



# Multilateral Convention to implement Tax Treaty related measures to prevent BEPS

December, 2018

# Contents

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# Multilateral Instrument - Overview

# Introduction

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- Multinational Enterprises have arranged their corporate structures to artificially shift profits to no or low-tax locations where there is little or no real activity
- Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules
- In order to combat the same, the BEPS Project was launched in 2013 and Final report on 15 Action Plans was issued in 2015
- BEPS Action plan need to be implemented by way of changes in domestic law and tax treaties
- Traditionally, a change in tax treaties can be introduced by way of protocol after extensive bilateral discussions and renegotiations, which is time consuming
- To modify existing tax treaties in an efficient manner to implement BEPS measure, Action Plan 15 - “Developing a Multilateral Instrument to Modify Bilateral Treaty” provide a innovative approach that enables jurisdictions to swiftly modify their bilateral tax treaties by introducing Multilateral Instrument (MLI)

# BEPS – Action Plans to be implemented through treaties / MLI

**Action 2- Neutralizing the effects of  
Hybrid mismatch arrangements**

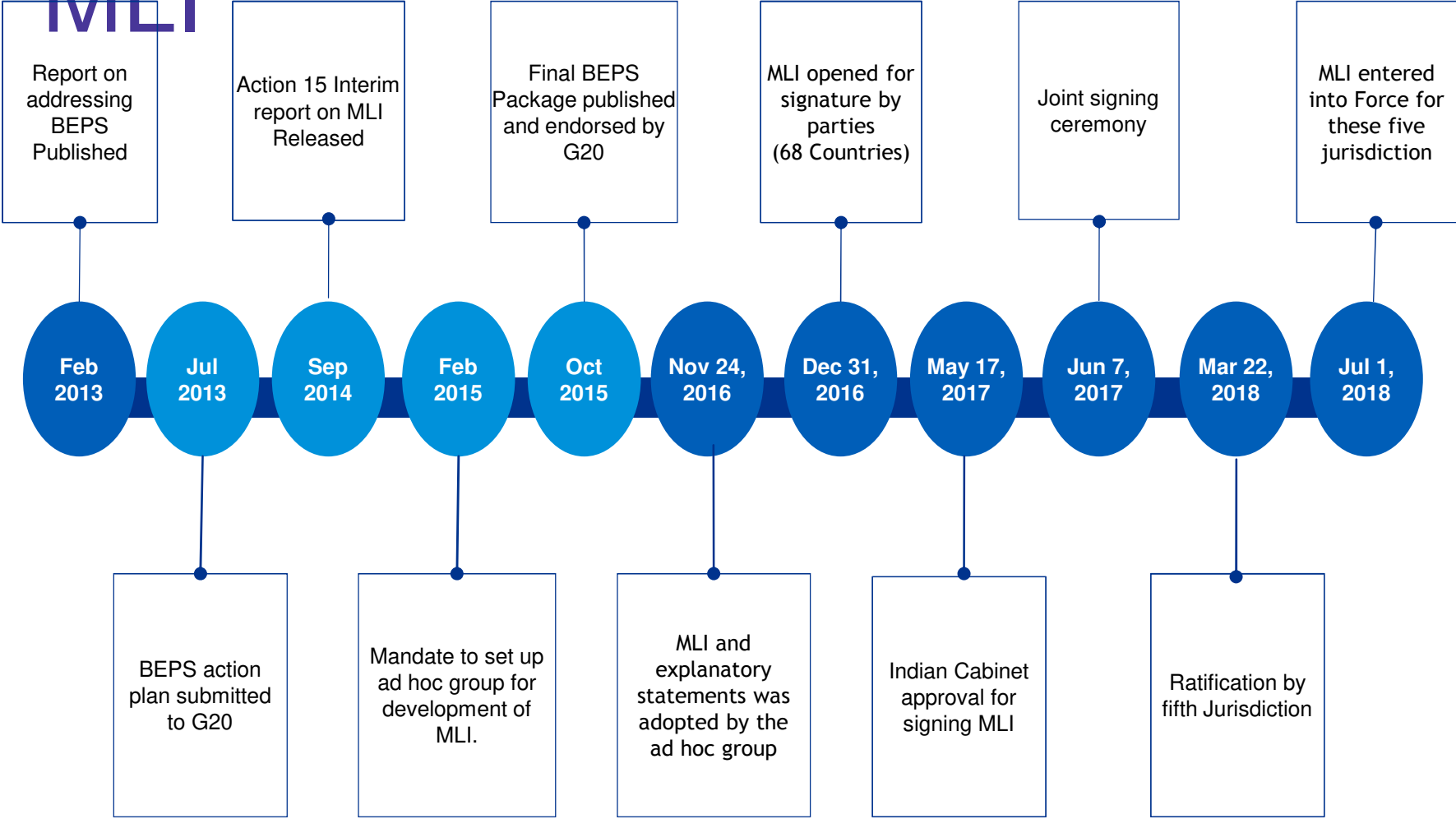
**Action 6 – Preventing Treaty abuse**

**Action 7 – Preventing the artificial  
Avoidance of PE Status**

**Action 14 – Making dispute resolution  
Mechanisms more effective**

# Relevant events in history of

## MLI



# MLI - Status

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85 countries (including India) have signed the MLI till date



India has notified its Tax Treaties with 93 countries as CTAs under MLI



Out of 93 countries, 36 countries have not signed MLI as on date



Out of the balance 57 countries, 3 countries have not included India in their CTAs



54 countries have notified India in their CTAs

# Status of other countries

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## Some countries which have included India in their list of CTAs

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

## Countries which have not included India in their list of CTAs

- Mauritius
- China
- Germany

## Some countries which have not signed MLI

- USA
- Philippines
- Brazil
- Thailand
- Kenya
- Sri Lanka
- Nepal
- Myanmar

India has also provided provisional list of reservations



# Articles under MLI

Part No.	Parts	Articles Covered	BEPS Action Plan
I	Scope and Interpretation of Terms	Article 1 & 2	
II	Hybrid Mismatches	Article 3 to 5	Action Plan 2 & 6
III	Treaty Abuse	Article 6 to 11	Action Plan 6
IV	Avoidance of Permanent Establishment Status	Article 12 to 15	Action Plan 7
V	Improving Dispute Resolution	Article 16 & 17	Action Plan 14
VI	Arbitration	Article 18 to 26	
VII	Final Provisions	Article 27 to 39	



# Concept of MLI

# MLI – Evolution

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## Adoption

- Text of MLI and the Explanatory Statement adopted on 24 November 2016
- Adopted by approximately 100 countries
- Not binding for all these countries to eventually sign the MLI

## Signing

- Countries willing to modify their tax treaties need to sign the MLI
- Each signatory is expected to submit provisional list of tax treaties which it wishes to covered under MLI along with MLI Position (reservations and notifications)

## Reservation

- Option provided to opt-out of MLI provisions by making reservation
- Reservations will operate qua each article and not qua each countries
- Final reservations list to be furnished at the time of ratification

## Notifications

- Notification are filed in respect MLI provisions opted in
- Expected to notify alternative provision opted and treaties to be governed by MLI
- Final notifications list to be furnished at the time of ratification

# MLI – Evolution

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## Ratification

- Ratification is a process by which a country provides its consent to MLI
- Each signatory needs to ratify the MLI as per its domestic procedures
- The ratified instrument to be submitted to OECD Depository along with Final list of treaties and its MLI Positions

## Covered Tax Agreement

- Covered Tax Agreement (CTA) is not any new or fresh agreement
- Existing tax treaties notified by both the treaty partners

## Entry into Force

- For first five jurisdiction, from first day of the month after expiry of 3 months from the date of deposit of ratified copy of MLI by fifth jurisdiction with OECD
- For other, from first day of the month after expiry of 3 months from the date of deposit of ratified copy of MLI with OECD
- Entry into force is qua each country and not qua each CTA
- Generally, Entry into force is relevant date for calculating date of Entry into effect

## Entry into Effect

- MLI has effect for events occurring on or after the date of Entry into Effect
- Entry into effect is qua each CTA

# Important terms

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## Covered Tax Agreement (CTA)

An existing tax treaty shall be considered as CTA once the following conditions are satisfied by both the countries to the tax treaty:

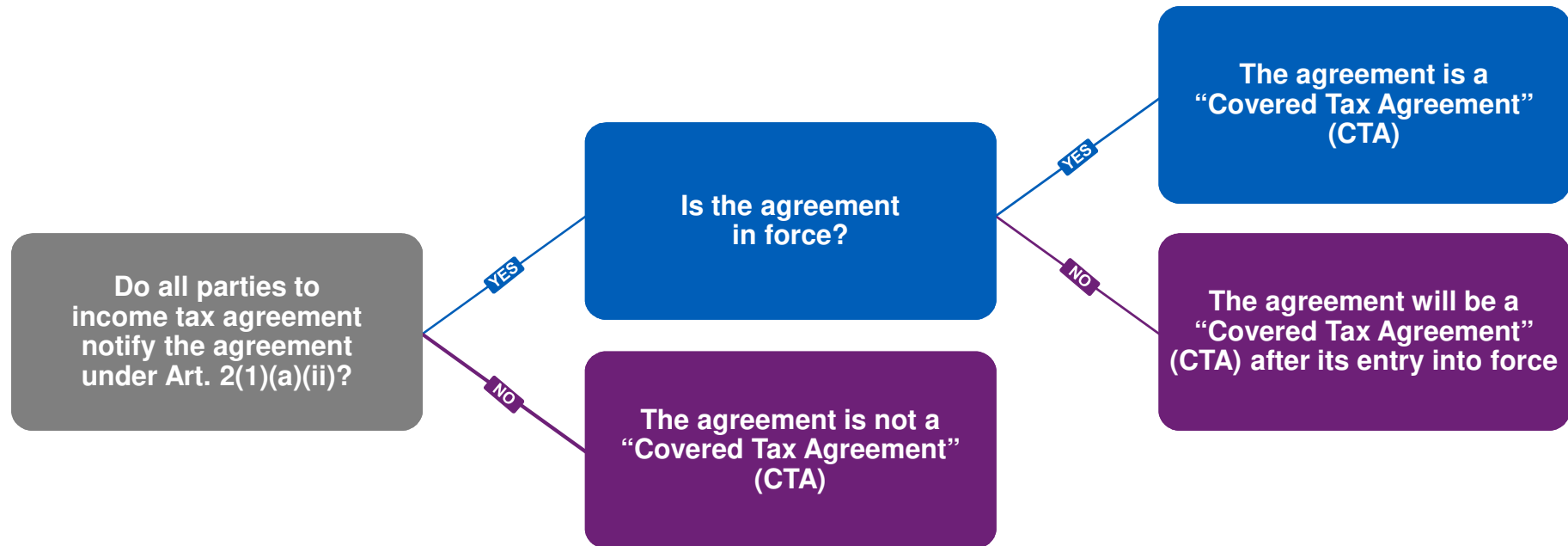
- Signed the MLI;
- Ratified the MLI under their domestic procedures
- Deposited the ratified copy (along with notifications and reservations) of MLI with OECD
- Listed each other in its list of treaties which are to be modified by MLI and have submitted the list to OECD

## Signatories or Parties to the MLI

- Signatories means a country which has signed MLI but for which MLI is not yet in force
- Parties means a country which has signed the MLI and for which MLI is in force.

# Covered Tax Agreements

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# MLI – certain basic concepts

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## Applicability

Not automatically applicable – will apply only if both the countries notify their treaty as a CTA

## Impact on existing treaty

Will not replace the existing treaty, but operate alongside it – supplement, compliment, modify its application

## Will it freeze the treaty?

No – subsequent modification to the CTA possible

## Changes to MLI positions

Subsequent changes / modifications to MLI positions possible – withdrawal from MLI also possible

## Basic rule of interpretation

To be interpreted in accordance with the ordinary principle of treaty interpretation

# 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

## Reservations

- Flexibility to opt out of a provision if it is not a minimum standard
- Either completely or for sub-set of CTAs (to preserve the existing provisions)
- General : Qua each article and not qua each Country

## 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

## Compatibility clauses

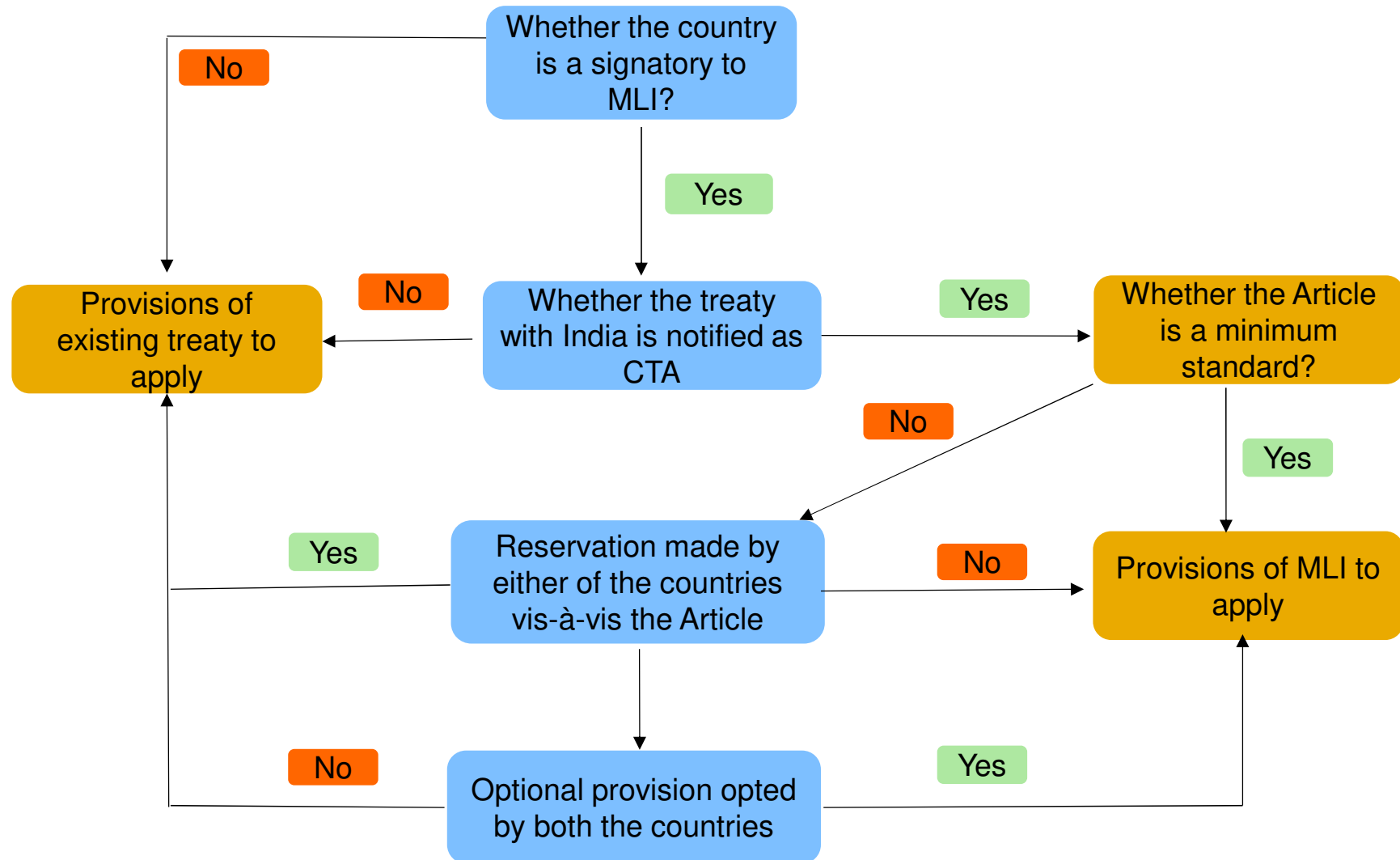
- Defines the relationship / addresses conflict between the MLI and the provisions of a CTA
- MLI provision applies –
  - ‘in place of’
  - ‘applies to’ or ‘modifies’
  - ‘in the absence of’
  - ‘in place of or in the absence of’

## Notification clauses

- Rules for notifying the OECD Depository so that impact of MLI becomes clear
- Notify choice of optional provision
- Also, notify the existing provision of CTA to be modified / replaced



# MLI - Snapshot



# Compatibility clauses

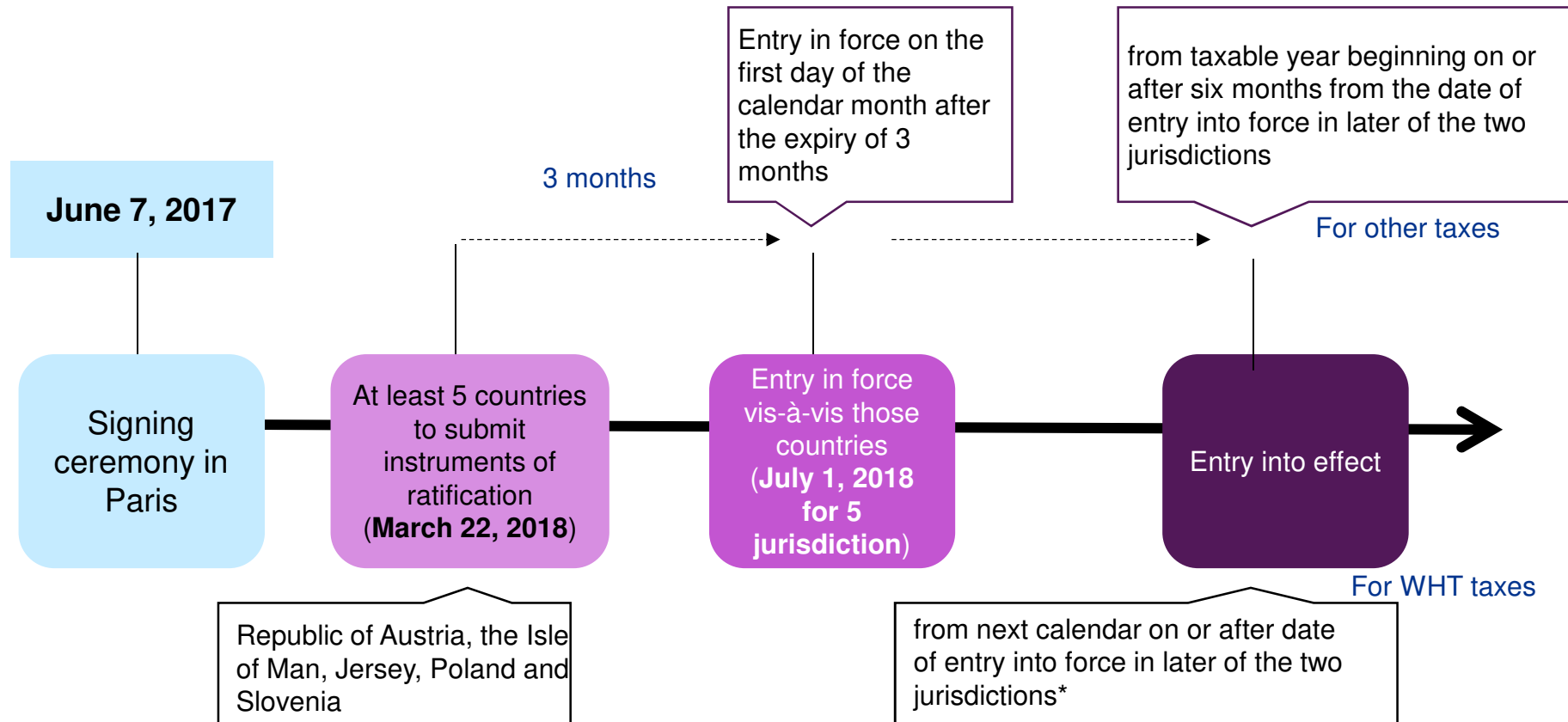
Terms Used	When applicable	Impact
"in place of"	There is an existing provision in the CTA	Existing CTA provision is replaced
"applies to" or "modifies"		Application of an existing provision is amended without replacing it
"in absence of"	The provision is absent in the CTA	The provision is added to the 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 of MLI – Rules for opt in / opt out

Expression used in the MLI compatibility provisions ↓	Scenarios	1	2	3	4	5	6
	Country A →	Notified (opt in)	Notified (opt in)	Reserved (opt out)	Notified (opt in)	Silent	Silent
	Country B →	Notified (opt in)	Reserved (opt out)	Reserved (opt out)	Silent	Reserved (opt out)	Silent
“in place of”		Yes	No	No	No	No	No
“applies to” or “modifies”		Yes	No	No	No	No	No
“in absence of”		Yes	No	No	No	No	No
“in place of or in absence of”		Yes	No	No	Generally yes*	No	Yes*

*\* Exception Article 5 (elimination of double taxation) , Article 8 (Dividend Transfer Transaction). In absence of full matching, the MLI Article will apply and supersede the provision of CTA to the extent of incompatibility as against replacement of MLI Article in the CTA*

# Process timeline for entry in effect



\* Note 1 : Option is provided to use “taxable period” in place of “calendar year” and such option is effective unilaterally. India has opted for such option.

Note 2 : Separate rule provided for entry into effect of Article 16 on Mutual Agreement Procedure

# India's Position along with Illustration

India has opted for the following language:

Particulars	Date of Entry into Effect (EIE) of India CTA's	
For WHT	1st day of next calendar period (India has opted for taxable period) that begins on or after	30 days from latter of the dates on which OECD has received notification from India and its treaty partner about completion of its respective internal procedures with respect to such specific CTA
For other taxes	Taxable period that begins on or after expiry of 6 calendar months from	

*Symmetric application where countries have opted for such additional language of "completion of internal procedure"*

## Illustration:

Particulars		Scenario 1	Scenario 2	Scenario 3
Date of completion of internal procedures by Singapore		15 Apr 2018	15 Apr 2018	15 Apr 2018
Date of completion of internal procedures by India		1 Oct 2017	1 Jul 2019	20 Nov 2022
Relevant date for determining EIE of India- Singapore tax treaty (30 days from later of (a) or (b))		15 May 2018	31 Jul 2019	20 Dec 2022
<b>EIE of MLI for India</b>	WHT	1 Apr 2019	1 Apr 2020	1 Apr 2023
	Other taxes	1 Apr 2019	1 Apr 2020	1 Apr 2024
<b>EIE of MLI for Singapore</b>	WHT	1 Jan 2019	1 Jan 2020	1 Jan 2023
	Other taxes	1 Jan 2019	1 Jan 2021	1 Jan 2024

*Note: Singapore follow calendar year and India follow taxable year*



# India's Position

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 3 - Transparent Entities	Treaty benefits will only be allowed to the extent to which income is taxed in the Resident state	"in place of" or "in absence of"	No, article reserved
Article 4 – Dual Resident Entities	Competent Authorities (CAs) to agree the residence status of a Dual Resident Entities on a case by case basis	"in place of" or "in absence of"	Yes
Article 5 – Application of Methods for Elimination of Double Taxation	Provides three alternative option to address the problems arising from exempting the income in Resident state which are not taxed in the Source State	Differs for each option	No, article reserved
Article 6 – Purpose of a Covered Tax Agreement – Minimum Standard	Requires countries to include an express statement that their common intention is to <u>eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements.</u>	"in place of" or "in absence of"	Yes, India has been silent on this article

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 7 – Prevention of Treaty Abuse	<p>Provide three alternative rules to address situations of treaty abuse.</p> <ul style="list-style-type: none"> <li>• Principle Purpose Test (PPT) – General Rule;</li> <li>• PPT along with Simplified or a detailed Limitation of Benefit (LOB)</li> <li>• enter into bilateral negotiations to include a detailed LOB provision plus a PPT or anti-conduit rules.</li> </ul>	“in place of” or “in absence of”	India has opt for PPT along with SLOB
Article 8 – Dividend Transfer Transactions	<p>Minimum shareholding to be met throughout 365 days for beneficial dividend tax rate</p> <p>The Company receiving the dividend should be a beneficial owner or the recipient and should owns, holds or controls of shares</p>	“in place of” or “in absence of”	Yes, except CTAs that contain a period more than 365 days (Portugal – 2 years)



# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
<p>Article 9 – Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property</p>	<p>Gains to be taxable if value threshold met at any time during 365 days preceding alienation (including alienation of interest in a trust / partnership)</p> <p>Option provided to apply for those share deriving more than 50% value directly or indirectly from immovable property (real property)</p>	<p>“in place of” or “in absence of”</p>	<p>Yes, India has choose to apply this for shares deriving more than 50% value from immovable property (real property)</p> <p>In case optional provision is not adopted by treaty partner then main provision will apply</p>

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
<p>Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions</p>	<p>Address mischief of Triangular Cases</p> <p>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</p> <ul style="list-style-type: none"> <li>• Such income of the PE is not taxable in the resident state of the tax payer, and</li> <li>• Tax in the third state on income of the PE is less than 60% of the tax in the resident State</li> </ul> <p>There are certain exception to the above rule</p>	<p>“in place of” or “in absence of”</p>	<p>Yes, India has been silent on this article</p>

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 11 – Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents	<p>MLI provides that a CTA shall not affect taxation right of a country in respect of its residents.</p> <p>Except with respect to the benefits granted under specific provisions to non-residents e.g., corresponding adjustment for TP adjustment by source country, express provisions which provide right to tax in source country, etc.</p>	“in place of” or “in absence of”	Yes, India has been silent on this article
Article 12 - Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies	Address the issue of commissionaire agreements and other similar arrangements by providing that a PE is deemed to be established where a person, on behalf of an enterprise, conducts certain activities in a Contracting Jurisdiction. <i>(The same is dealt in detail in subsequent slides)</i>	“in place of”	Yes, India has been silent on this article

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 13 – Artificial avoidance of Permanent establishment Status through the Specific Activity Exemptions	Explicitly state that the activities listed herein will be deemed not to constitute a PE only if they are of a preparatory or auxiliary character. The MLI provision provide two options.	“in place of”	Yes
Article 14 - Splitting-up of Contracts	<p>Action 7 Report includes a draft provision specifically addressing the splitting-up of contracts for use in treaties that would not include the PPT, or for Contracting Jurisdictions that wish to address such abuses explicitly.</p> <p>Article 14 of the Convention provides for the implementation of that provision (<i>The same is dealt in detail in subsequent slides</i>)</p>	“in place of” or “in absence of”	Yes, India has been silent on this article

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 15 – Definition of a Person Closely Related to an Enterprise	<p>Articles 12, 13 and 14 of the MLI all rely on the concept of persons 'closely related' to an enterprise.</p> <p>Article 15 provides a definition of the same based on the text of Action Plan 7.</p>		Yes, India has been silent on this article
Article 16 – Mutual Agreement Procedure - Minimum standard	A person can approach the competent authority of either Contracting Jurisdiction (regardless of any remedy provided under domestic law), if person considers that the actions of one or both of the Contracting Jurisdictions results in taxation not in compliance with the provisions of the relevant tax treaty.		Yes with certain reservation.
Article 17 – Corresponding Adjustments	Requires contracting states to make appropriate corresponding adjustments in transfer pricing cases.		Yes with certain reservation.

# India's Position

Article of MLI	MLI Provision	Compatibility Clause	Applicable to India
Article 18 to 26 - Arbitration	If, under the MAP process, the CAs do not agree on the correct interpretation of the DTAA, the CAs can submit the matter to an independent arbitrator (or a panel of three arbitrators) for decision. The arbitrators will decide which of the CAs is correct		No, India has reserved this article



# Action Plan 6 - Treaty Abuse

Article 6 to 11 of  
MLI

# Articles covered

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## Articles covered under Treaty abuse

Article 6	Purpose of a Covered Tax Agreement (Preamble)
Article 7	Prevention of Treaty abuse
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 6 – Purpose of CTA [Preamble]

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*“...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 though treaty-shopping arrangements....)”*

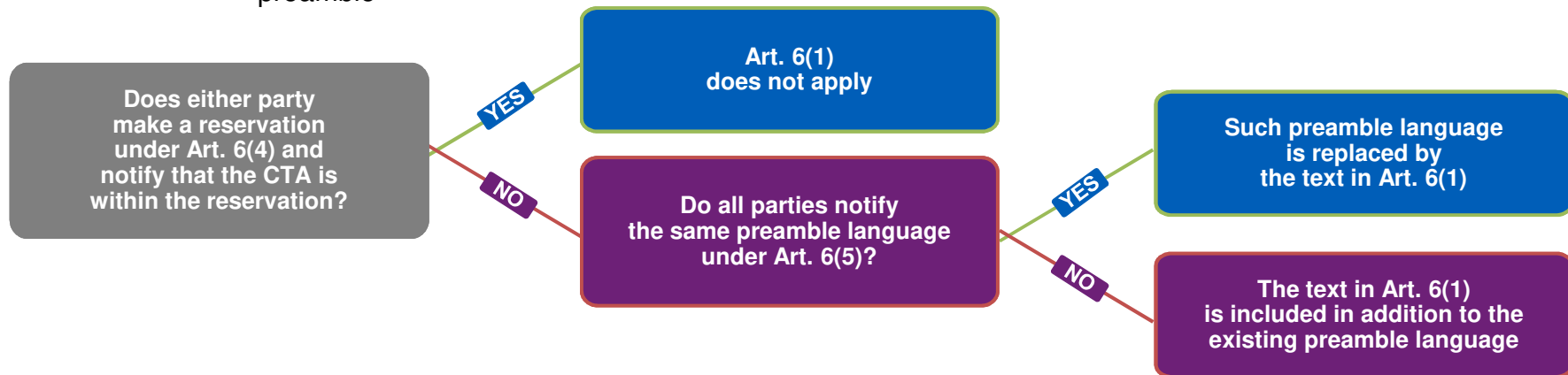
Minimum Standard

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

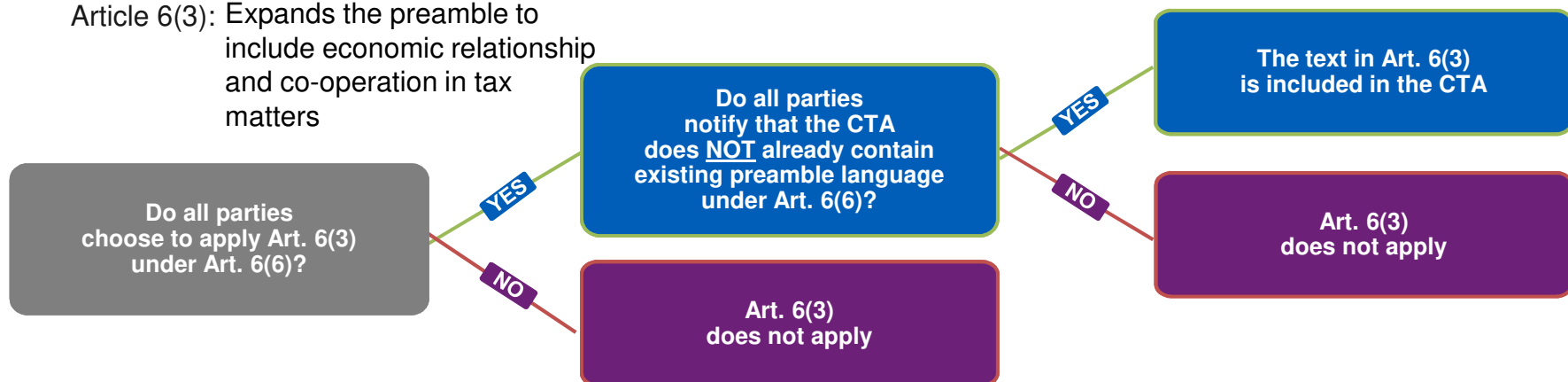
India’s position – no CTA notified

# Article 6 – Purpose of CTA [Preamble]

Article 6(1): Main provision of preamble



Article 6(3): Expands the preamble to include economic relationship and co-operation in tax matters



# Preamble – few examples

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## India-Mauritius Tax Treaty

*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*

## India-Singapore Tax Treaty

*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*

## India- Luxembourg Tax Treaty

*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 and on capital and with a view to promoting economic co-operation between the two countries, have agreed as follows*

# Article 7: Prevention of Treaty Abuse

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## Action 6

- PPT
- PPT along with simplified or detailed LOB
- Detailed LOB supplemented by anti-conduit mechanism

## MLI

- PPT alone
- PPT along with Simplified or detailed LOB
- Contracting Jurisdictions to agree on a detailed LOB provision

## India

Opted for PPT along with Simplified LOB

# Principal Purpose Test

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- Tax Treaty benefit will 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
- Scope wide enough to include direct as well as indirect benefit
- Supplements and does not restrict the scope or application of other provisions
  - A benefit that is denied under other para cannot be claimed under this para
- Non-obstante clause – benefits available under other para can be denied under this para
- Compatibility clause – ‘in place of or in absence of’

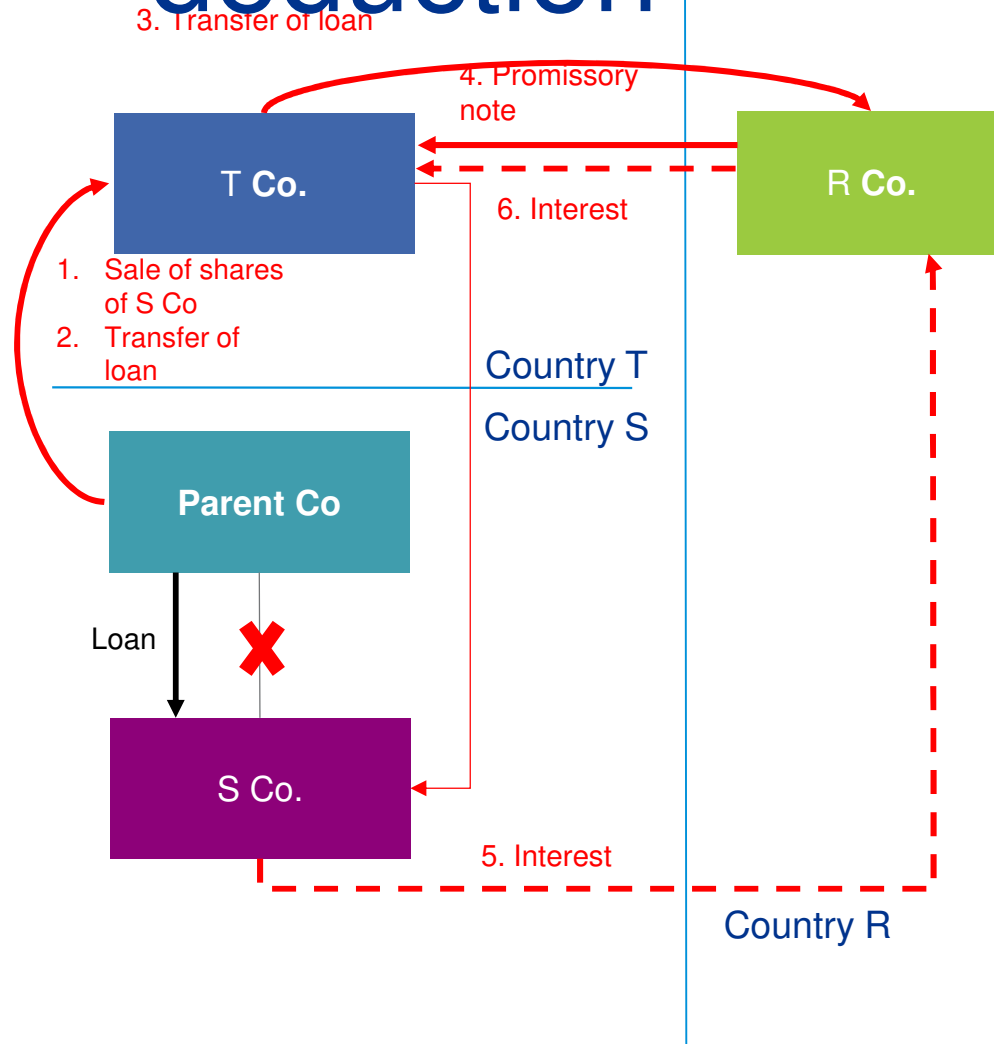
# Principal Purpose Test

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- Provisions wider than GAAR
- Subjectivity involved in demonstrating that 'principal purpose' is not to obtain a tax benefit
- In cases where the PPT is not satisfied, it may result in denial of Tax Treaty benefits such as :
  - Lower rate of WHT
  - Restricted definition of royalty / FTS
  - Non-applicability of beneficial Permanent Establishment provisions
  - Capital gain tax exemption

**Imperative to demonstrate substance and commercial rationale**

# PPT Rule: Example 1 – interest deduction



- Parent Co. holds entire share capital in S Co and has granted loan to S Co.
- T Co acquires all the shares and debt of S Co. from Parent Co.
- No Tax Treaty between Country T and country S
- Interest paid by S Co. to T Co. subject to WHT @ 25%
- No WHT on interest under S – R Tax Treaty
- Interest paid by R Co to T Co subject to WHT @5%
- T Co. transfers the loan to R Co. in exchange of a promissory note

## BEPS Recommendation:

- While the loan may have been granted to S Co for a valid commercial reasons, if it is shown that one of the principal purposes of T CO in transferring the loan to R Co. was to obtain the benefit of R–S Tax Treaty, then the benefits could be denied under Para 7

# PPT Rule: Example 2

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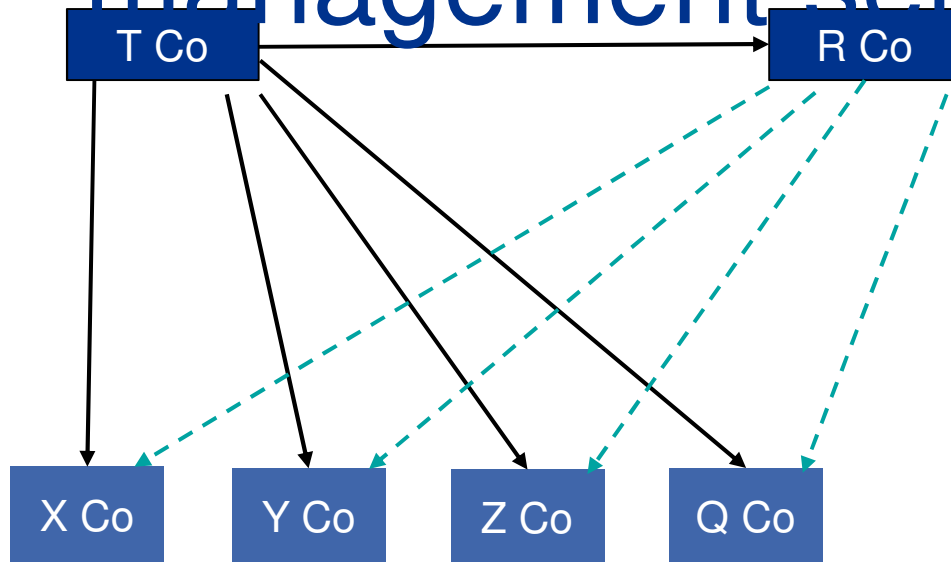
- R Co., a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly
- R Co. is considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs
- Possible locations in three different countries are identified. All three countries provide similar economic and political environments
- State S is only one of these countries with which State R has a tax convention
- Hence, the decision is made to build the plant in State S

## **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



# PPT Rule: Example 3 – management services



- 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

# Principal Purpose Test – India impact

- India's position
  - Notified Articles in 36 Tax Treaties
  - MLI provision will replace the existing provision in these Treaties, subject to similar notification by other countries
  - In other cases, PPT will supersede the existing provisions only to the extent of incompatibility
- Impact on grandfathering under India-Singapore Tax Treaty?
  - Whether PPT to be satisfied in addition to the existing PPT/LOB conditions?
  - Whether granting benefit (subject to satisfaction of the existing LOB conditions) would be in accordance with 'object and purpose' of the Treaty?

## Singapore PPT

**A Singapore tax resident would not be entitled to the capital gains tax benefit arising on transfer of shares an Indian company, if**

- a) Its affairs were arranged with the primary purpose to take the advantage of that benefit; or**
- b) the company claiming the benefit is a 'shell or a conduit company'**

# Simplified LOB

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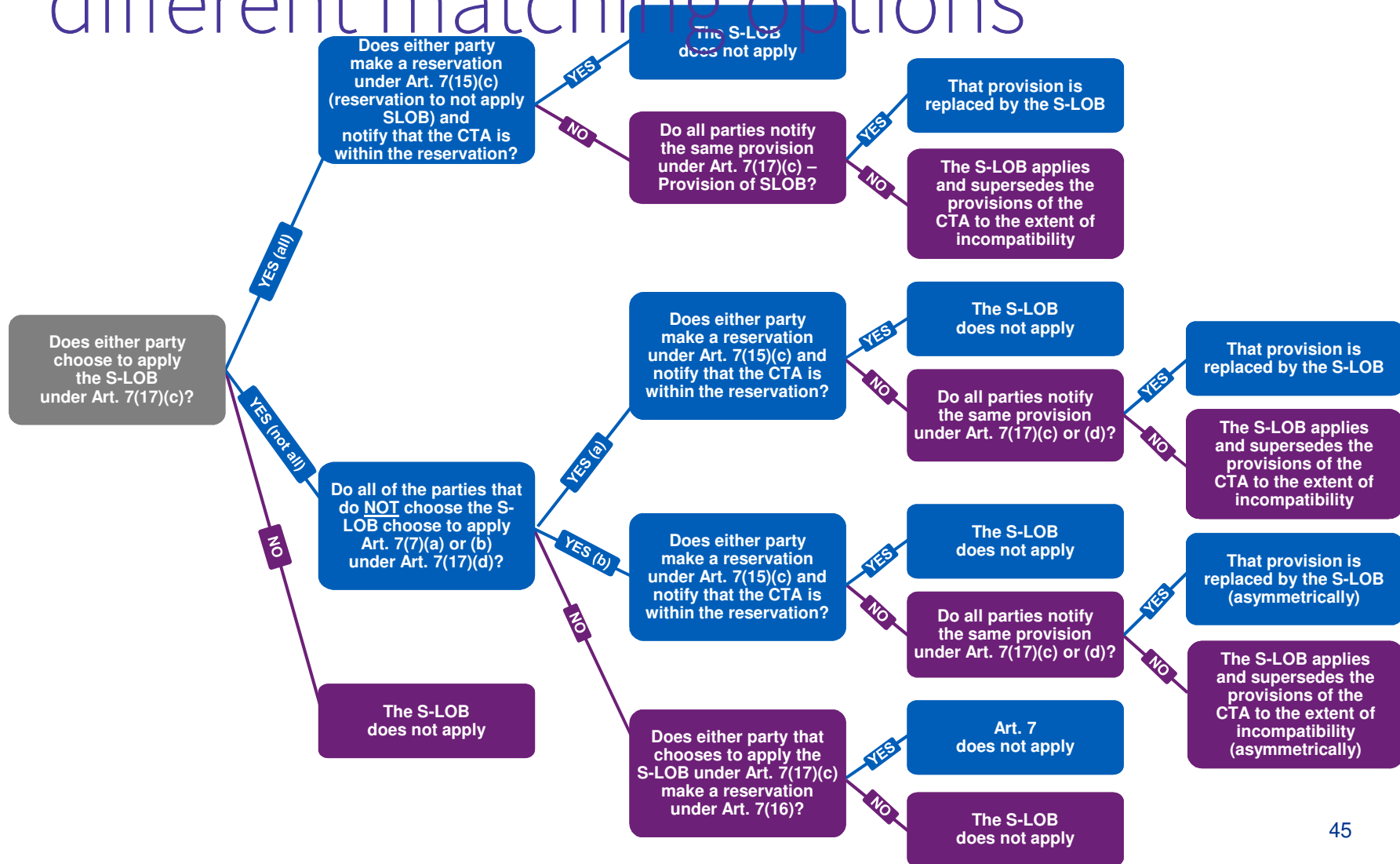
- Tax Treaty benefits available only to **‘qualified person’**, which covers:
  - Individual
  - Contracting jurisdiction / political subdivision/ local authority
  - Listed entity
  - NGO / regulated retirement benefit entity
  - Entity in which atleast 50% shares held by above persons who are residents of the State, on atleast 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
- If income is derived from the business activity conducted in the other country or from a connected person in the other country:
  - business activity carried on in the country of residence to be substantial in relation to the same or complimentary business activity carried on in the source country
- Activities conducted by connected person deemed to be conducted by the tax payer

# Simplified LOB

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- Active conduct of business
  - only if persons through whom the entity is acting, such as officers or employees of a company, conduct substantial managerial and operational activities
- 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 companies / registered security dealer)
- Income ‘emanates from’ active conduct of business if
  - There is factual connection between the actively connected business and item of income
  - Important to compare lines of business – upstream or downstream

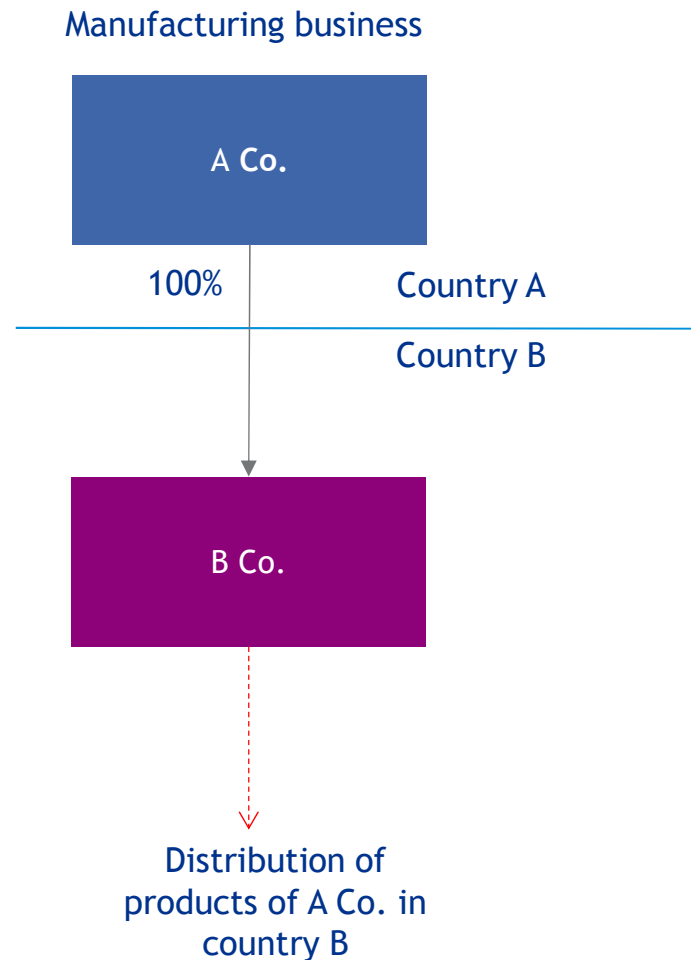
# Application of PPT/SLOB under different matching options



# Application of PPT/SLOB under

Country A Notification	Country B Notification	Impact of A – B tax treaty
PPT or PPT + SLOB	Not a part of MLI	Not Applicable (e.g. US has not yet signed the MLI)
PPT + SLOB	Not listed Country A	Not applicable (e.g. Mauritius has not notified its treaty with India)
PPT	PPT	PPT will apply
PPT + SLOB	PPT + SLOB	PPT + SLOB will apply
PPT + SLOB	PPT	<p><b>Situation 1:</b> only PPT rule will apply</p> <p><b>Situation 2:</b> Country B adopt PPT and agree to allow country A to apply the SLOB asymmetrically. Country A to apply PPT+SLOB and Country B to apply PPT</p>

# Example 1

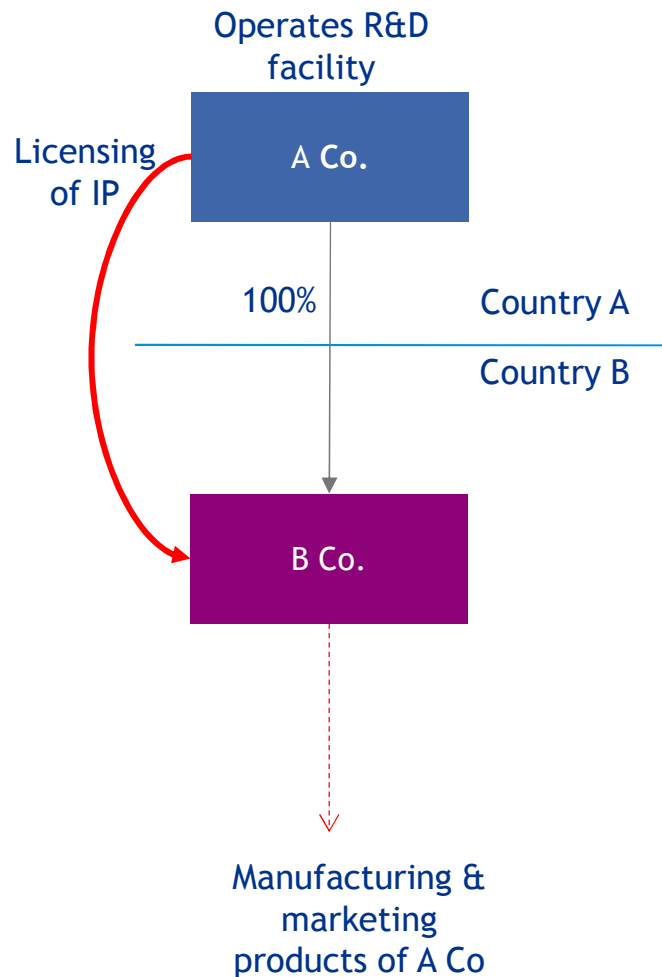


- A Co. is a company resident of State A
- Engaged in manufacturing business in State A
- Owns 100 per cent of the shares of B Co., a company resident of State B
- B Co. distributes A Co's products in State B
- Whether dividends paid by B Co to A Co entitled to treaty benefits?

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

# Example 2



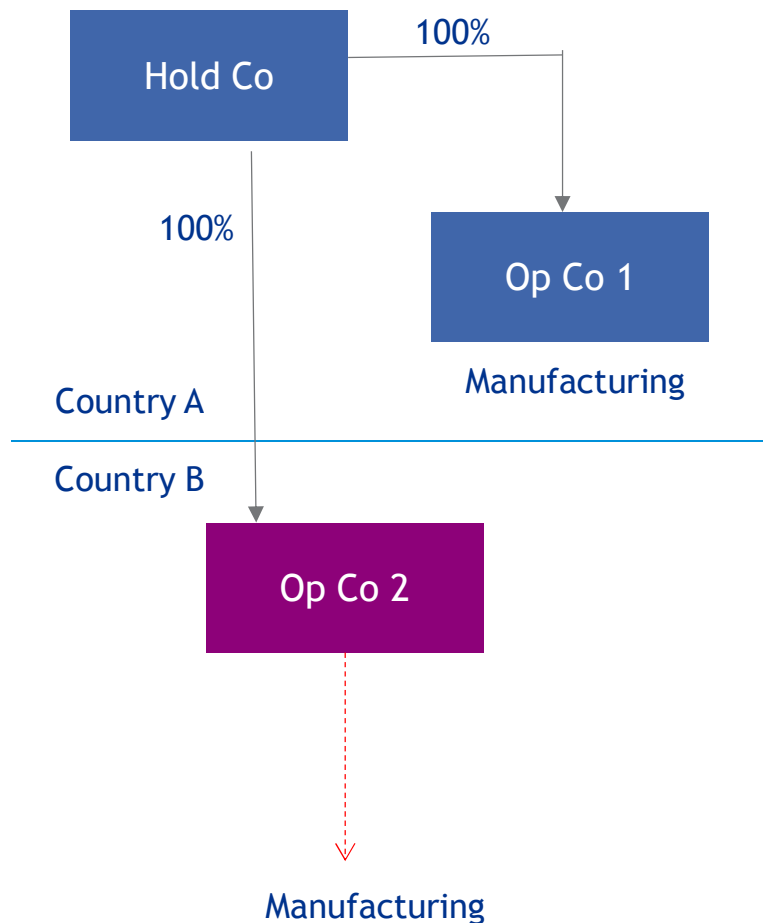
- A Co. is a company resident of State A
- Operates a large R&D facility in State A
- It licenses intellectual property to affiliates worldwide
- Owns 100 per cent of the shares of BCO, a company resident of State B
- A Co. licenses intellectual property to B Co.
- BCO then manufactures and markets the A Co designed products in state B
- Whether royalty paid by B Co to A Co entitled to treaty benefits?

Activities of B Co are “factually connected” to A Co’s business

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



# Example 3

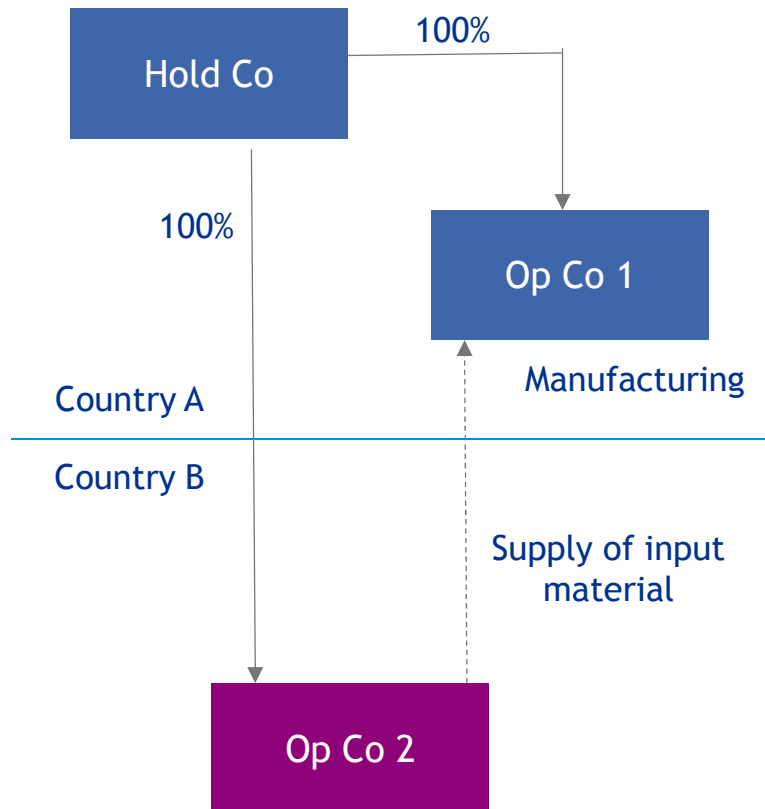


- Hold Co. is a parent company of Op Co 1 and Op Co 2
- Op Co 1 and Op Co 2 are engaged in business of manufacturing of same product in their respective countries
- Whether dividends paid by Op Co 2 to Hold Co eligible for treaty benefits?
  - Whether Hold Co engaged in active conduct of business?
  - If yes, whether dividends paid by Op Co 2 “emanates from” Hold Co’s business?

Hold Co is deemed to be engaged in active conduct of business on account of activities carried out by connected person, Op Co 1

However, dividends paid by Op Co 2 cannot be said to be “factually connected” to Hold Co’s business - treaty benefits not available

# Example 4



- Hold Co. is a parent company of Op Co 1 and Op Co 2
- Op Co 1 is engaged in business of manufacturing of product in country A
- Op Co 2 supplies input material to Op Co 2 for its manufacturing
- Whether dividends paid by Op Co 2 to Hold Co eligible for treaty benefits?
  - Whether Hold Co engaged in active conduct of business?
  - If yes, whether dividends paid by Op Co 2 “emanates from” Hold Co’s business?

Hold Co is deemed to be engaged in active conduct of business on account of activities carried out by connected person, Op Co 1

Activities carried on by Op Co 2 provides upstream inputs for use by Op Co 1 - “factually connected”- treaty benefits available

# Simplified LOB

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- 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
- Complimentary business activity
  - Part of same overall industry
  - Need not relate to the same product or service
- Optional provision – applicable only if both the parties opt for it
- Possible to apply Simplified LOB symmetrically or asymmetrically

# Simplified LOB – India impact

## Some Countries that have chosen to apply Simplified LOB

- Argentina
- Armenia (India's CTA)
- Bulgaria (India's CTA)
- Colombia (India's CTA)
- Indonesia (India's CTA)
- India
- Jamaica
- Kazakhstan
- Mexico (India's CTA)
- Russia (India's CTA)
- The Slovak Republic (India's CTA)
- Uruguay (India's CTA)

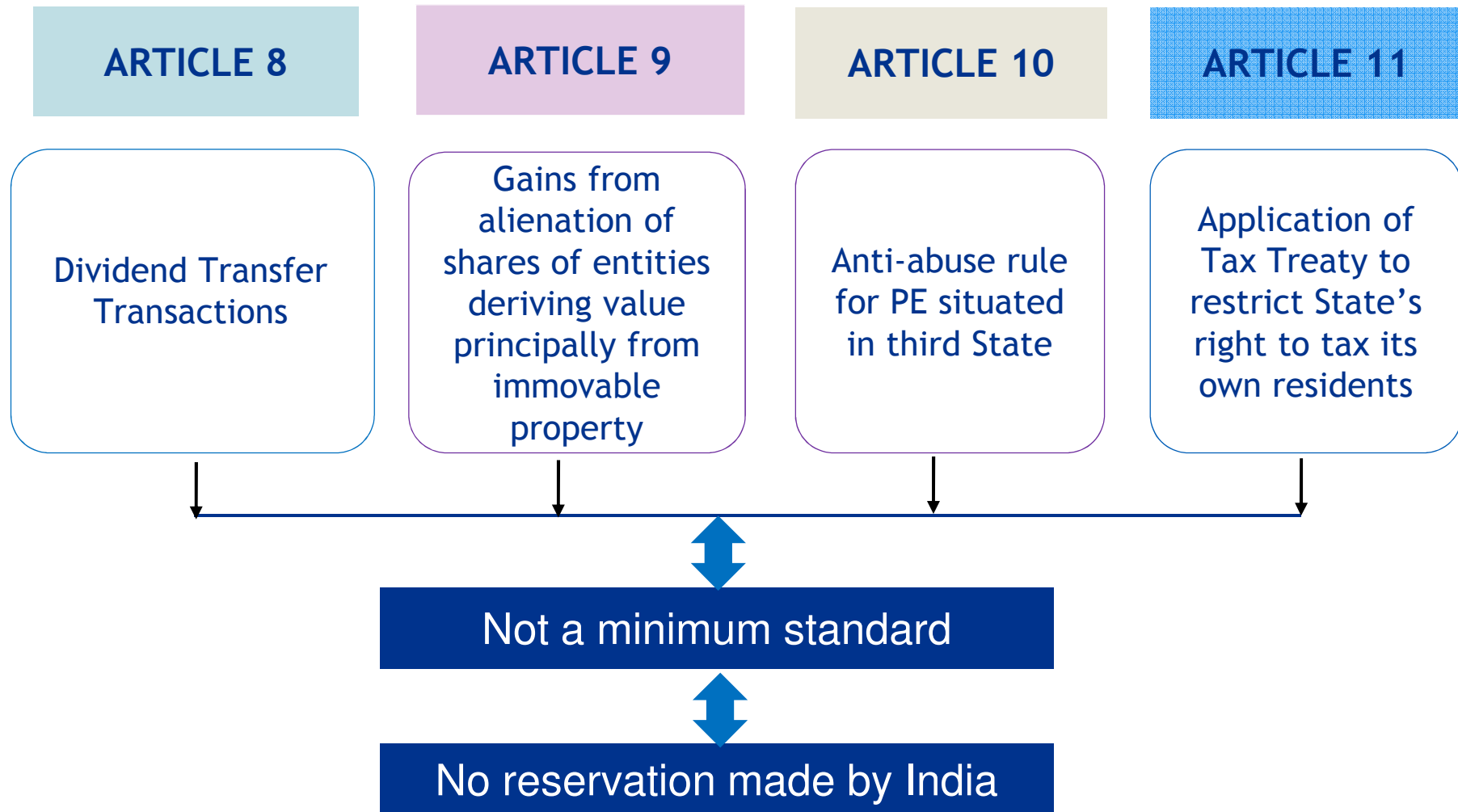
## Countries where Simplified LOB to become applicable

- Bulgaria
- Colombia
- Indonesia
- Russia and
- The Slovak Republic

## Countries that already have Simplified LOB in Tax Treaty with India

- Albania
- Armenia
- Iceland
- Mexico
- Sri Lanka
- Tajikistan
- Tanzania
- Uruguay
- USA

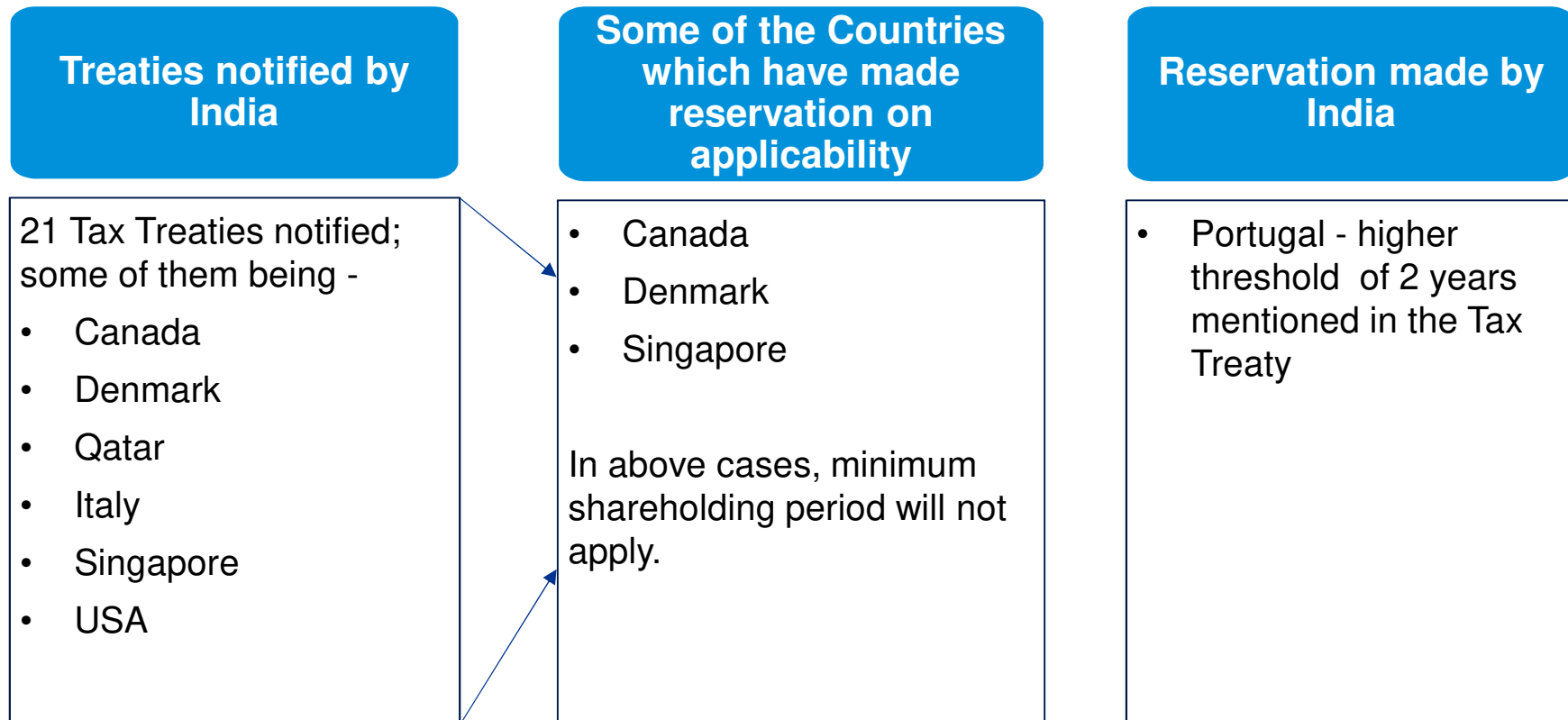
# Action 6 – Treaty abuse – other Articles



# Article 8 - Dividend Transfer

## Transactions

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



# Article 9 - Gains from alienation of shares of entities deriving value 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)

## 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

# Article 10 - Anti-abuse rule for PE

- 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



# Article 11 - Application of Tax Treaty to restrict a State's right to tax its own residents

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- 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, this provision should not apply



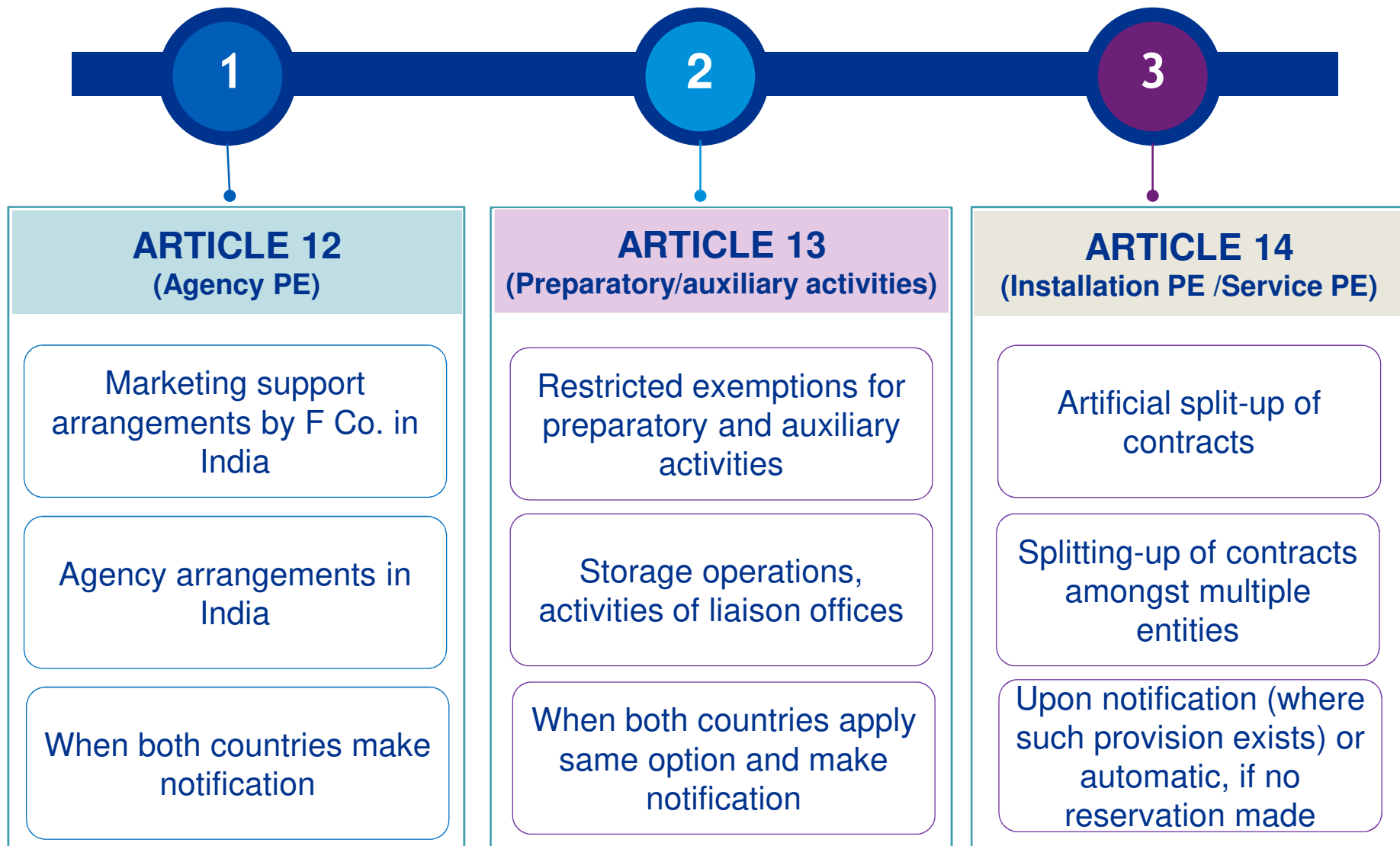
# Action Plan 7 - Avoidance of PE Status

Article 12 to 15  
of MLI

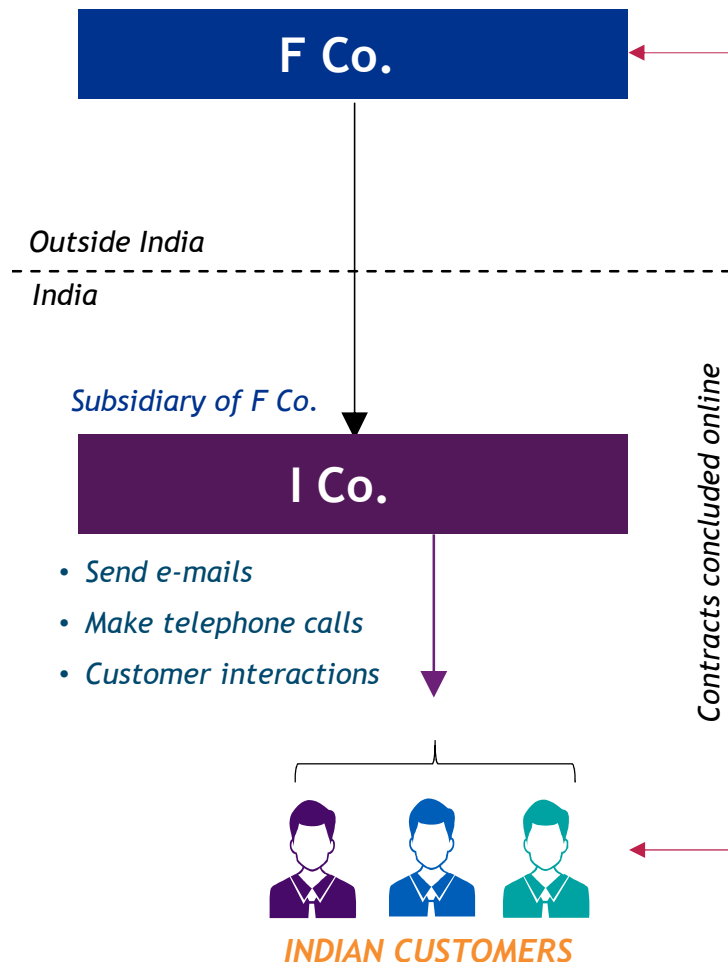
# Artificial avoidance of PE – Action Plan

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## KEY IMPACT AREAS



# Article 12 – Agency PE



- F Co. distributes various **products / services** worldwide through its **websites**
- I Co. is a **wholly owned subsidiary** of F Co. in India
- I Co.'s employees send **e-mails, make calls, visit customers** to convince them to buy F Co.'s products/ services
- I Co.'s employees indicate **price of product** and explain **standard terms of contract** with F Co. (*fixed by F Co.*)
- **Contracts** with customers **concluded online with F Co.** for **quantity** agreed and **price** discussed with employees
- I Co.'s employees did not have authority to vary standard terms contract, including the fixed pricing structure

Since no authority to vary/ conclude contract in India, possible to artificially avoid constitution of PE

# MLI impact on marketing support arrangements



## EXPANDING SCOPE OF AGENCY PE

- Scope of Agency PE expanded to include agents which **play principal role**, leading to routine conclusion of contracts, **without material modification, either:**
  - in the **name of the enterprise**; or
  - for transfer of **ownership** of or granting of **right to use**, property owned by F Co. or that F Co. has the right to use; or
  - for the **provision of service** by F Co.



## RESTRICTING SCOPE OF INDEPENDENT AGENT

- Agents acting **exclusively** or **almost exclusively** on behalf of one or more **closely related enterprises** not to be considered independent
- **'Closely related'**—to be determined based on **'control'** or **'beneficial interest'** test

## India adopts MLI changes

### Key treaties impacted

JAPAN

INDONESIA

NETHERLANDS

FRANCE

### Key treaties not impacted

UK

CYPRUS

SINGAPORE

CANADA

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

# Conclusion of contracts – Key determinants



## WHAT CONSTITUTES CONTRACT CONCLUSION

- **Participation in negotiation** may be 'relevant' **but not 'sufficient factor'**
- Mere **promotion and marketing goods or services** not a sufficient factor
- Conclusion of contract by agent, or as a direct result of actions of agent, should be '**repetitive**' and **not 'isolated'**
- **Absence of authority to conclude contract**- no longer a decisive factor for PE
- Place of actual signing of contract not relevant
- Person in effect acts as **sales force** or **convinces** the customer for the enterprise
- No precise test – depends on facts and circumstances of each page

### CASE FOR 'YES PE' POST MLI

F Co.



LO



- F Co. engaged in **distribution of electronic components**
- F Co. operating in India through LO
- LO's employees engaged in active **price negotiations, varying prices**, but contract conclusion outside India

### CASE FOR 'NO PE' POST MLI

Pharma Co.



Representatives of Pharma Co.

- Representatives of pharmaceutical company:
  - **Actively promoting drugs produced by the company**
  - Contacting doctors, who **subsequently prescribe drugs**

# Restricting scope of Independent agents



## EXPANDED TESTS OF INDEPENDENCE

- Acting **‘almost exclusively’** - no threshold defined (10% revenue threshold as per BEPS Action Plan 7 (“AP-7”))
- **Multiplicity of closely related principles** to be viewed collectively for ascertaining independence
- If **multiple non-related principles ‘act in concert’**, independence may be impacted



## ILLUSTRATION

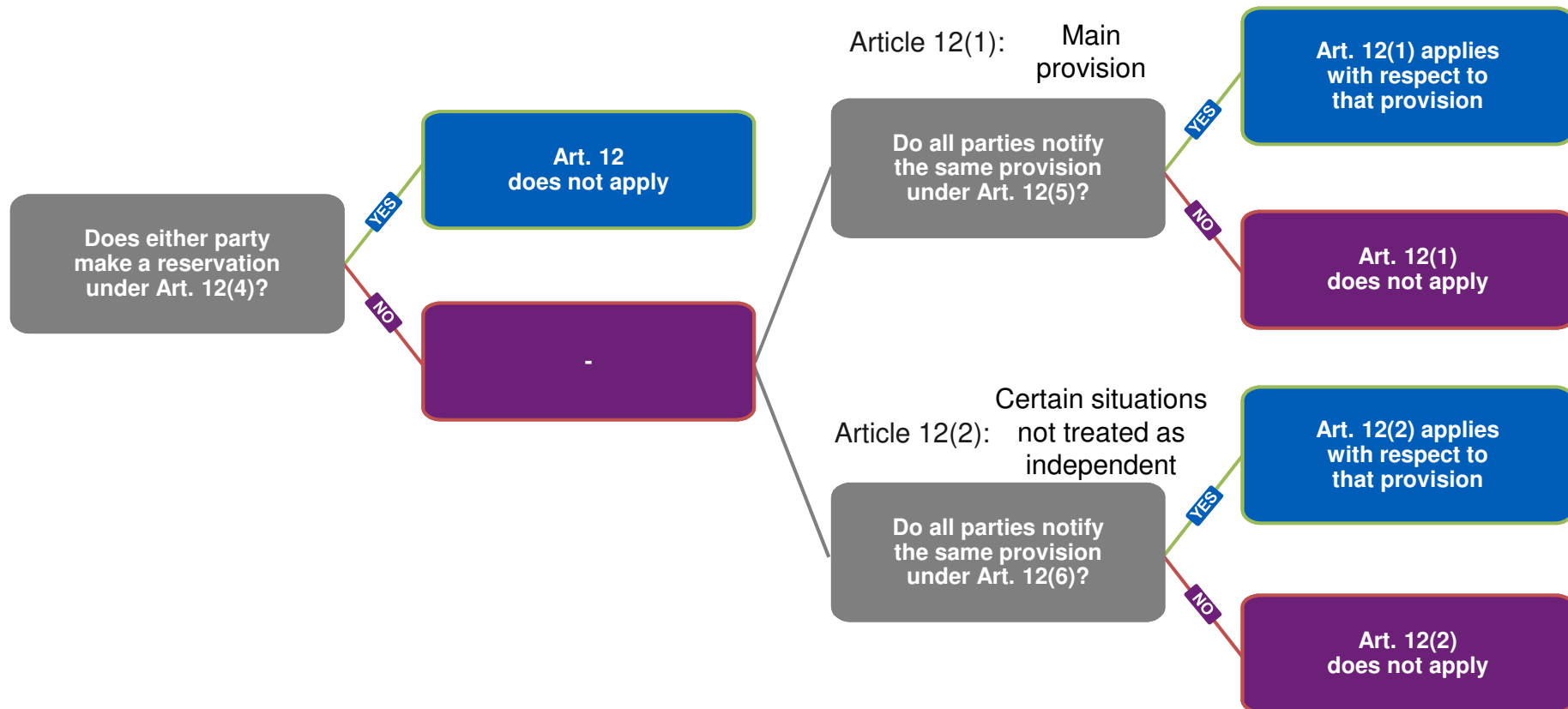
- I Co., an Indian agent engaged in **distribution of goods for various principals**
- **Majority of sales** by I Co. are concluded for **related F Cos.**
- Sales concluded by I Co. for **unrelated enterprises** constitute **less than 10%** of its **total sales**
- I Co. to be viewed as acting **‘exclusively’** or **‘almost exclusively’** on behalf of **closely related enterprises**

**Agent acting in the ‘ordinary course of its business’ as an ‘independent agent’**

**Business of agent unrelated to the agency not relevant**

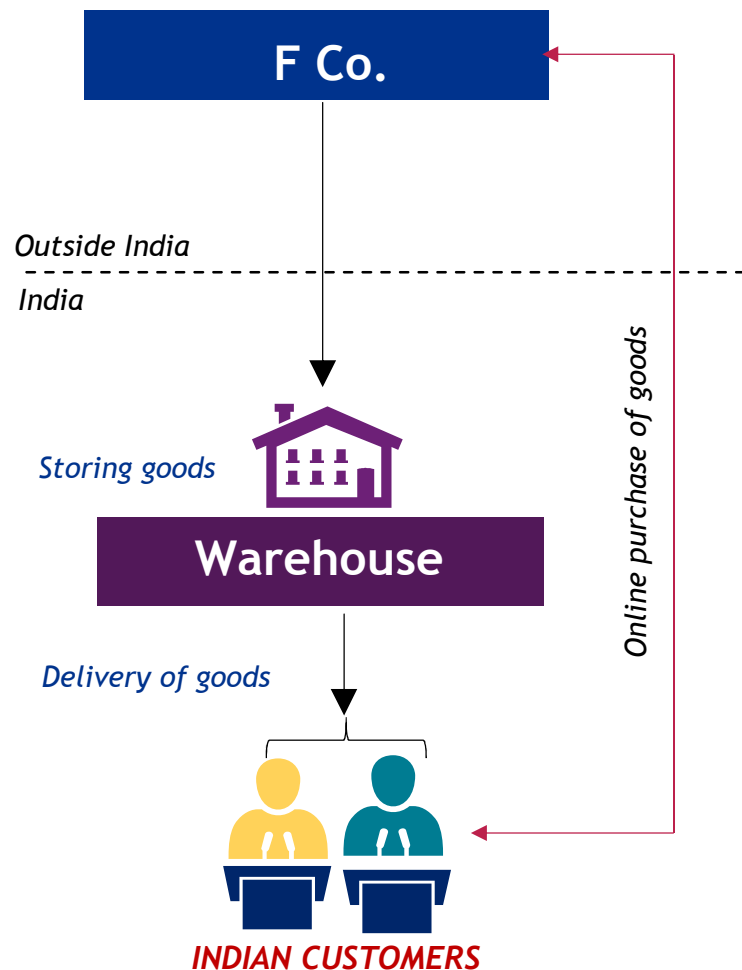
**Likely to have wide implications and increase in PE disputes**

# Article 12 – Agency PE





# Article 13 - Preparatory/auxiliary activity



- F Co. **sells goods** on **e-commerce model**
- **Operates a warehouse** in India to cater to Indian customers
- Warehouse used for **storing and delivering goods** to Indian customers
- Employees hired by F Co. in India for **warehousing operations**
- No tax implication on **warehousing activity** in India since it is considered to be **preparatory or auxiliary in nature**
- F Co. obtains **treaty benefit under Article 5(4)** to avoid PE implication

**OECD to re-characterize seemingly preparatory / auxiliary activity as core business activity**

# Preparatory/auxiliary activities restricting scope of exemption



## SITUATION SO FAR (Option B)

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

- a. **Use of facilities** for **storage, display or delivery** of goods
- b. **Maintenance** of stock of goods for the purpose of **storage, display and delivery**
- c. **Maintenance** of stock of goods for **processing** by other enterprise
- d. **Maintenance** of **fixed place of business** for **purchase of goods** or **collecting information**
- e. **Maintenance** of a **fixed place of business** for other activities not listed above, if it is **preparatory or auxiliary**
- f. **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 BY MLI (Option A)

Activities of F Co. (i.e. (a) to (e) above) need to be tested on **individual**, as well as **collective** basis for meeting '**Preparatory and auxiliary test**'

## India adopts Option A

### Key treaties impacted

JAPAN

NETHERLANDS

INDONESIA

RUSSIA

### Key treaties not impacted

UK

SINGAPORE

CYPRUS

FRANCE

# What constitutes preparatory or auxiliary (& A')?



## WHAT CONSTITUTES PREPARATORY / AUXILIARY

- **Activities generally carried out for a shorter period of time, preceding main activity**
- Do not require **significant assets or employees base**
- General purpose of fixed place not similar to general purpose of main enterprise
- **Enterprise management functions, wholly or in part, can not be P&A**
- To be carried out **only for F Co** – If carried out for F Co and others then not P & A

### EXAMPLES OF YES 'P&A'

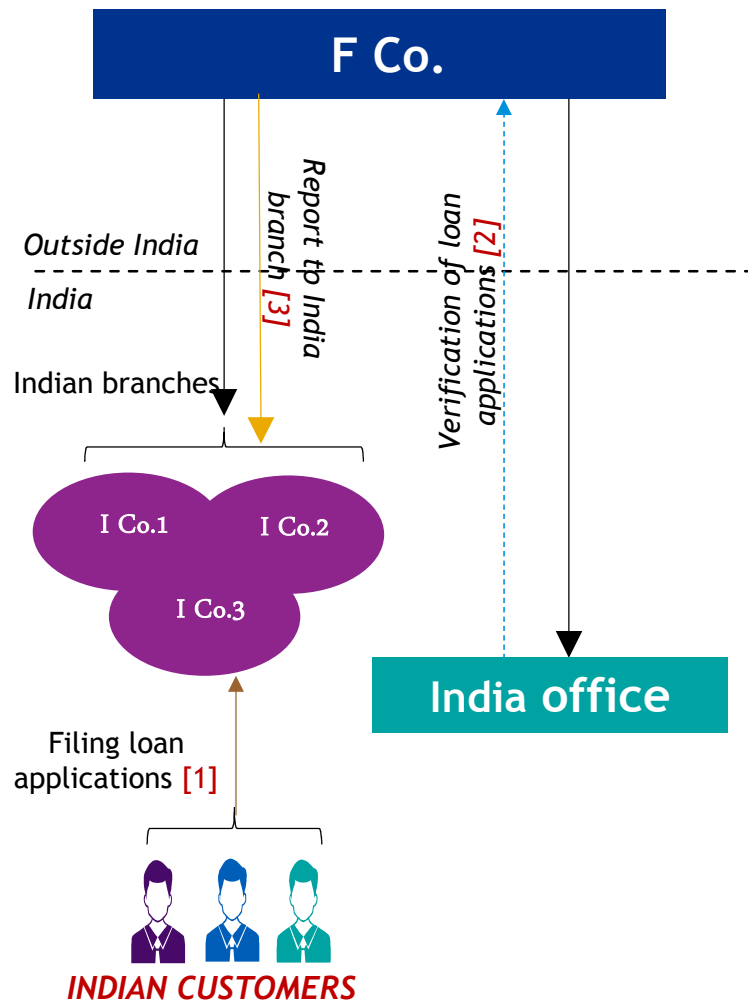
- **Storing of fruits in a bonded warehouse** by an exporter before custom clearance
- **Training of employees at one place, prior to commencement of work site in another country**

### EXAMPLES OF NO 'P&A'

- Sourcing of goods by experienced buyers employed by F Co., entering into contracts with supplier
- Independent logistics company operating a warehouse in source state, where such warehouse is at the disposal of F Co.

**Ascertaining preparatory or auxiliary character a highly fact driven exercise**

# Fragmentation of operations



- F Co. is a **foreign bank** having **multiple branches** in India
- **Each branch** in India constitutes **PE** of F Co.
- F Co. has an **office in India** where its employees **verify loan applications of customers** filed at various branches
- **Results of verification forwarded to F Co.** for review and approval. Later, these are sent by F Co to **India branches**
- **Decision for loan disbursement** taken by India branches based on the report received from F Co.
- F Co. obtains **treaty benefit under Article 5(4)** for activities **carried out at India office** to avoid PE implication

Key focus of OECD on PE avoidance through fragmentation of cohesive business activities

# Introducing Anti-fragmentation Rule



## ANTI-FRAGMENTATION RULE

- No P & A exemption if enterprise / closely related enterprise carry on **business at same place** or **different place** and :
  - Such place / places **constitute PE** for enterprise / closely related enterprise; or
  - **Overall activities resulting from combination of activities** carried on by the above enterprises is not of **preparatory or auxiliary character**
- PE to constitute only if above business activities of enterprise / related enterprises constitute **complementary functions** of **cohesive business operation**

## India adopts anti-fragmentation rule

### Key treaties impacted

JAPAN

NETHERLANDS

INDONESIA

RUSSIA

### Key treaties not impacted

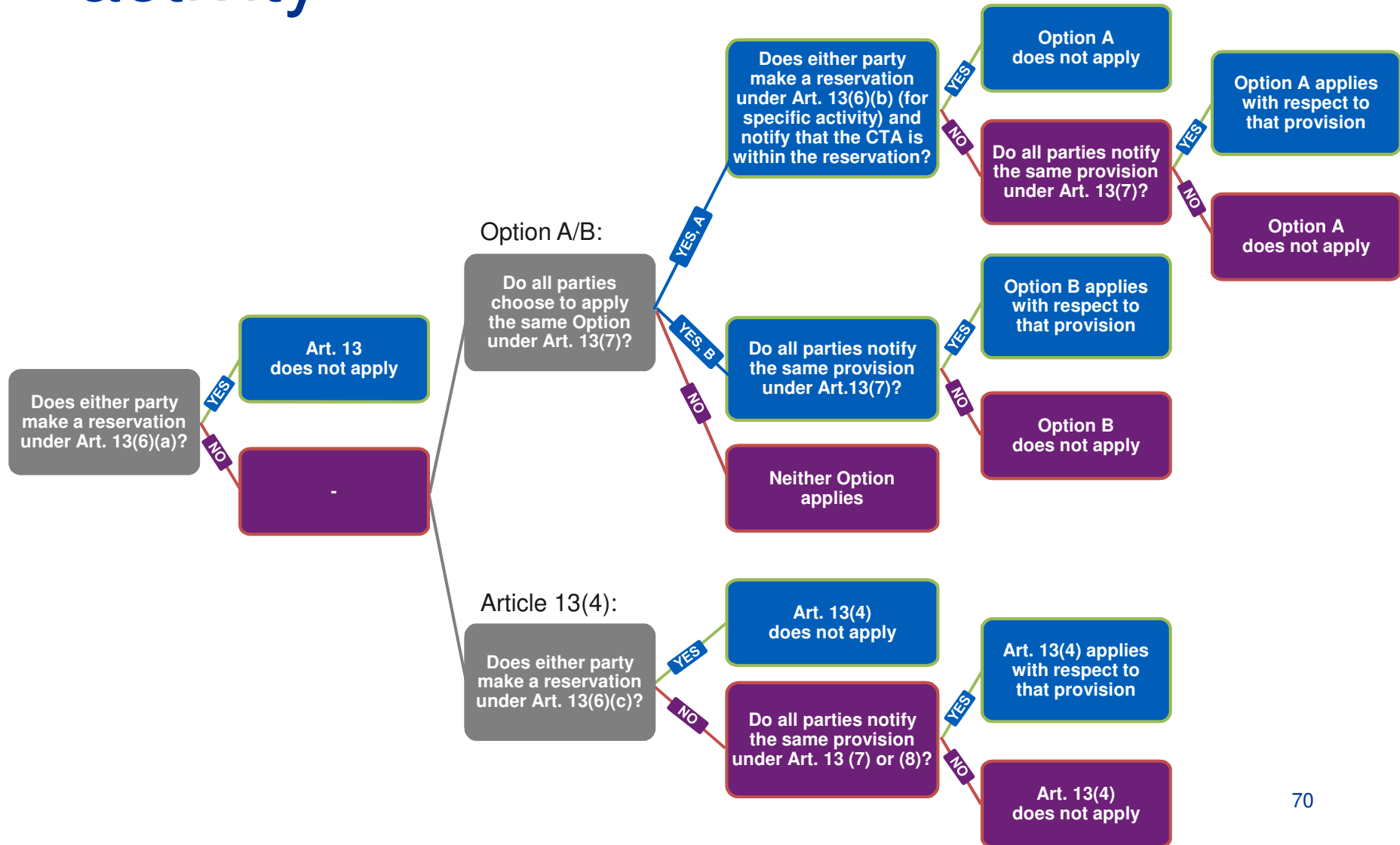
UK

SINGAPORE

CYPRUS

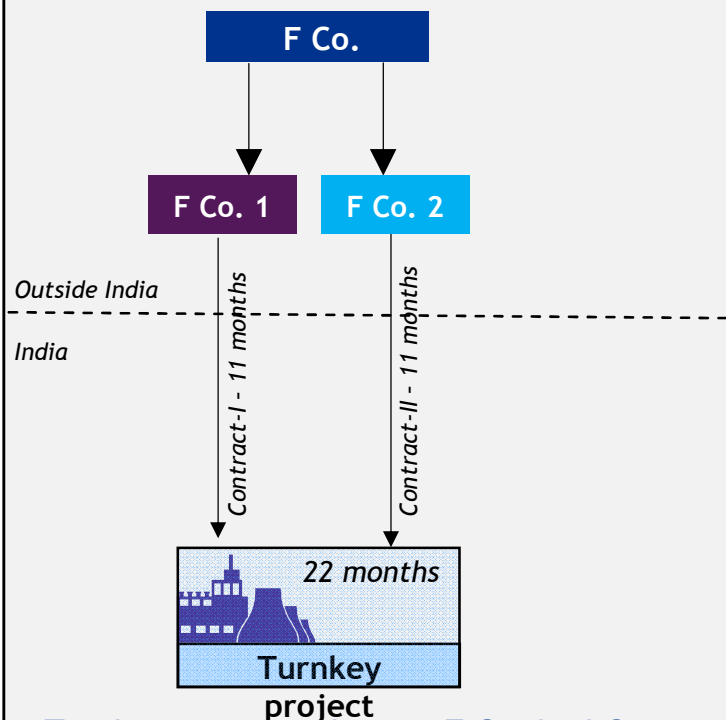
FRANCE

# Article 13 - Preparatory/auxiliary activity



# Article 14 - Artificial splitting-up of contracts

## TYPICAL SPLITTING-UP OF CONTRACT



- Turnkey contract given to F Co. by I Co.
- Contract split-up into several components
- Time spent on each contract less than prescribed threshold

## KEY CHANGES PROPOSED BY MLI

- PE to be formed by **disregarding artificial splitting-up** of contracts between F Co. and its affiliates if:
  - Enterprise's site / project or 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**

## ACTIVITIES LIKELY TO BE 'CONNECTED' IF

- Contracts for **different activities** with same or **related persons**
- Conclusion of **additional contract** in a **logical sequence** of **previous contract**
- Activities could be covered in a **single contract** in **absence of tax planning considerations**
- Nature of work involved under **different contracts** is **similar**
- **Same employees** performing activities under **different contracts**

## Key treaties impacted

FRANCE

NETHERLANDS

INDONESIA

NEW ZELAND

## Key treaties not impacted

UK

SINGAPORE

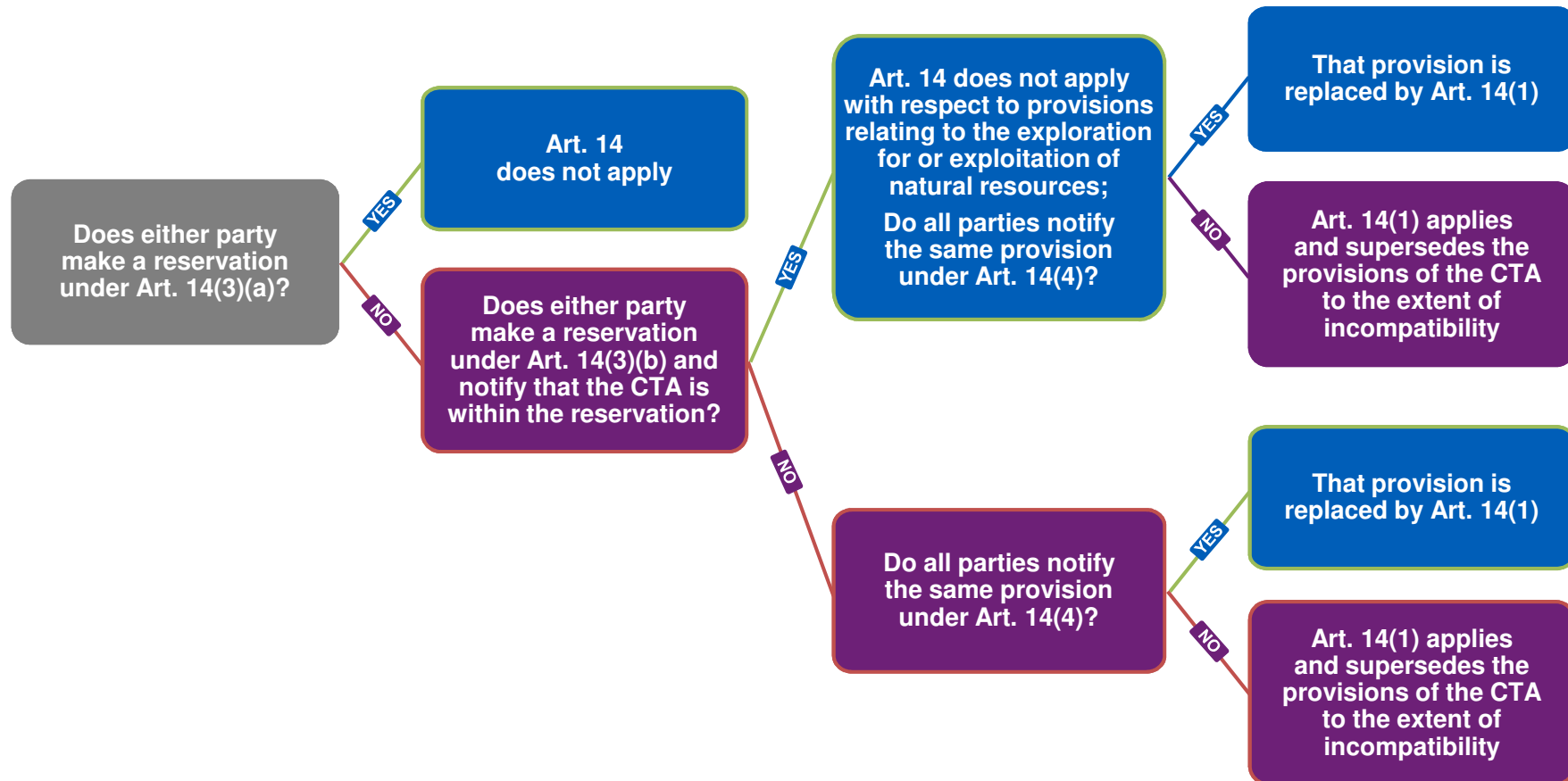
JAPAN

GERMANY

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

# Article 14 - Artificial splitting-up of contracts

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# Action 14 Dispute Resolution

## Article 16 of MLI

# Article 16 - Mutual Agreement

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## Procedure

- Article 16 is based on the minimum standards and best practice recommended under BEPS Action Plan 14.
- Not all the provision of this article are minimum standard and hence reservation can be made
- MLI provides that a person may approach the competent authority of either Contracting Jurisdiction regardless of any remedy provided under domestic law
- India has expressed reservation on presentation and provided that case can be presented only in the country of its residence subject to certain exception
- Time limit for presenting the case for MAP is three years from the first notification of the action alleged to have resulted in taxation not in compliance with the tax treaty

# Things to refer

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- **Text of the existing tax treaty**
- **Protocols (if any) to the existing tax treaty**
- **Text of MLI**
- **MLI position adopted by countries which is deposited at OECD**
- **Explanatory statement to MLI**
- **Relevance of OECD commentaries and BEPS Action reports**

- **Flow chart on matching of reservations and notifications of MLI**
- **Document containing signatories and parties to the MLI.**
- **Legal note on functioning on MLI under public international Law.**
- **FAQ's on MLI**
- **Information brochure on MLI.**
- **Step by step tool on applying the MLI**
- **MLI matching database (beta version)**

# Things to do

- **Self-study each MLI provisions along with Explanatory Statement**
- **Check your results with the OECD Depository so that impact of MLI becomes clear (refer <http://www.oecd.org/tax/treaties/mli-matching-database.htm>)**

The screenshot shows the OECD MLI Matching Database (beta) interface. The browser address bar indicates the URL: [www.oecd.org/tax/treaties/mli-matching-database.htm](http://www.oecd.org/tax/treaties/mli-matching-database.htm). The page title is "MLI Matching Database (beta)".

On the left, there is a navigation menu with the following items:

- > Aggressive tax planning
- > Base erosion and profit shifting
- > Consumption tax
- > Dispute resolution
- > Exchange of information
- > Fiscal federalism network
- > Global relations in taxation
- > Tax administration
- > Tax and crime
- > Tax policy analysis
- > Tax treaties**
- > Transfer pricing

The main content area is titled "MLI Matching Database (beta)". It contains the following text:

The **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI)** Matching Database makes projections on how the MLI modifies a specific tax treaty covered by the MLI by matching information from Signatories' MLI Positions.

This tool is a preliminary (beta) version that will be improved over time. The OECD welcomes **comments and suggestions** from the public on the development of improved versions of the MLI Matching Database.

For more information on the database, see the [user manual](#) and [disclaimer](#).

The main table displays the matching results for India and Russia. The table is titled "MLI Matching Database beta" and "Select jurisdictions: India Russia". The table has columns for "Status as of 27 September 2018", "Signature MLI", "Identificative instrument deposited", and "Status of List". The table also includes a "Read the Disclaimer" link.

Select jurisdictions:	India	Russia	Read the Disclaimer
Status as of 27 September 2018	India	Russia	
Signature MLI	6/7/2017	6/7/2017	
Identificative instrument deposited			
Status of List	Provisional	Provisional	
Article 2   Covered Tax Agreement	The agreement would be a 'Covered Tax Agreement'.		
Article 3   Transparent Entities	Article 3 would not apply.		
Article 4   Dual Resident Entities	4.4(3) would be replaced by Article 4(1).		
Article 5   Application for methods for Elimination of Double Taxation	Article 5 would not apply.		
	The preamble text described in Article 6(1) would be included		

# Q & A

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THANK YOU ALL FOR YOUR ATTENTION !

CA Rajiv Gandhi

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