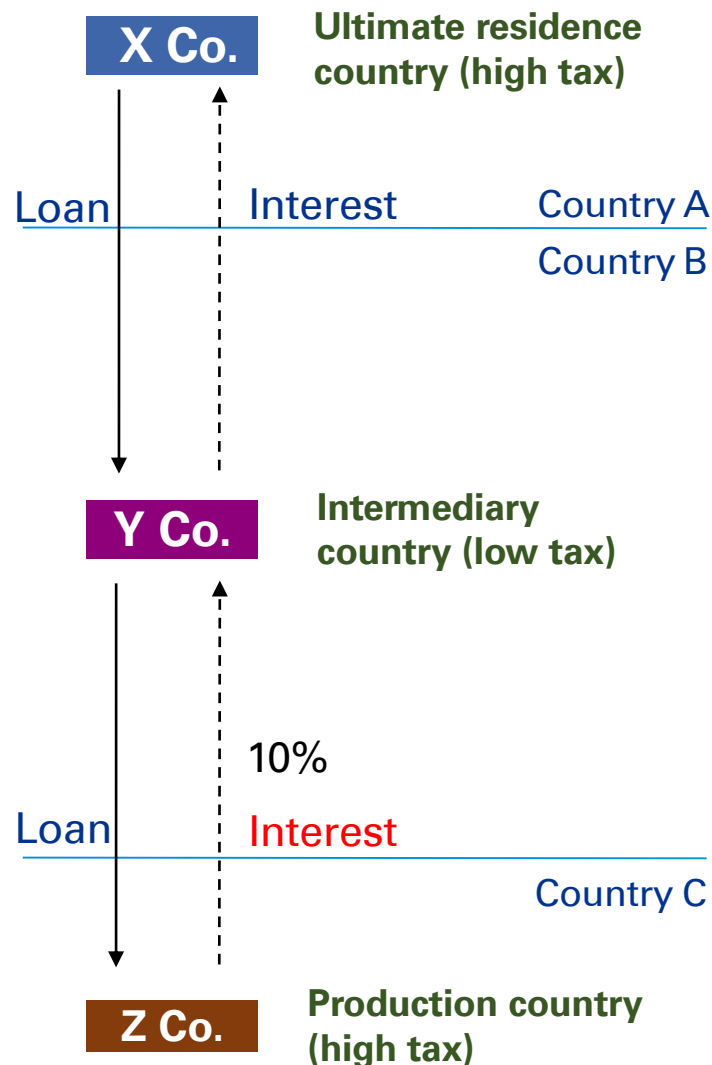
Artificial Avoidance of PE Status

Tax on Particular Streams of Income

A close-up photograph of a person's hands in an office environment. The right hand holds a black pen, and the left hand holds a smartphone. The background is blurred, showing a laptop keyboard and some papers. A blue arrow-shaped banner is overlaid on the bottom half of the image, containing the text 'Setting the Context' in white.

Setting the Context

Setting the Context



- X Co. plans to give loans to Z Co. situated in Country C which does not have a tax treaty with Country A.
- Y Co. is set up in Country B. X provides loan to Y Co. and Y Co provides loans to Z Co.
- Under domestic laws of Z Co., interest is taxable @ 40%. However, by way of treaty benefit, interest paid to Y Co. is taxable @ 10%.
- Y is located in low tax jurisdiction whose domestic laws exempt foreign income and also does not tax interest payment to X Co.
- This situation leads to a Base Erosion and Profit Shifting ('BEPS') concern in Country C.
- **To address such issues, the OECD has developed various BEPS Action Plans.**
- **Action Plan 15 aims at development of Multilateral Instruments to help streamline BEPS measures.**

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Introduction to MLI

Introduction to MLI

What is MLI?

MLI is a multilateral treaty that enables jurisdictions to swiftly modify their bilateral tax treaties to implement to better address multinational tax avoidance

Why has MLI been developed?

MLI helps fight against base erosion and profit shifting (BEPS) by abuse of tax treaties. The MLI instruments modifies treaties by sitting alongside treaties.

MLI - Overview

What is MLI and its objectives

- Single instrument that modifies bilateral tax treaties in a synchronised, fast and consistent manner
- One negotiation, one signature, one ratification

Impact

- To modify 1200+ tax treaties in first signing; intended to cover 3000+ tax treaties

Actions implemented

- Action 2 (Hybrid mismatches)
- Action 6 (Treaty abuse)
- Action 7 (Permanent Establishment)
- Action 14 (Dispute resolution)

Legal status

- MLI does not function as protocol, needs to be read with existing tax treaties – applicable only when both countries sign MLI
- Does not replace existing tax treaties but modifies them

MLI - Framework

Minimum Standards

- All countries to meet certain minimum standards (Action 6 - Treaty Abuse; Action 14 – Dispute Resolution)
- No leeway to opt out of the minimum standards, except in limited cases
- Flexibility to opt out of a provision if it is not a minimum standard

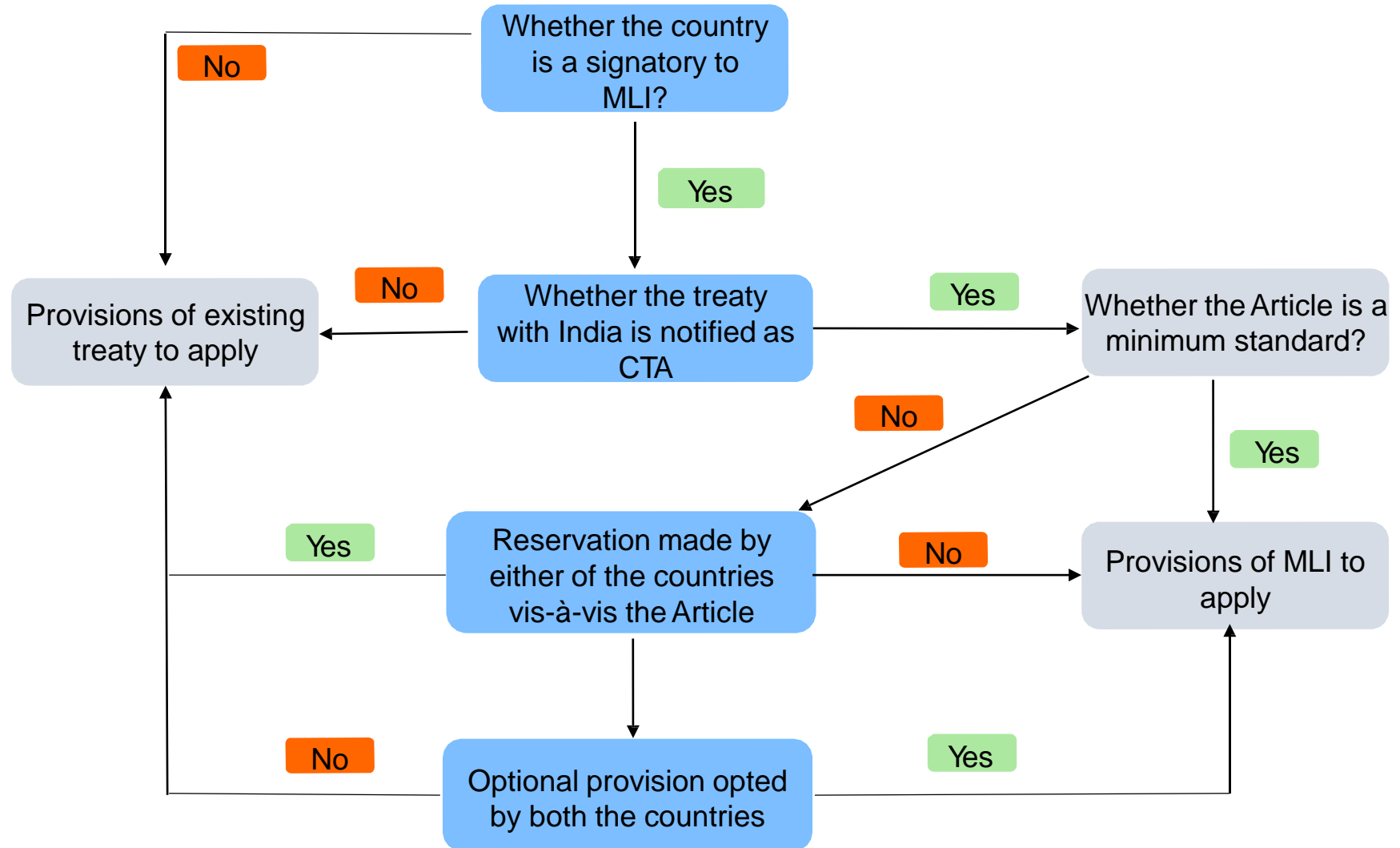
Optional provisions

- Option to choose among alternative provisions intended to address the same issue
- Both the countries to choose the same option in order for it to apply

Notification Clauses

- Notify choice of optional provision
- Also, notify the existing provision of Covered Tax Agreement ('CTA') to be modified / replaced

Applicability of MLI - Process Flow



India's Positions on MLI - Current Status


India has specified 93 tax treaties to be covered by MLI



Out of 93 countries, 59 countries have signed MLI as on date



Out of 59 countries, 3 countries have not included India in their CTAs
(viz. China, Germany and Mauritius)



56 countries have included India in their CTAs

MLI Status of India's Major Trading Partners

Some countries which have not signed MLI

- USA
- Brazil
- Philippines
- Thailand
- Kenya

Countries which have not included India as a CTA

- China
- Germany
- Mauritius

Some countries which have included India as a CTA

- Singapore
- Netherlands
- Australia
- United Kingdom
- France
- Canada
- Japan
- Sweden
- Luxembourg
- Spain
- Korea
- Cyprus

A close-up photograph of a person's hands in a professional setting. The left hand holds a black pen, and the right hand holds a smartphone. The background is slightly blurred, showing a laptop keyboard and some papers. A blue arrow-shaped banner is overlaid on the bottom half of the image, containing the text 'India's Positions on Articles of MLI'.

India's Positions on Articles of MLI

India's Positions on MLI – India's Reservations

India's Reservations

- Article 3 – Transparent Entities
- Article 5 – Application of Methods for Elimination of Double Taxation
- Articles 18 to 26 – Mandatory Arbitration

Since India has made reservations on applicability of aforesaid Articles, these shall not amend / modify existing CTAs and are of a lesser practical significance.

A close-up photograph of a person's hands. The right hand holds a black pen, and the left hand holds a smartphone. The background is a blurred laptop keyboard and a white document. A blue arrow-shaped graphic points to the right, containing text.

Denial of Treaty Benefits

- **Article 4** – Dual Resident Entities
- **Article 6** – Purpose of CTA
- **Article 7** – Prevention of Treaty Abuse

Article 4 – Dual Resident Entities - Overview

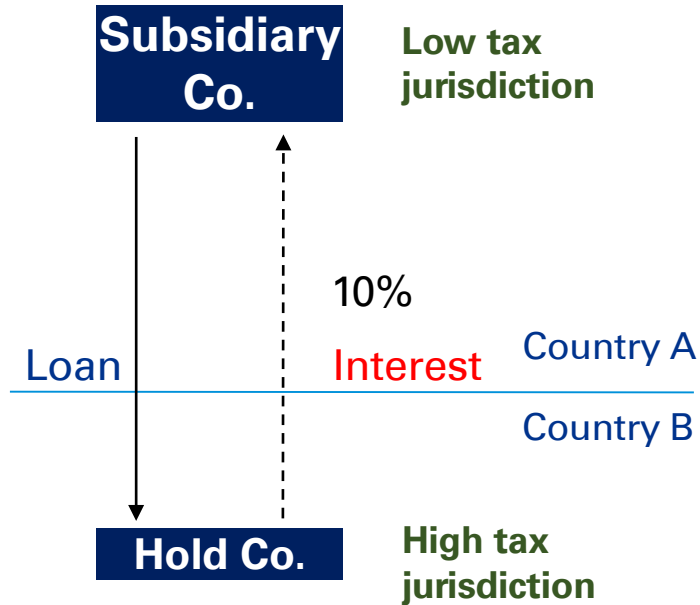
Article 4(1) of MLI –

*“Where by reason of the provisions of a Covered Tax Agreement a **person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities ('CA') of the Contracting Jurisdictions shall endeavor to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the CA of the Contracting Jurisdictions**”*

Impact on India:

- India has not made any reservation in respect of this Article;
- Applicability depends on treaty partner reservations;
- May lead to practical challenges in India in light of the POEM as test of corporate residency under domestic law

Article 4 - Dual Resident Entities - India Impact



Case Study

X has its residence in Country A under its domestic laws, due to place of incorporation

X has its residence in Country B under its domestic laws, due to Place of Effective Management

If Country A and B have a CTA, the competent authorities shall then mutually decide the basis of residency of entity X

Key Treaties – Modified	Key Treaties – Unchanged
Netherlands, Australia, UK, Japan	Cyprus, Singapore, Luxembourg, Canada, Sweden, France

Article 4 - Dual Resident Entities - Issues

- **Tax Treaties do not define POEM so domestic tax law relevant as per Article 2**
- **POEM test per CBDT Circular v. Model Conventions v. Domestic Tax Law of other Jurisdiction involved**
- **MAP decision / rationale are not made public by Tax Authorities**
- **The biggest impact of this article is on taxpayer. However, the taxpayer is not involved in the Mutual Agreement Procedure between two jurisdictions to determine the status of dual residency.**

Article 6 – Purpose of CTA (Preamble) – Overview

“...to eliminate double taxation with respect to taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements....)”

Minimum Standard

Compatibility clause – *‘in place of or in absence of’*

India position – no CTA notified

Intent of Preamble –

- Intent of preamble to prevent treaty abuse without impairing mutual economic co-operation;
- Prevent inappropriate use of treaty by residents of third country or avoid double non-taxation/reduced taxation

Article 6 - Purpose of CTA - Impact on India

- India-Mauritius tax treaty embodies the philosophy of encouragement of mutual trade and investment as one of the objects in the preamble to the treaty.
- The Supreme Court, in the case of *Azadi Bachao Andolan (263 ITR 706)*, concluded that a developing country may, in the interest of encouraging economy, tolerate hardship of treaty shopping on a conscious basis, just as it may tolerate inflation.
- It remains a question whether aforesaid decision shall prevail over the MLI or shall get diluted due to the MLI.

Whether the preamble to impact interpretation of position approved by courts?

Article 6 - Purpose of CTA - Few Examples

India - Mauritius Treaty Preamble	<i>The Government of, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains and for the encouragement of mutual trade and investment, have agreed as follows</i>
Impact on Treaty	<i>Mauritius has not notified India as a country whose treaty it wants to modify through MLI. Until Mauritius has shown willingness, no part of MLI can modify the India-Mauritius treaty on a unilateral basis. As a result, existing India-Mauritius treaty continues to subsist without a change and has not acquired the status of CTA.</i>

India-Singapore Treaty Preamble	<i>The Government of, desiring to conclude an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows</i>
Impact on Treaty	<i>Singapore has notified India as a CTA and hence the preamble language is likely to change. The current preamble of treaty contains the objective of prevention of double taxation and fiscal evasion. The preamble language is likely to get widened with new preamble which provides for 'without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance' and anti-treaty shopping objective.</i>

Change in language of preamble would have impact on the way in which tax treaties are interpreted by judicial authorities in India

Article 7 – What is PPT and SLOB?

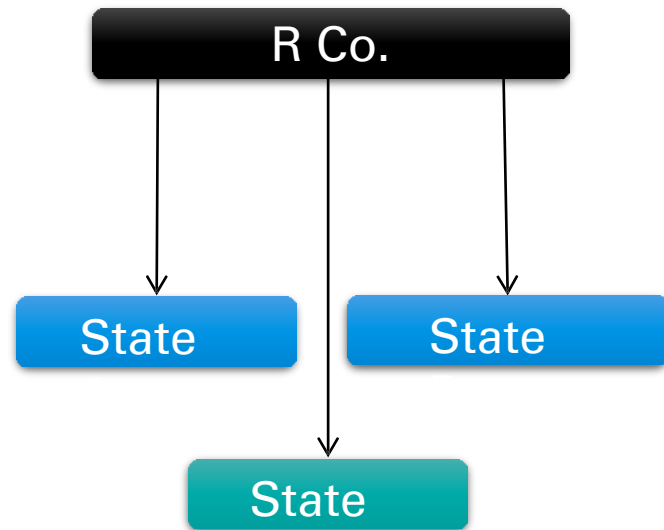
PPT

- A benefit under a treaty shall not be granted if it is reasonable to conclude, having regard to all facts and circumstances that obtaining a tax benefit was the principal purpose or one of the principal purposes of an arrangement / transaction that led to the benefit.
- Article 7 is a minimum standard – the PPT will apply to all of India's covered tax agreements
- Provisions are similar to GAAR, but apply independently of the Income-tax Act

SLOB

SLOB is an objective test to define the objective criterion that forms the basis of whether the income recipient would be a qualifying treaty eligible person. Essentially, a person will not qualify for treaty benefit if it does not satisfy the SLOB test. It will be eligible for treaty benefit only if it fulfils any one of the prescribed tests.

Article 7 - PPT - Case Study 1

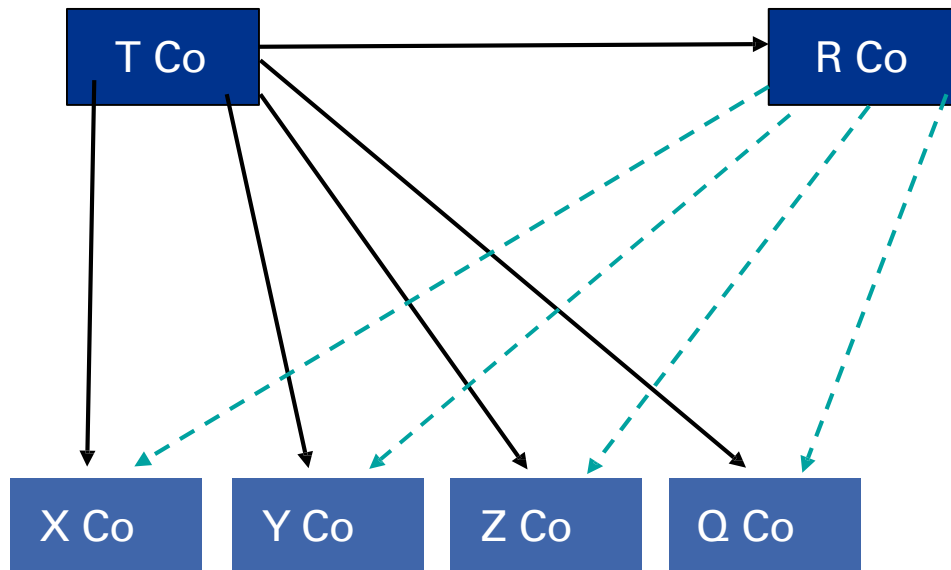


- RCo, a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly.
- It is now considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs.
- After a preliminary review, possible locations in three different countries are identified. All 3 countries provide similar environments.
- After considering the fact that State S is the only one of these countries with which State R has a tax convention, the decision is made to build the plant in that State.
- **Can treaty benefit be denied?**

BEPS recommendations

- Whilst the decision to invest in State S is taken in the light of the benefits provided by the State R-State S tax convention, it is clear that the principal purpose for making that investment and building the plant are related to the expansion of R Co's business and the lower manufacturing costs of that country
- Given that a general objective of tax conventions is to encourage cross-border investment, obtaining the benefits of the State R-State S convention for the investment in the plant built in State S is in accordance with the object and purpose of the provisions of that convention

Article 7 - PPT - Case Study 2



- T Co owns number of operating subsidiaries in different countries
- It sets up R Co, regional company, to render accounting, legal, HR, financing & treasury services, etc.
- This decision is mainly driven by
 - Availability of skilled labour, reliable legal system, business friendly environment, political stability, sophisticated banking industry, etc.; and
 - the comprehensive double taxation Tax Treaty network of State R

PPT rule not to apply if R Co undertakes significant FAR for providing services through its own personnel

Article 7 – Interplay of PPT and GAAR

- Notwithstanding any provisions of a CTA, a **benefit** under the CTA shall not be granted if it is **reasonable to conclude** that **one of the principal purposes** of **any transaction or arrangement** is to obtain benefit under the Tax Treaty
 - **Unless it is established that granting benefit would be in accordance with the object and purpose of the Tax Treaty**
- PPT supplements and does not restrict the scope or application of other provisions. Objects of PPT and GAAR are similar
- A benefit that is denied under other para cannot be claimed under this para
- Non-obstante clause could deny benefits available under other paragraphs
- GAAR denies treaty benefit if tax benefit is the main purpose. Whereas, obtaining the benefit under a tax convention should be **one of the** principal purpose to attract PPT Rule for treaty benefit denial
- Provisions wider than GAAR. One must also examine whether PPT rule is powerful enough to undo the grandfathering provisions present in GAAR with respect to Capital Gains

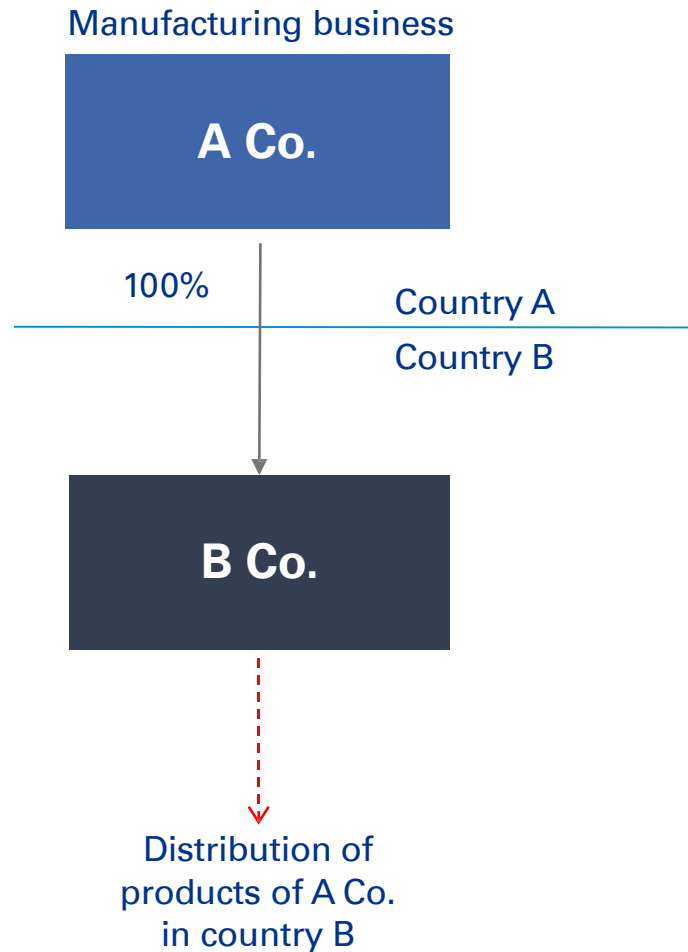
Article 7 – Position adopted by India – SLOB

- Optional provision. Possible to apply SLOB symmetrically or asymmetrically.
- Tax Treaty benefits available only to **'qualified person'**, which covers:
 - Individual
 - Contracting jurisdiction / political subdivision / local authority
 - Listed entity
 - NGO / regulated retirement benefit entity
 - Entity where > 50% shares held by above persons who are residents of the State, on at least half of the days in 12 month period
- Tax Treaty benefits to be available to non-qualified persons engaged in **'active conduct of business'** if income derived from other State **'emanates from'** or **'is incidental to'** that business (*including conduct of business through connected person*)
- Activities not falling under **'active conduct of business'**
 - Operating as Holding Company
 - Supervision / administration of group companies
 - Group financing
 - Making / managing investments (except banks / insurance cos / registered security dealer)

- **Derivative Benefit:**

A resident who is not a QP shall also be entitled to tax treaty benefits if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, as per Equivalent Beneficiary Rules, directly or indirectly, at least 75% of the beneficial interests of the resident

Article 7 – SLOB – Case Study



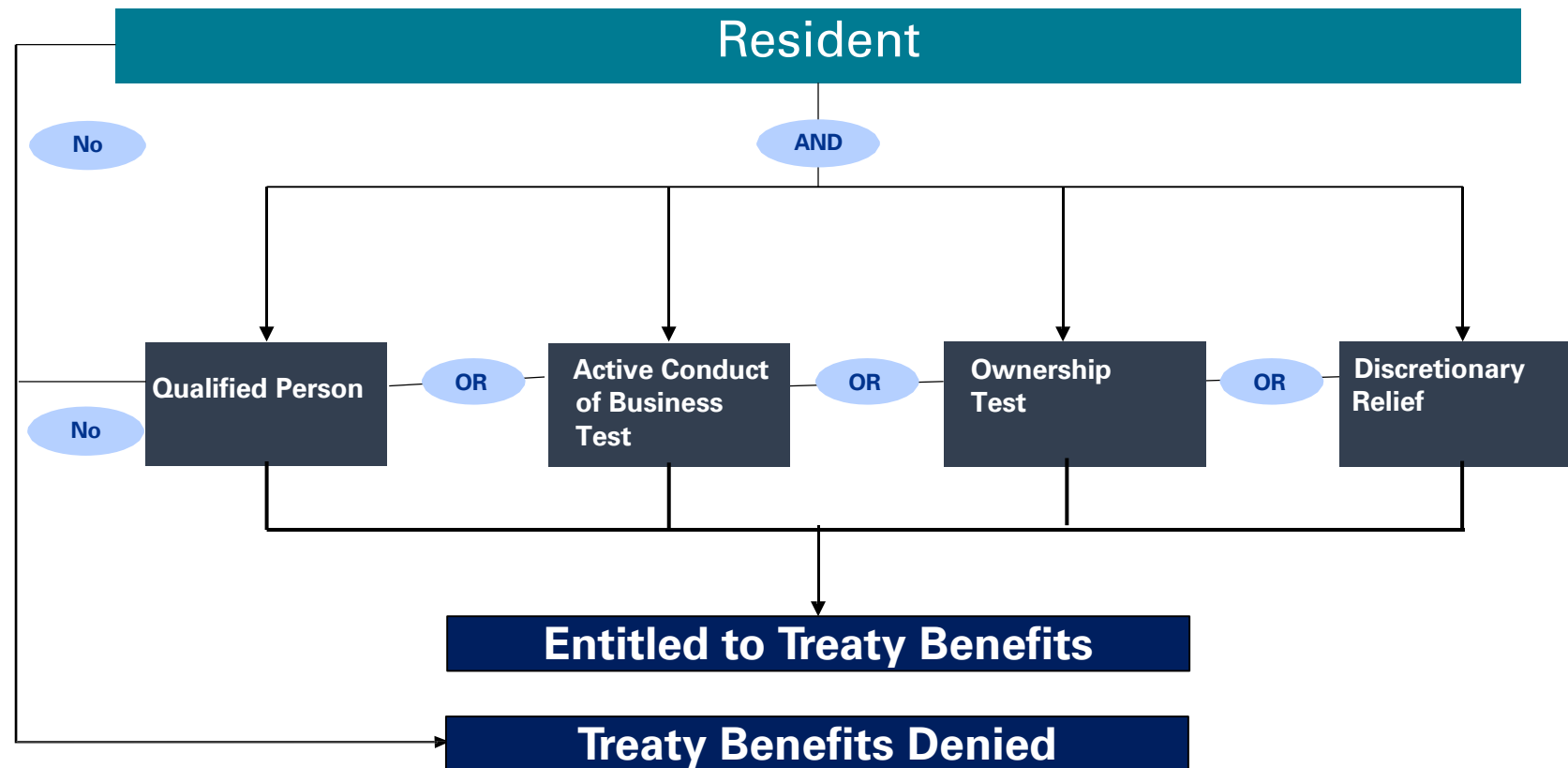
- A Co. is a company resident of State A
- Engaged in manufacturing business in State A
- Owns 100 per cent of the shares of B Co., a company resident of State B
- B Co. distributes A Co's products in State B
- Whether dividends paid by B Co. to A Co. entitled to treaty benefits?

Distribution activity of B Co is “factually connected” to A Co.’s manufacturing activity

Dividends paid by B Co to be treated as “emanating from” A Co’s business

Article 7 – Position adopted by India – SLOB – Process Flow

Entitlement to Treaty Benefits where SLOB is applicable:



SLOB clause has been adopted by 12 jurisdictions viz. Argentina, Armenia, Bulgaria, Chile, Colombia, India, Indonesia, Mexico, Russia, Senegal, Slovakia and Uruguay. Since none of these are major trading partners to India, SLOB clause shall not have significant impact from India perspective. Greece allows asymmetrical application of SLOB clause along with PPT.

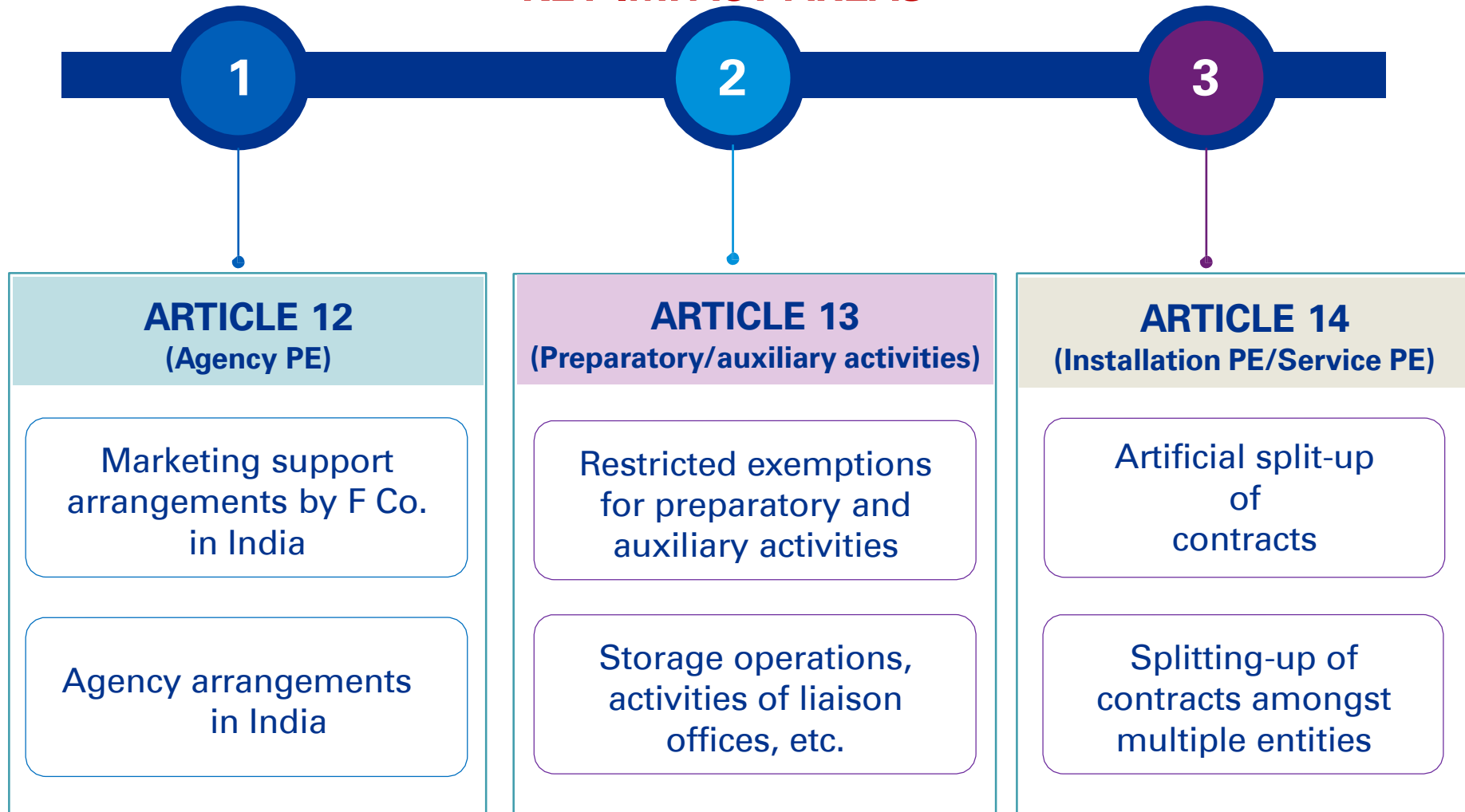
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Artificial Avoidance of PE Status

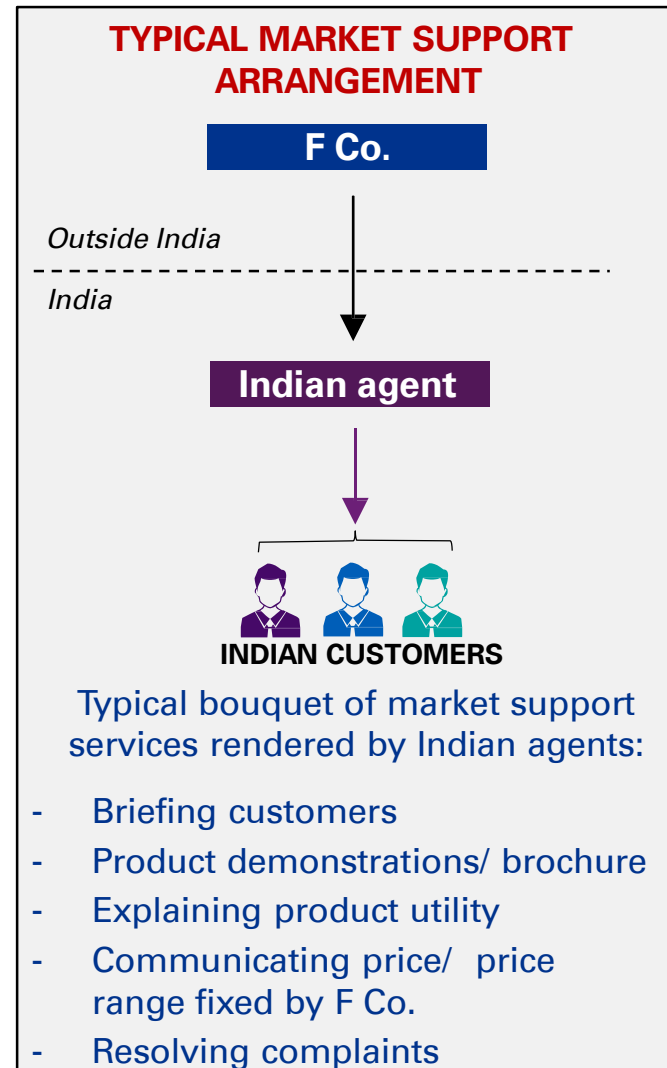
- **Article 12** - Commissionnaire Arrangements and Similar Strategies
- **Article 13** – Specific Activity Exemptions
- **Article 14** – Splitting-up of Contracts

Artificial Avoidance of PE Status

KEY IMPACT AREAS



Article 12 – Commissionaire / Market support arrangements



KEY CHANGES PROPOSED BY MLI

- **Scope** of PE expanded to include agent **playing principal role**, leading to routine conclusion of contracts, **without material modification**
- Agent acting **exclusively** or **almost exclusively** on behalf of one or more closely related enterprises not to be considered independent

CASE FOR 'NO PE' SO FAR

- **No agency PE, absent** authority to **conclude contracts**
- **No PE** if agent working for **multiple principles**

CASE FOR 'YES PE' POST MLI

- **Substantive activities** of agent leading to contract conclusion, even if no authority to conclude contracts
- **Multiplicity of closely related principles** to be viewed collectively for ascertaining independence

No reservations made by India

Some countries that have not made reservation

Netherland, France, Japan, Indonesia

Some countries that have made reservation

UK, Singapore, Cyprus, Canada, Ireland, Australia, Luxembourg

Likely rise in PE disputes – Imperative for corporates to mitigate risk through robust documentation

Agency PE – Parameters Amended – Business Connection

Definition under the Act aligned as per Article 12 of the MLI

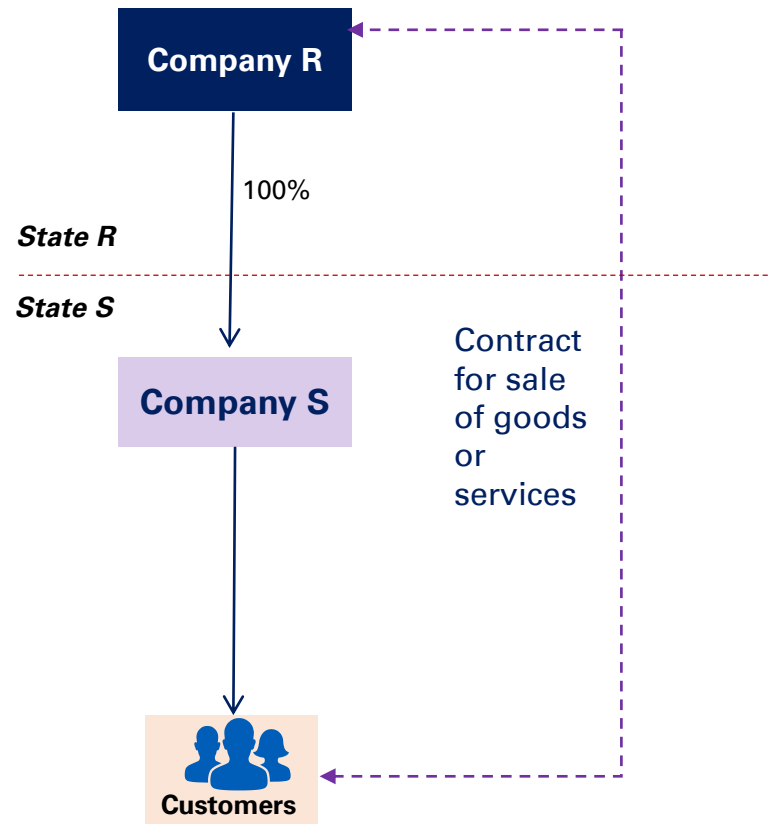
No PE case Pre-amendment

- **Agency scope** – No authority to **conclude contracts** for F Co
- **Non-exclusivity of agency:**
 - agent not **rendering service solely** to F Co. in source state; and
 - agent not deriving **entire / almost entire revenue** from F Co.

Amendment

- **Scope** of PE expanded to include agent **playing principal role** leading to routine conclusion of contracts by Foreign Company **without material modification**
- Participation in **negotiation** may be **relevant** but not **sufficient** factor
- **Principal role not defined**

Principal role - Case Study



MECHANICS

- Employees of Company S interact with prospective customers (in State S) and convinces them for contracting with Company R;
- They (i.e. employees of Company S) explain the standard terms of (Company R's) contract to prospective customers;
- Employees are not authorized to modify the contracts (to be executed online) and the price is also fixed by Company R;
- **Routine on-line contracts executed without material modifications** between the customers and Company R;

Principal role associated with actions of the persons who convinced 3rd party to enter into contracts

Article 13 - Restricted exemptions - Preparatory/auxiliary activities

SITUATION SO FAR

TYPICAL EXEMPTIONS FOR PE UNDER VARIOUS INDIAN TREATIES

No PE for F Co. in India if activities performed are preparatory and auxiliary like:

- Use of facilities for storage, display or delivery of goods
- Maintenance of stock of goods for the purpose of storage, display and delivery
- Maintenance of stock of goods for processing by other enterprise
- Maintenance of fixed place of business for purchase of goods or collecting information
- Maintenance of a fixed place of business for other activities not listed above, if it is preparatory or auxiliary
- Maintenance of fixed place of business for any combination of activities in (a) to (e) above, if such overall activity is preparatory or auxiliary

KEY CHANGES PROPOSED BY MLI

- Activities of F Co. need to be tested on individual, as well as collective basis for meeting 'Preparatory and auxiliary test' [Option A]
- PE to be formed by disregarding fragmentation of cohesive business operations whether :
 - within entity; or
 - within the group

India adopts Option A

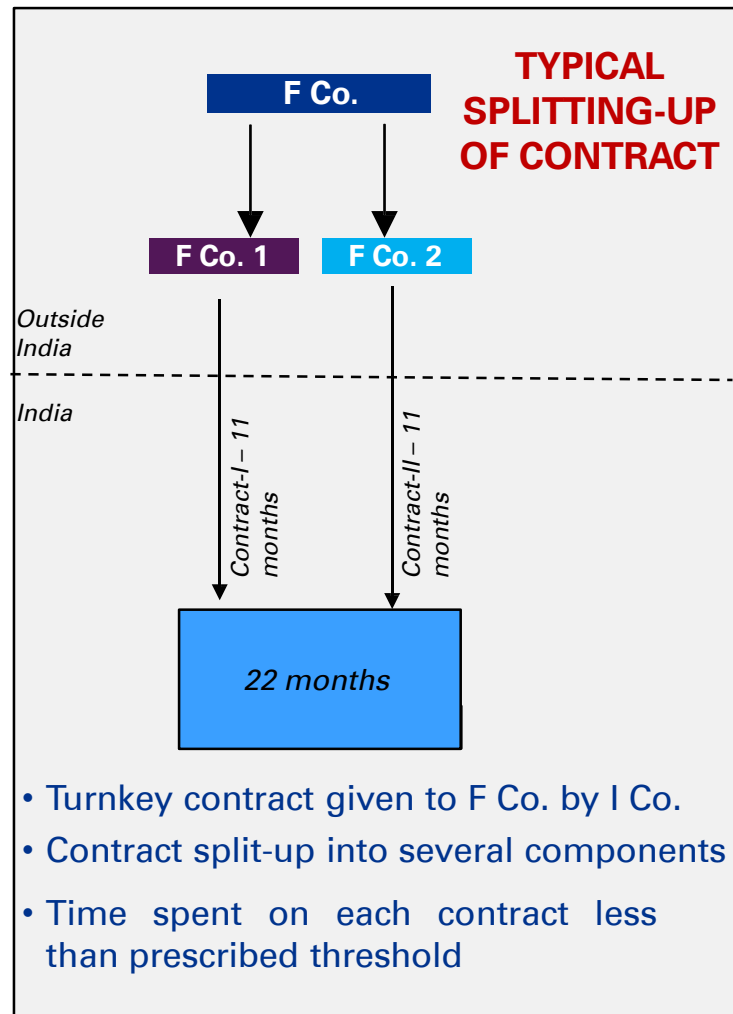
KEY IMPACT AREAS

1 Storage operations	2 Liaison office operations	3 Other non-core business operations
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Key treaties impacted		Key treaties not impacted	
JAPAN	NETHERLANDS	UK	SINGAPORE
INDONESIA	RUSSIA	CYPRUS	FRANCE

Significant impact on 'preparatory and auxiliary' exemptions to F Co's

Article 14 - Artificial splitting-up of contracts



KEY CHANGES PROPOSED BY MLI

PE to be formed by disregarding artificial splitting-up of contracts between F Co and its affiliates if

- Installation activities performed by **affiliates** are **connected** to F Co.'s activities; and
- **Duration** of each such activity (i.e. of F Co. as well as affiliates) exceeds **30 days**

No reservations made by India

Some countries that have not made reservation











































Netherland, France, Australia, Ireland, Indonesia, New Zealand


Some countries that have made reservation

UK, Singapore, Cyprus, Canada, Japan, Luxembourg, Sweden

Enhanced PE exposure for F Cos. undertaking long term construction/service contracts

Position of Key Treaty Partners

Key treaty partners	AGENCY PE	PREPARATORY / AUXILIARY ACTIVITIES	INSTALLATION PE
	<ul style="list-style-type: none"> Market support arrangement Agency arrangements 	<ul style="list-style-type: none"> Rigorous tests for claiming exemptions (LO activities) 	<ul style="list-style-type: none"> Artificial split-up of contract Split up amongst multiple entities
Netherlands			
Indonesia			
Russia			
New Zealand			
France			
Japan			
Singapore			
Germany			
United Kingdom			
China			
Cyprus			
Korea			
Canada			
Switzerland			

 Aligned to India

 Not aligned to India

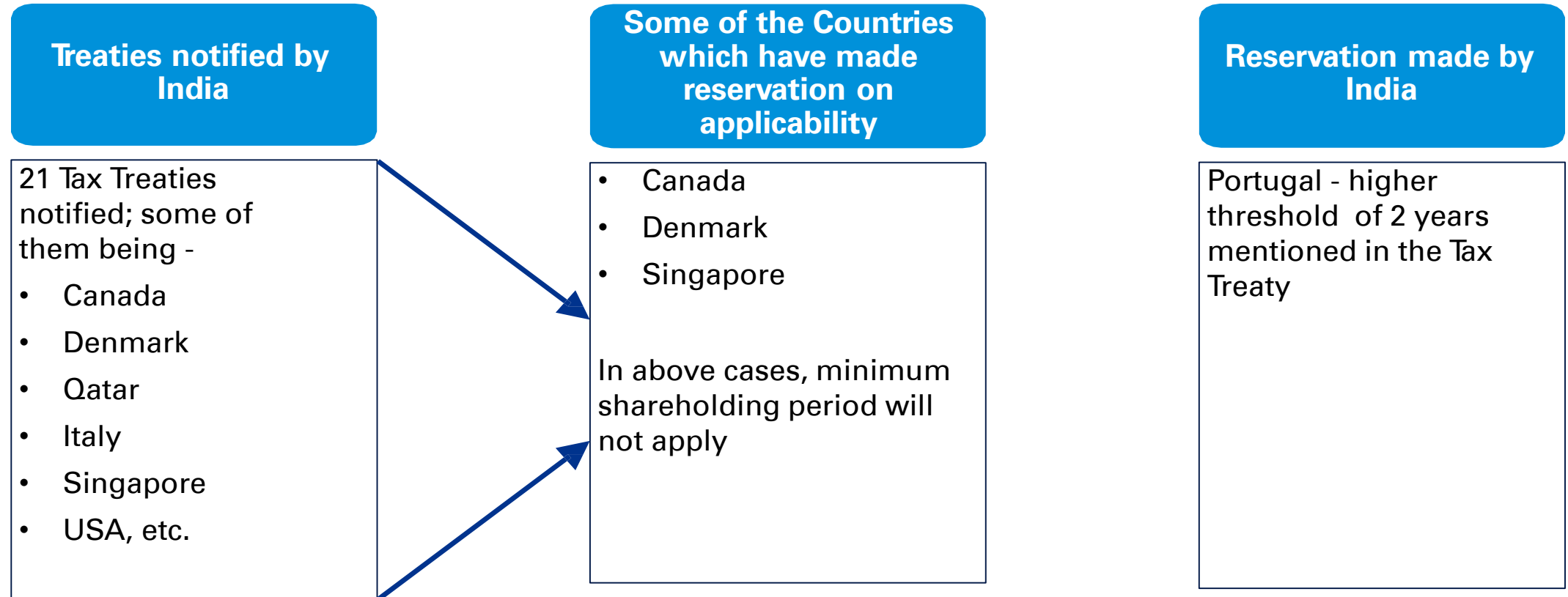
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Tax on Particular Streams of Income

- **Article 8** - Dividend Transfer Transactions
- **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 PE situated in third jurisdictions
- **Article 11** - Application of tax agreements to restrict a party's right to tax its own residents

Article 8 - Analysis & India Position

Minimum shareholding to be met throughout 365 days for beneficial dividend tax rate



Article 9 – Analysis & India Position

- MLI introduces a treaty provision that strengthens the anti-abuse test (with respect to transfer of shares of entities deriving their value principally from immovable property);
- Gains to be taxable if value threshold met at any time during 365 days preceding alienation (including alienation of interest in a trust / partnership);
- Entity derives value of more than 50 percent from immovable property

Treaties notified by India

71 Tax Treaties notified, including :

- Cyprus
- France
- Netherlands
- Australia

Provision gets replaced in the above Tax Treaties

Some countries which have made reservation on applicability

- Canada
- Singapore
- UK

In above cases, this provision should not apply

India Position and Impact

Under India's current tax treaties practice, this right generally exists where the value test is met at the time transfer takes place. With the adoption of this MLI provision, Article on Capital gains in Indian tax treaties would be amended subject to condition that there is a matching position

Article 10 - Analysis & India Position

- Benefit of Tax Treaty shall not be available to the tax payer where income is derived from the source State by the PE of such tax payer situated in third State, if
 - Such income of the PE is not taxable in the resident State of the tax payer, and
 - Tax in the third State on income of the PE is less than 60% of the tax in the resident State
- No reservation / notification made by India

Some of the countries that have not made any reservation

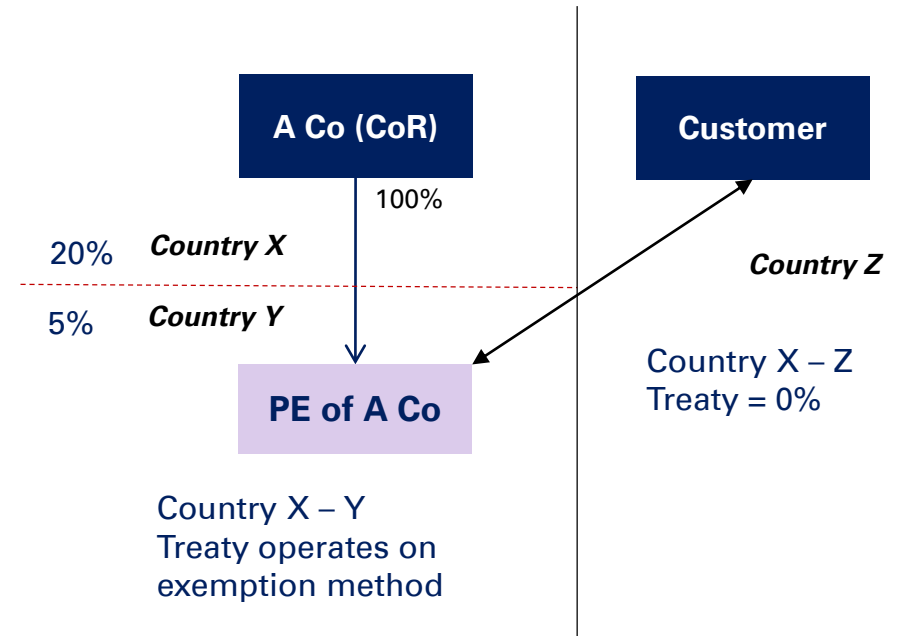
- Netherlands
- Russia

Provisions would get added in the Tax Treaty with India

Some of the countries that have made reservation

- Singapore
- UK
- Canada
- France

In above cases, the provision should not apply



Where an entity resident in Country X renders / executes a contract in Country Z through the PE in Country Y. In such cases, an issue may arise as to which treaty to be applied i.e. Country X-Z or Country Y-Z.

Article 11 - Analysis & India Position

- Treaty shall not affect taxation right of a country in respect of its residents, except in few cases
- No reservation / notification made by India

Some of the countries that have not made any reservation

- UK
- Russia

Provisions would get added in the Tax Treaty with India

Some of the countries that have made reservation

- Singapore
- Netherlands
- Canada
- Cyprus

In above cases, the provision should not apply

Entry into Effect - Case Study

Particulars	Scenario
Date of completion of internal procedures by Country A	15 April 2019
Date of completion of internal procedures by India	31 December 2018
Relevant date for determining Entry into Effect of India – Country A tax treaty (30 days from later of (a) or (b))	15 May 2019
Entry into Effect of MLI for India	
Withholding tax	1 April 2020
Other taxes	1 April 2020
EIE of MLI for Country A	
Withholding tax	1 January 2020
Other taxes	1 January 2020

Thank You!

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