



# **Institute of Chartered Accountants of India**

## **Western India Regional Council**

### **Study Course on MLI**

### **February, 2020**

**24<sup>TH</sup> FEBRUARY 2020**

**CA. T.P. OSTWAL**

# BEPS-History and Progress

- ❖ The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project is about bringing coherence, transparency and substance to the international tax rules, in a vastly different time.
- ❖ OECD and G20 governments came together in 2013 to address the issue of tax avoidance, and agreed a series of actions to tackle it.
- ❖ On 19 July 2013 the OECD released an *Action Plan on Base Erosion and Profit Shifting (BEPS)*.
  - ❖ The purpose of the Action Plan which have been under pressure in recent years from the pace of globalisation and the heightened sophistication of international business transactions and global value chains, as well as the strains that digitalisation has brought to rules developed a century ago an is “to prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from activities that generate it.”
  - ❖ The report indicates that “no or low taxation is not per se a cause for concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.”

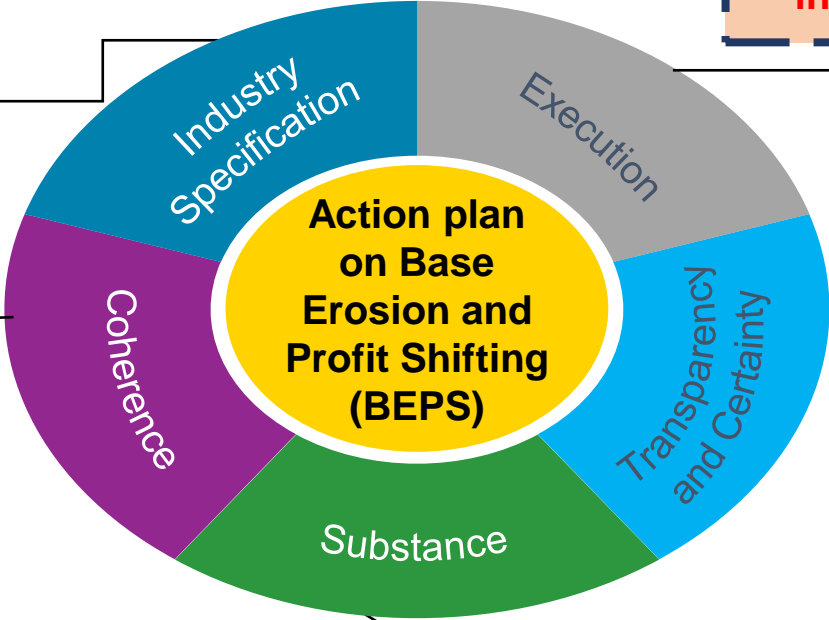
# BEPS-History and Progress

- ❖ The OECD/G20 Inclusive Framework continues to grow from 82 members at the inaugural meeting of the OECD/G20 Inclusive Framework in July 2016 in Kyoto, **it is now composed of 129 members and 14 observers, including over 70% of non-OECD and non-G20 countries and jurisdictions from all geographic regions**. They are working together on an equal footing, and not only to implement the BEPS measures agreed in 2015

# BEPS Actions

▶ Action 1 : Address the tax challenges of the digital economy

▶ **Action 15: Development of a multilateral instrument for amending bilateral treaties**



- ▶ Action 2: Neutralise the effects of hybrid mismatch arrangements
- ▶ Action 3: Strengthen CFC rules
- ▶ Action 4: Limit base erosion via interest deductions and other financial payments
- ▶ Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance

- ▶ Action 11: Establish methodologies to collect and analyse data on BEPS and actions addressing it
- ▶ Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
- ▶ Action 13: Re-examine transfer pricing documentation
- ▶ Action 14: Making dispute resolutions more effective

- ▶ Action 6: Prevent treaty abuse
- ▶ Action 7: Prevent the artificial avoidance of permanent establishment status
- ▶ Action 8: Consider transfer pricing for intangibles
- ▶ Action 9: Consider transfer pricing for risks and capital
- ▶ Action 10: Consider transfer pricing for other high-risk transactions

# Action 15-Multilateral Instrument (MLI)

- ❖ Recognising that there will be a need to consider innovative ways to implement the measures resulting from this work, Action 15 of the BEPS Action Plan provides for the development of a multilateral instrument
- ❖ The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) entered into force on 1 July 2018, following Slovenia depositing the fifth ratification instrument on 22 March 2018.
- ❖ The entry into force of the MLI for double tax treaty Parties (as defined) determines when its provisions come into effect for the treaties between them. Different dates potentially apply for withholding taxes, other taxes, mutual agreement procedures to resolve disputes, and the use of arbitration to resolve disputes, where territories have chosen to apply arbitration
- ❖ As on 14<sup>th</sup> February, 2020 94 Jurisdictions have signed the MLI. 4 Jurisdiction have showed the intention to sign the MLI

# Major changes to Indian Tax Treaties through MLI

- ✓ Modification to the Preamble – explicitly mentioned that purpose of treaty is also to prevent treaty abuse and double non-taxation and to prevent extension of benefit of the treaty to persons resident in a third jurisdiction (prevention of treaty shopping)
- ✓ Resolution of status of Dual Residence through MAP
- ✓ Expansion to the scope of Permanent Establishment
  - Independent Agent scope expanded (i.e. where agent provides services to closely related entities)
  - Dependent Agent PE rule
  - PE exclusion for certain activities to now be restricted only if such activities have a Preparatory or Auxiliary character
  - Anti-fragmentation rule to prevent avoidance of PE through artificial disintegration of cohesive activities

# Major changes to Indian Tax Treaties through MLI

- ✓ Expansion to the scope of Permanent Establishment
  - Anti-splitting of contracts rule to prevent artificial splitting of contracts between related parties to manipulate time period threshold for PE creation
  - Address the avoidance of PE through Commissionaire Arrangements & similar arrangements
- ✓ Corresponding Adjustments in case of related party transactions
- ✓ Lower rate of tax on dividends only if shareholding is maintained for past 365 days, not just on dividend payment date
- ✓ Capital gains from transfer of security whose principal value was derived from immovable property in a country would be taxable not just if such value is derived at the time of transfer but at any time in past 365 days from date of transfer
- ✓ Principle Purpose Test (minimum standard)
- ✓ Simplified Limitation of Benefits Test to prevent treaty abuse
- ✓ Anti-Abuse Rule for PEs in Third Jurisdictions

# Synthesized Text of Indian Tax Treaties

- ❑ The “Synthesized Text” represents the shared understanding between the two Governments of the modifications to their DTAA through the MLI and is prepared jointly by the relevant Competent Authorities.
- ❑ The CBDT periodically publishes the “Synthesized Text” of Indian Tax Treaties as and when they are prepared. The treaties whose text has been published till date include the following:

Treaty with	Articles Modified	Articles Added
Australia	Preamble, 1, 4, 5, 13, 25	PPT Clause
Austria	Preamble, 5, 23	Anti-Abuse Rule for PEs in Third Jurisdictions, PPT Clause
Finland	Preamble	PPT Clause
Ireland	Preamble, 4, 5, 13	Anti-Abuse Rule for PEs in Third Jurisdictions, PPT Clause
Japan	Preamble, 4, 5, 9, 13	PPT Clause
Lithuania	Preamble, 5, 9, 30	(PPT clause part of Article 30)
Poland	Preamble, 1, 4, 14, 28A	(PPT clause part of Article 28A)
Singapore	Preamble	PPT Clause
Slovak Republic	Preamble, 1, 4, 5, 9, 10, 13, 23	SLOB, Anti-Abuse Rule for PEs in Third Jurisdictions, PPT
United Kingdom	Preamble, 1, 4, 5, 27, 28C	(PPT clause part of Article 28C)

*[Since the India-Slovak treaty has most of the MLI related amendments, this Treaty is used to show the impact on Indian treaties]*



# Features of MLI

# Features of MLI

- Allowing the countries the option to specify DTAA to which they want MLI to apply
- Matching concept – only if both countries notify their respective DTAA, changes will take place.
- Such DTAAs will be “Covered Tax Agreements” or CTAs. *Other DTAAs to be negotiated bilaterally.*
- Certain minimum standards to apply to if DTAA is CTA
- Possibility to opt out of provisions which do not reflect a BEPS minimum standard with the possibility to opt in later
- Possibility to apply optional provisions and alternative provisions at any time where there are multiple ways to address BEPS
- Notifications of CTAs, reservations, options and affected existing provisions (MLI Positions) to identify modifications. MLI positions provided by each jurisdiction available on the *OECD* website

# Covered Tax Agreement (CTA)

The term “Covered Tax Agreement” means an agreement for the avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered):

i) that is in force between two or more:

A) Parties; and/or

B) jurisdictions or territories which are parties to an agreement described above and for whose international relations a Party is responsible; and

ii) with respect to which each such Party has made a notification to the Depositary listing the agreement as well as any amending or accompanying instruments thereto (identified by title, names of the parties, date of signature, and, if applicable at the time of the notification, date of entry into force) as an agreement which it wishes to be covered by this Convention.

# **Article 6 - Purpose of a Covered Tax Agreement**

# Article 6- Purpose of a Covered Tax Agreement

- ❖ Prevention of treaty abuse is a minimum standard covered under Action 6 of the Final BEPS package. Pursuant to such minimum standard under Action 6, requiring express intent in tax treaties to exclude opportunities for treaty abuse, Article 6(1) of the MLI provides for introduction of the following preamble text in a CTA –

*“Intending to eliminate double taxation with respect to the taxes covered by this agreement 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 this agreement for the indirect benefit of residents of third jurisdictions),”*



- ❖ This preamble text (“MLI Preamble”) is included in place of or in absence of existing preamble language of a CTA which expresses an intent to eliminate double taxation. However, a Party is permitted to make a reservation with respect to those CTAs which already satisfy the minimum standard and contain the requisite preamble language. In case of such reservation by one of the Treaty Partners to a CTA, the preamble of that CTA will remain unchanged.

# Article 6- Purpose of a Covered Tax Agreement

## Impact & Analysis

- ❖ India has been silent on its position on Article 6. Therefore, in the absence of India notifying any treaty provisions/preamble language, the MLI Preamble will not replace the existing preamble language in India's CTAs but will only be added to the existing preamble text, irrespective of whether or not the other Treaty Partners notify India's treaty for this purpose

### India-Mauritius

**Please note that Mauritius is not yet a signatory or a party to the MLI. However Mauritius has signalled its intent to sign up to the MLI and this analysis is based on the assumption that Mauritius shall also notify the India-Mauritius DTAA as a CTA.**

- ❖ The existing preamble in the Mauritius treaty provides its object as *“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”*.
- ❖ In the landmark judgment of **Union of India v. Azadi Bachao Andolan**, the Supreme Court referred to the text of the preamble of the Mauritius Treaty providing for “encouragement of mutual trade and investment” and legitimized treaty shopping as being consistent with India's intention at the time when the Mauritius Treaty was entered into.

# Article 6- Purpose of a Covered Tax Agreement

## Impact & Analysis


- ❖ In the context of treaty shopping in a developing economy, the Supreme Court ruled as follows:

*“125. There are many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy, in the interest of long term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so called ‘abuse’ of ‘treaty shopping’, perhaps, it may have been intended at the time when Indo-Mauritius DTAC was entered into. Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations. This Court cannot judge the legality of treaty shopping merely because one section of thought considers it improper. A holistic view has to be taken to adjudge what is perhaps regarded in contemporary thinking as a necessary evil in a developing economy.”*
- ❖ The addition of MLI Preamble to the Mauritius Treaty (if and when signed) is likely to significantly change the position established in **Azadi Bachao Andolan** as the MLI Preamble specifically provides for intent to prevent opportunities for tax avoidance evasion through treaty shopping. **However, where an entity is set up in Mauritius primarily for the purposes of investment into India, the same could be argued to be within the overall object and purpose of the Mauritius Treaty by virtue of the existing preamble language of the treaty, thereby qualifying for treaty benefits.**
- ❖ ***Interestingly US is not a signatory to the MLI***

# **Article 4 of the MLI- Residency of Dual Resident Entity**



# Article 4 of the MLI- Residency of Dual Resident Entity

- ❖ No change as far as individuals are concerned
- ❖ Dual Resident Entity (“DRE”) is a person resident in more than one Contracting Jurisdiction.
- ❖ Article 4 of MLI seeks to provide clarity on manner of determination of residential status of non-individual DRE.
- ❖ Presently under DTAA, Place of Effective Management (“POEM”) is the only tie-breaker rule to determine the residential status.
- ❖ It is now proposed that the residential status of a DRE shall be determined by a Mutual Agreement Procedure (“MAP”) between Treaty Partners taking into account place of incorporation or constitution and any other relevant factors in addition to POEM. 
- ❖ **This will help to resolve dual residency issues through mutual agreement as POEM rules may differ from country to country resulting in hardship to the tax payer.**

# **Article 7- Prevention of Treaty Abuse**

# Article 7- Prevention of Treaty Abuse

- ❖ Article 7 provides safeguard against ‘**Treaty Abuse**’ and in particular ‘**Treaty Shopping**’
- ❖ Three-pronged approach recommended to address treaty shopping arrangements:
  - **Clear statement of intent** in tax treaties to avoid creation of opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements
  - Introduction of specific anti-abuse rule, for instance, the **Limitation-of-Benefits** rule, that limits availability of treaty benefits to entities meeting certain conditions (based on legal nature, ownership in, and general activities of entity to ensure sufficient link between entity and State of residence)
  - Introduction of a more general anti-abuse rule based on the **principal purposes test**

This is a **Minimum Standard** – to include in the tax treaties an express statement that common intention is to eliminate double taxation without creating opportunities for non-taxation, tax evasion or avoidance

In order to implement the minimum standard the treaties should include

- LOB
- PPT
- Simplified LOB supplemented by PPT

# Article 7- Simplified LOB (Para 8-13)

- ❖ It is a SAAR aimed at treaty shopping
- ❖ Treaty benefits to be denied to a resident of a Contracting State who is not a ‘Qualified Person’
- ❖ ‘Qualified Person’ to include -
  - An individual;
  - The State, its political subdivision, entities owned by the State;
  - Certain charities and pension funds;
  - Certain public entities and their affiliates;
  - Certain entities that meet certain ownership requirements and/or turnover requirements;
  - Certain collective investment vehicles;
  - Entities permitted by competent authorities.
- ❖ If a person is not a ‘Qualified Person’, the benefit of treaty would be available on satisfaction of certain conditions

# Article 7- Principle Purpose Test ('PPT') (Para 1)

*“Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that **obtaining that benefit was one of the principal purposes\*** of any arrangement or transaction that resulted directly or indirectly in that benefit,*

*unless*

*it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement**”*

*\* this is more stringent than GAAR*

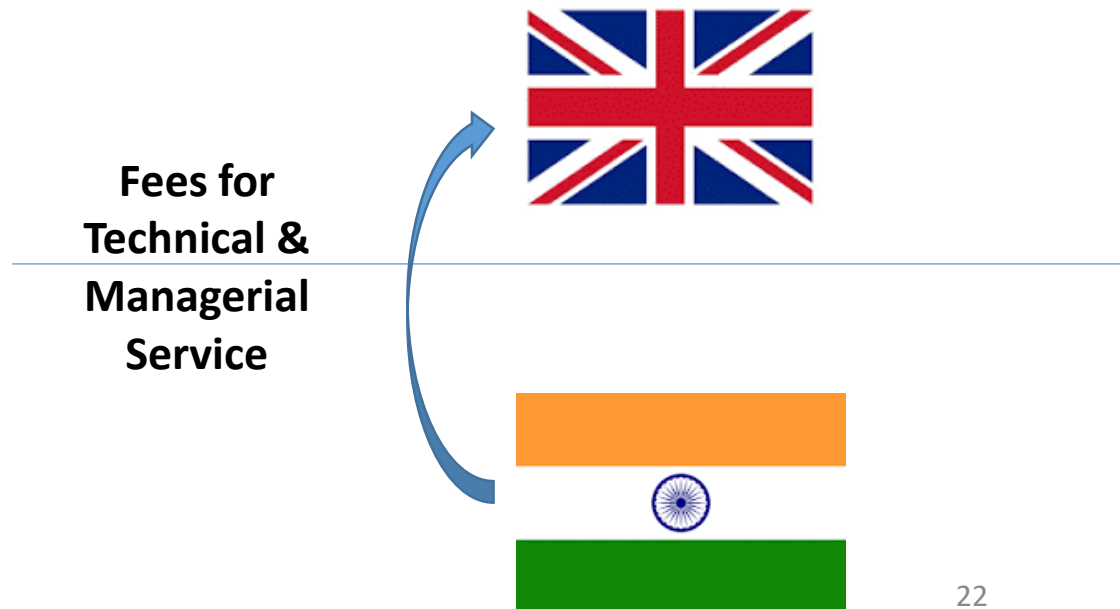
## **PPT – BURDEN OF PROOF**

- ❖ Obtaining tax benefit is one of the principal purposes – Onus on the tax department
- ❖ Arrangement is in accordance with the object and purpose of the treaty – Defence available with the tax payer

# Example- Principle Purpose Test

- ❖ XY a Company registered in UK is looking for expanding its business in Asia. It has identified three different countries with similar economic and political environments. The entity set up by XY will perform its operating in the basis of technical and managerial support provided by XY.
- ❖ It selects India for setting up its business on account of favourable treaty (Make available clause) with India.
- ❖ Will PPT apply?

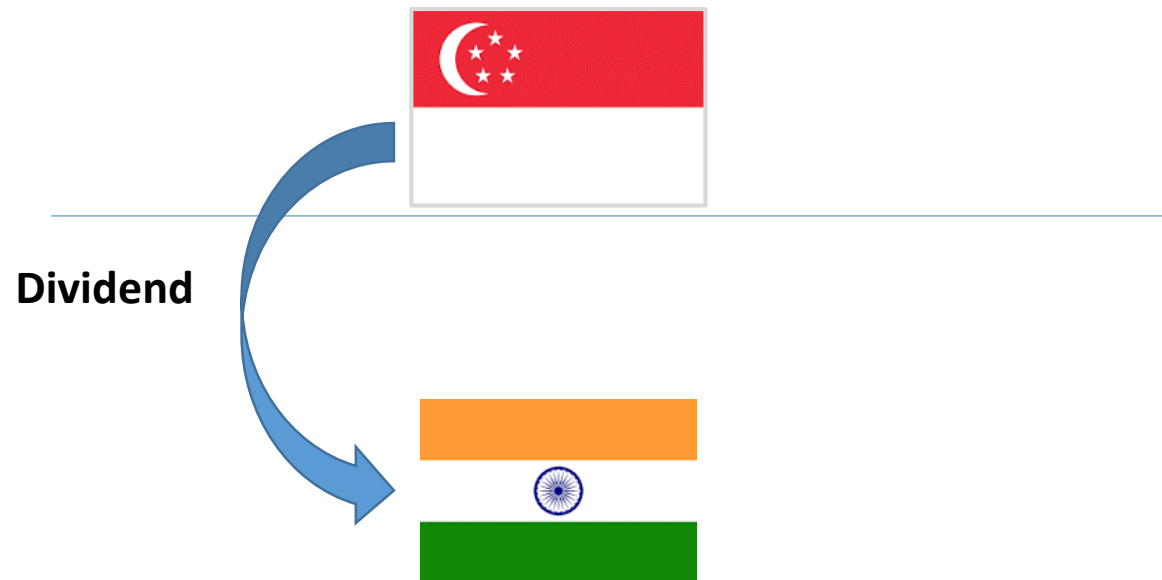
Expansion of business in the principal purpose, but favourable treaty provisions were taken into consideration.



# Example- Principle Purpose Test

- ❖ I Co is a collective investment vehicle registered in India managing diversified portfolios of investment globally. It has significant investments in Singapore on account favourable treaty (underlying tax credit) on dividend taxation.
- ❖ Whether PPT applies?

One of the intents of treaties is to provide benefit to encourage cross border investments.



**Article 12- Artificial Avoidance of Permanent Establishment Status  
through Commissionaire Arrangements and Similar Strategies**



## Article 12- Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

1. Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, habitually concludes contracts, or **habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise**, and these contracts are:

a) in the name of the enterprise; or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or

c) for the provision of services by that enterprise,

## Article 12- Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

2. that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement (as it may be modified by this Convention).

3. Paragraph 1 shall not apply where the person acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise of the other Contracting Jurisdiction carries on business in the first-mentioned Contracting Jurisdiction as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

# Article 12- Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

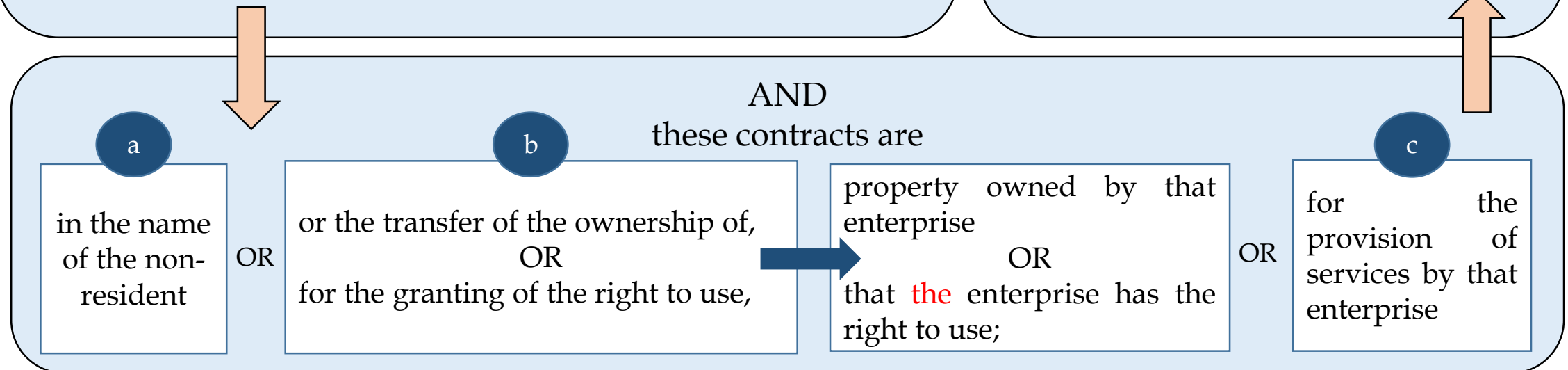
where a person is acting in State S on behalf of an enterprise

**AND in doing so,**

- habitually concludes contracts, OR
- habitually plays the principal role leading to conclusion of contracts by that non-resident **that are routinely conclude without material modification by the enterprise**

- that enterprise shall be deemed to have a PE in State S

- **UNLESS these activities in State S are Preparatory & Auxiliary in nature**



*“OR HABITUALLY PLAYS THE PRINCIPAL ROLE”*  
– OCED COMMENTARY

- Covers a scenario where the conclusion of a contract directly results from the actions that the person performs in a State S on behalf of the enterprise, resident of State R, even though, under the relevant law, the contract is not concluded by that person in State S;
- Addresses cases where the conclusion of contracts is clearly the direct result of substantive activities taking place in a country although the relevant rules of contract law provide that the conclusion of the contract takes place outside that State;
- The phrase is typically associated with the actions of the person who convinced the third party to enter into a contract with the enterprise;

*“OR HABITUALLY PLAYS THE PRINCIPAL ROLE”*  
– OCED COMMENTARY

- Example - A person solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the enterprise are delivered and where the enterprise routinely approves these transactions;
- The phrase does not apply, however, where a person merely promotes and markets goods or services of an enterprise in a way that does not directly result in the conclusion of contracts

## “CONTRACTS THAT ARE ROUTINELY CONCLUDED WITHOUT MATERIAL MODIFICATION BY THE ENTERPRISE” – OCED COMMENTARY

- The phrase clarifies that where such principal role is performed in that State, the actions of that person will fall within the scope of Art. 5(5) of the Model Convention even if the contracts are not formally concluded in State S, for example, where the contracts are routinely subject, outside that State, to review and approval without such review resulting in a modification of the key aspects of these contracts



**Article 13- Artificial Avoidance of Permanent Establishment Status  
through the Specific Activity Exemptions**



# Article 13 of MLI – Activity based PE exclusions

Article 13(2) – Activity based PE exclusion under DTAA will now be available only if the overall character of such activity is preparatory and/or auxiliary 

## Article 13(4) of MLI - NEW ANTI-FRAGMENTATION RULES ('AFR')

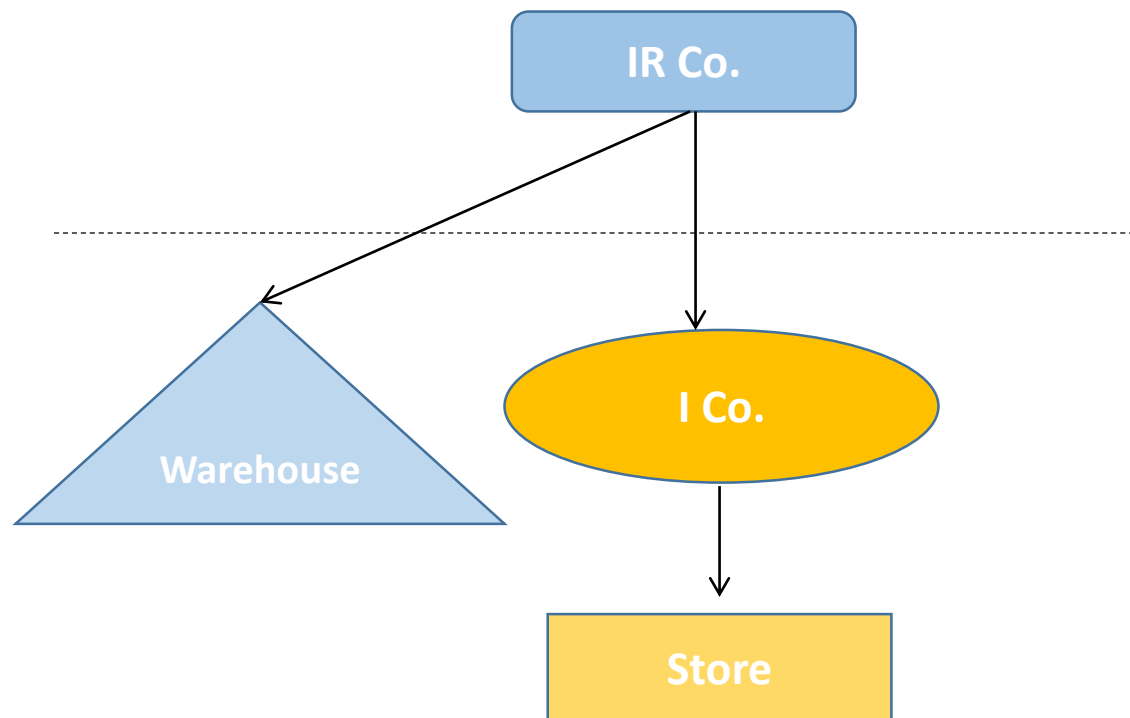
*“4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and:*

*a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*

*b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

*provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”*

# Example- Anti Fragmentation



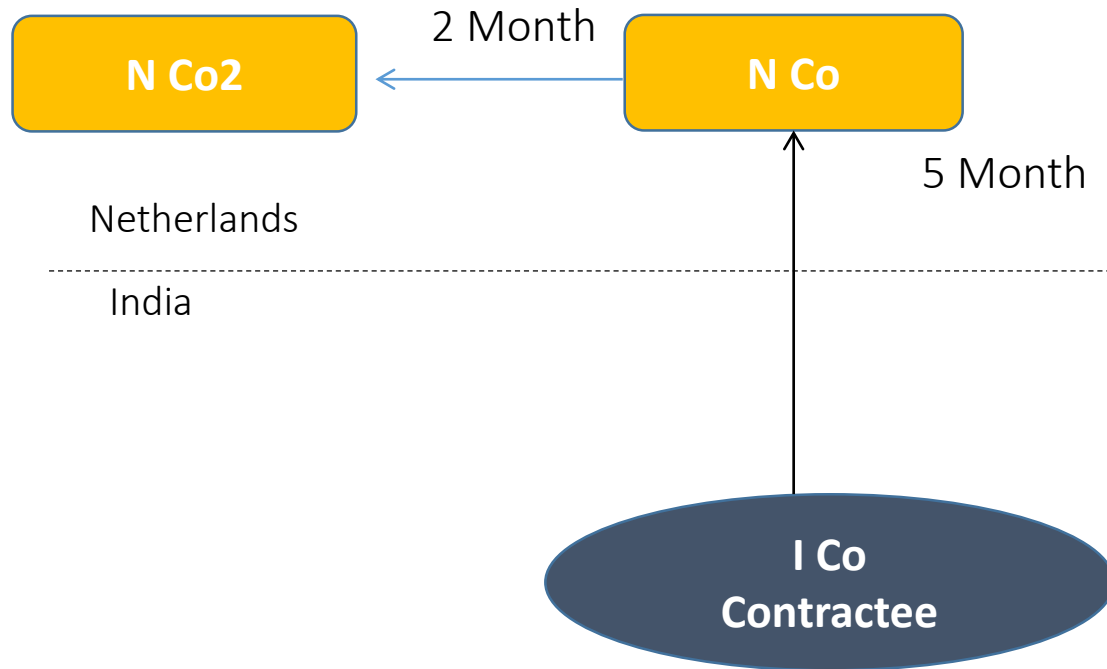
## Structure Mechanics:

- ❑ IR Co, a company resident of Ireland, manufactures and sells appliances. I Co, a resident of India that is a wholly owned subsidiary of IR Co, owns a store where it sells appliances that it acquires from IR Co
- ❑ IR Co also owns a warehouse in India where it stores goods displayed in the store owned by I Co
- ❑ Whenever any product is completely sold out from the store, the warehouse supplies such product to the store. It also delivers directly to the customer when a large quantity of any product is ordered

**Whether the warehouse would constitute a PE in terms of the new Anti-Fragmentation Rule?**

# **Article 14 – Splitting-up of Contracts**

# Example- Splitting of Contract →



## Structure Mechanics:

- ❑ I Co. a company resident in India wishes to establish a mall in India. The project will take 7 months to complete
- ❑ I Co. engages a Netherland Company, N Co. as the main contractor for undertaking the said construction.
- ❑ N Co engages its associated entity N Co 2 to undertake a part of the project which would take 2 months

**Whether N Co and N Co2 will be construed as PE in India post- MLI?**

# **Article 8 – Dividend Transfer Transaction**

## Article 8 – Dividend Transfer Transaction

- ❖ **Minimum shareholding to be met throughout 365 days for beneficial dividend tax rate**
- ❖ Further, this article or the notification of India's MLI Position is unlikely to have a significant impact on the distribution of dividends. This is because of the imposition of **Dividends Distribution Tax (DDT)** on the corporate profits out of which dividends are distributed. Hence, any limitation on the availability of treaty benefits with respect to taxes on dividends is unlikely to have an impact on the DDT or the distributions made by Indian companies.
- ❖ A lot of countries such as Canada, Denmark, Singapore, Netherlands, Australia, Cyprus have reserved Article 8 and hence are not interested in adding the Testing Period to the dividend article thereby implying that they consider the already existing Beneficial Owner Test to be enough to ensure that exemption from dividend taxation in the source state does not lead to base erosion
- ❖ Earlier, lower rate of tax on dividends applied if the ownership condition was met on the date of payment of dividend – now the condition has to be met for a continuous period of 365 days

**Article 9 – Capital Gains from Alienation of Shares or  
Interests of Entities Deriving their Value Principally from  
Immovable Property**

# Article 9 – Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

- ❖ 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);

## 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


- ❖ Earlier, gains were taxed if the value was derived at the time of alienation – now gains would be taxed if value was derived at any time during 365 preceding the alienation also

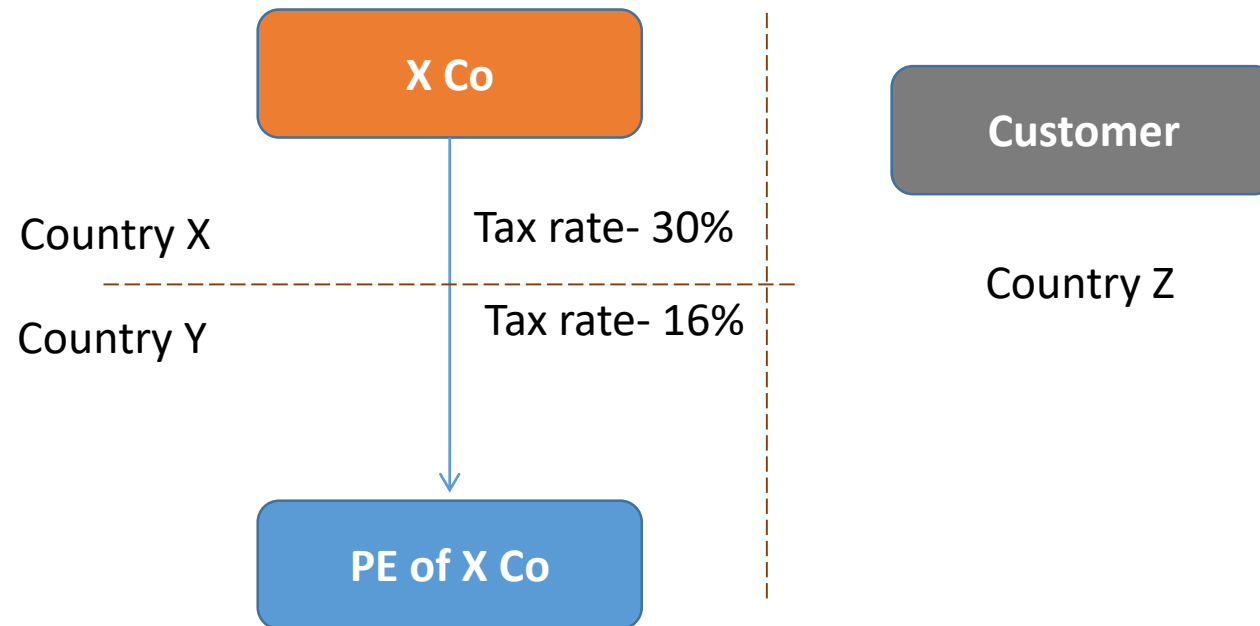




# **Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions**

# Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions

- ❖ Benefit of Tax Treaty shall not be available to the taxpayer where income is derived from the source State by the PE of such taxpayer situated in third State, If: 
- Such income of the PE is not taxable in the resident State of the taxpayer, and
- Tax in the third State on income of the PE is less than 60% of the tax in the resident State



## Mechanics:

- Country X-Y treaty operates on exemption method
- Country X-Z treaty provides for a 0% rate

# **Other MLI Related changes**

# Other MLI related changes

- ❖ Corresponding Adjustment introduced to Article 9 through addition of text of Article 17(1) of the MLI:

An adjustment to the tax liability of the AE in a second jurisdiction (for example Slovak Republic) made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction (for example India), so that the allocation of profits by the two jurisdictions is consistent.



- ❖ Scope of DAPE expanded Article 12(2) of the MLI :

An agent will not be considered independent if such agent works for other persons but such persons are considered closely related to the first enterprise – accordingly, such agent would constitute a PE of the first enterprise



- ❖ Consequent addition of definition of persons “closely related to an enterprise”



# **Amendments to India-China DTAA**

**Notification dated 17<sup>th</sup> July, 2019 S.O. 2562(E)**

# INDIA-CHINA DTAA

- ❖ India & China, both signatories to the MLI, have not notified each other's DTAA to be CTA
- ❖ Instead, India and China chose to bilaterally renegotiate their DTAA to align the Articles with that of the MLI and BEPS Action Plans as mutually agreeable to both parties
- ❖ The amended DTAA incorporates the following changes related to the MLI/ BEPS:
  - Additional text to the Preamble
  - Treatment of income through/ by Fiscally Transparent Entities
  - Dual residency to be resolved through MAP
  - Installation/ Construction PE, Agency PE, Service PE amended
  - Independent Agent status widened (Article 5)
  - PPT inserted to prevent treaty abuse

*“Multilateralism as an evident change in the global tax arena, where the focus of countries has shifted to multilateral discussions and consensus building...”*

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**THANK YOU**

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# Reference Material Slides



# Modified Preamble in India – Slovak Republic DTAA

Relevant Article	Synthesized Treaty [Changes Highlighted in RED]
<p><b>Preamble of Treaty</b>  (Text from Article 6(1) of the MLI added)</p>	<p>The Government of India and the Government of the Slovak Republic [<i>part of erstwhile Czechoslovak Socialist Republic</i>], Desiring to conclude an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,</p> <p>Intending to eliminate double taxation with respect to the taxes covered by this agreement 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 this agreement for the indirect benefit of residents of third jurisdictions),</p> <p>Have agreed as follows:</p>
<p><b>Article 1</b>  (Text from Article 11(1) of the MLI added)</p>	<p>This agreement shall apply to persons who are residents of one or both of the Contracting States.</p> <p>The Agreement shall not affect the taxation by a Contracting State 1 of its residents, except with respect to the benefits granted under Article 9 as modified by paragraph 1 of Article 17 of MLI, Article 18, 20, 21, 23, 24, 25 and 27 of the Agreement.</p>



# Dual Residency clause India – Slovak Republic DTAA

Relevant Article	Amended Treaty Changes [Highlighted in RED]
<p><b>Article 4(3)</b>  (Text replaced by <b>Article 4(1) of the MLI</b>)</p>	<p><del>Where, by reason of the provisions of paragraph 1, a person other than an individual is a resident of both the Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.</del></p> <p>Where by reason of the provisions of [the Agreement] a person other than an individual is a resident of more than one [Contracting State], the competent authorities of the [Contracting State] shall endeavour to determine by mutual agreement the [Contracting State] of which such person shall be deemed to be a resident for the purposes of [the 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 Agreement] except to the extent and in such manner as may be agreed upon by the competent authorities of the [Contracting States].</p>

## Article 7 para (8) to (13) of MLI added to India-Slovak Republic DTAA - Simplified Limitation on Benefits Provision



(8) Except as otherwise provided in the Simplified Limitation on Benefits Provision, a resident of a [Contracting State] shall not be entitled to a benefit that would otherwise be accorded by [this Agreement], other than a benefit under [paragraph 3 of Article 4, Article 9 of this Agreement as modified by Paragraph 1 of Article 17 of MLI or Article 25 of this Agreement], unless such resident is a “qualified person”, as defined in paragraph 9 [of Article 7 of the MLI] at the time that the benefit would be accorded.

(9) A resident of a [Contracting State] to [the Agreement] shall be a qualified person at a time when a benefit would otherwise be accorded by [the Agreement] if, at that time, the resident is:

- a) an individual;
- b) that [Contracting State], or a political subdivision or local authority thereof, or an agency or instrumentality of any such [Contracting State], political subdivision or local authority;
- c) a company or other entity, if the principal class of its shares is regularly traded on one or more recognised stock exchanges;
- d) a person, other than an individual, that:
  - i) is a non-profit organisation of a type that is agreed to by the [Contracting States] through an exchange of diplomatic notes; or
  - ii) is an entity or arrangement established in that [Contracting State] that is treated as a separate person under the taxation laws of that [Contracting State] and:
    - A) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that [Contracting State] or one of its political subdivisions or local authorities; or
    - B) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision A);



e) a person other than an individual, if, on at least half the days of a twelve-month period that includes the time when the benefit would otherwise be accorded, persons who are residents of that [Contracting State] and that are entitled to benefits of the Agreement under subparagraphs a) to d) own, directly or indirectly, at least 50 per cent of the shares of the person.

(10) a) A resident of a [Contracting State] will be entitled to benefits of [the Agreement] with respect to an item of income derived from the other [Contracting State], regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned [Contracting State], and the income derived from the other [Contracting State] emanates from, or is incidental to, that business. For purposes of the Simplified Limitation on Benefits Provision, the term “active conduct of a business” shall not include the following activities or any combination thereof:

- i) operating as a holding company;
- ii) providing overall supervision or administration of a group of companies;
- iii) providing group financing (including cash pooling); or
- iv) making or managing investments, unless these activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such.

b) If a resident of a [Contracting State] derives an item of income from a business activity conducted by that resident in the other [Contracting State], or derives an item of income arising in the other [Contracting State] from a connected person, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned [Contracting State] to which the item is related is substantial in relation to the same activity or a complementary business activity carried on by the resident or such connected person in the other [Contracting State]. Whether a business activity is substantial for the purposes of this subparagraph shall be determined based on all the facts and circumstances.

## **SLOB – Article 7 para (8) to (13) of MLI added to Treaty (... continued)**



c) For purposes of applying this paragraph, activities conducted by connected persons with respect to a resident of a [Contracting State] shall be deemed to be conducted by such resident.

(11) A resident of a [Contracting State] that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded by [the Agreement] with respect to an item of income if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least 75 per cent of the beneficial interests of the resident.

(12) If a resident of a [Contracting State] is neither a qualified person pursuant to the provisions of paragraph 9 [of Article 7 of the MLI], nor entitled to benefits under paragraph 10 or 11 [of Article 7 of the MLI], the competent authority of the other [Contracting State] may, nevertheless, grant the benefits of [the Agreement], or benefits with respect to a specific item of income, taking into account the object and purpose of [the Agreement], but only if such resident demonstrates to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under [the Agreement]. Before either granting or denying a request made under this paragraph by a resident of a [Contracting State], the competent authority of the other [Contracting State] to which the request has been made shall consult with the competent authority of the first-mentioned [Contracting State].

*[Para 13 includes definitions of certain terms for the purpose of the SLOB provision and is not included here]*



## **Activity based PE-exclusion: Article 5(3) of India-Slovak Republic DTAA (text from Article 13(2) of MLI added)**

Notwithstanding [Article 5 of the Agreement], the term “permanent establishment” shall be deemed not to include:

- a) i) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- ii) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
- iii) the maintenance of stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by an enterprise of the other Contracting State;
- iv) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or for collecting information, for the enterprise;
- v) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise. However, this provision shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State for any purpose or purposes other than the purposes herein specified.

**b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a);**

**c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b),**

**provided that such activity or, in the case of subparagraph c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.**



## **This is the Anti-Fragmentation Clause inserted into activity based PE exclusion para**

### **Article 5(3) (text from Article 13(4) of MLI added to India-Slovak Republic DTAA**

Paragraph 3 of Article 5 of the Agreement, as modified by paragraph 2 of Article 13 of the MLI] shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same [Contracting State] and: a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of [Article 5 of the Agreement]; or b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.





## Anti-Splitting of Contracts provision in DTAA

### **Article 5(2)(g) – (text from Article 14(1) of MLI added to India-Slovak Republic DTAA**

a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery or equipment.

For the sole purpose of determining whether the period (or periods) referred to [in subparagraph (g) of paragraph 2 of Article 5 of the Agreement] has been exceeded:

- a) where an enterprise of a [Contracting State] carries on activities in the other [Contracting State] at a place that constitutes a building site [or] construction or [assembly project], or carries on supervisory activities in connection with such a place, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding period or periods referred to in [subparagraph (g) of paragraph 2 of Article 5 of the Agreement]; and
- b) where connected activities are carried on in that other [Contracting State] at the same building site [or] construction or [assembly project] or [supervisory activities in connection therewith] during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise, these different periods of time shall be added to the aggregate period of time during which the first-mentioned enterprise has carried on activities at that building site [or] construction or [assembly project,] or [supervisory activities in connection therewith].



## Beneficial Owner test for taxation of Dividends

### **Text from Article 8(1) of MLI added to Article 10(2)(a) of India-Slovak Republic DTAA**

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed:

a) 15 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 25 per cent of the shares of company paying the dividends;

[Subparagraph (a) of paragraph 2 of Article 10 of the Agreement] shall apply only if the ownership conditions described in those provisions are met throughout a 365 day period that includes the day of the payment of the dividends (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividends)

b) 25 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid



## Derivation of value test for taxation of Capital Gains

### **Article 13(4) of India-Slovak Republic DTAA replaced by Article 9(4) of MLI**

~~Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State.~~

For purposes of [this Agreement], gains derived by a resident of a [Contracting State] from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other [Contracting State] if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other [Contracting State].



## Anti-abuse Rule For PE Situated In Third Jurisdictions

### **Article 10 para (1)-(3) of MLI added to India-Slovakia DTAA**

Where:

- a. an enterprise of a [Contracting State] derives income from the other [Contracting State] and the first-mentioned [Contracting State] treats such income as attributable to a permanent establishment of the enterprise situated in a third jurisdiction; and
- b. the profits attributable to that permanent establishment are exempt from tax in the first-mentioned [Contracting State], the benefits of [the Agreement] shall not apply to any item of income on which the tax in the third jurisdiction is less than 60 per cent of the tax that would be imposed in the first mentioned [Contracting State] on that item of income if that permanent establishment were situated in the first-mentioned [Contracting State]. In such a case, any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other [Contracting State], notwithstanding any other provisions of [the Agreement].

Paragraph 1 [of Article 10 of the MLI] shall not apply if the income derived from the other [Contracting State] described in paragraph 1 [of Article 10 of the MLI] is derived in connection with or is incidental to the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).

If benefits under [the Agreement] are denied pursuant to paragraph 1 [of Article 10 of the MLI] with respect to an item of income derived by a resident of a [Contracting State], the competent authority of the other [Contracting State] may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of paragraphs 1 and 2 [of Article 10 of the MLI]. The competent authority of the [Contracting State] to which a request has been made under the preceding sentence by a resident of the other [Contracting State] shall consult with the competent authority of that other [Contracting State] before either granting or denying the request.



## **Corresponding Adjustment provision**

### **Text from Article 17(1) of MLI added to Article 9 of India-Slovak Republic DTAA**

Where a [Contracting State] includes in the profits of an enterprise of that [Contracting State] — and taxes accordingly — profits on which an enterprise of the other [Contracting State] has been charged to tax in that other [Contracting State] and the profits so included are profits which would have accrued to the enterprise of the first-mentioned [Contracting State] if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other [Contracting State] shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of [the Agreement] and the competent authorities of the [Contracting States] shall if necessary consult each other.



## **Text from Article 12(2) of MLI added to Article 5(5) of India-Slovak Republic DTAA**

An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an individual status, where such persons are acting in the ordinary course of their business.

Paragraph 4 of Article 5 of the Agreement as modified by Paragraph 1 of Article 12 of the MLI] shall not apply where the person acting in a [Contracting State] on behalf of an enterprise of the other [Contracting State] carries on business in the first-mentioned [Contracting State] as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

## **Text from Article 15(1) of MLI added to Article 5 of India-Slovak Republic DTAA – to apply to entire Article**

For the purposes of the provisions of [Article 5 of the Agreement as modified by paragraph 2 of Article 12, paragraph 4 of Article 13 and paragraph 1 of Article 14 of the MLI], a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise.