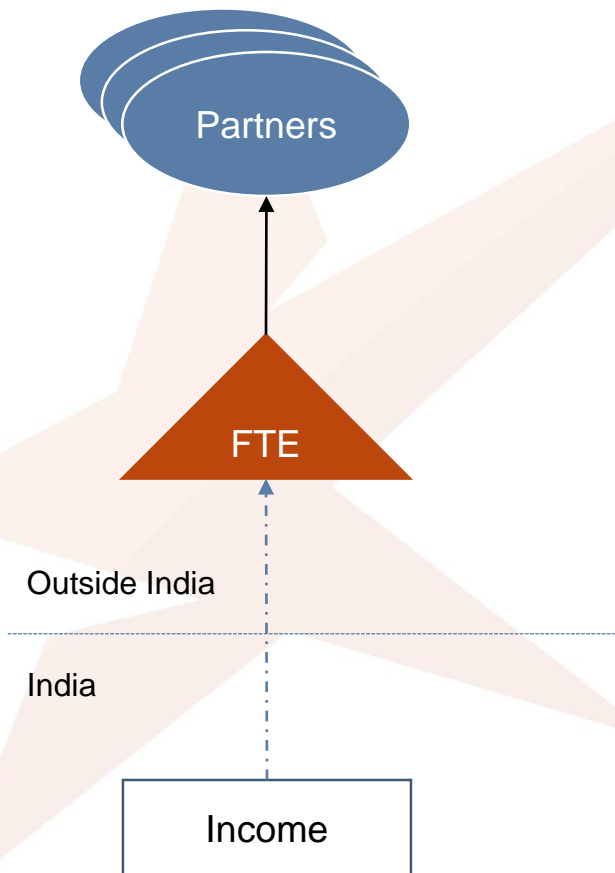


Treatment of transparent entities as per multilateral instrument

- Prashant Bhojwani

19 February 2020

Fiscally transparent entity (FTE)



- ‘Fiscally transparent’ refers to situations where, under domestic law of a Contracting State, income (or part thereof) of entity or arrangement is not taxed at level of such entity but at level of persons who have an interest in that entity
- Complexities
 - Some countries treat partnerships as transparent entities imposing no tax at partnership itself but taxing each partners on its share of partnership income
 - Others treat partnership as taxable entity taxing partnership on its income
- Illustrations of FTEs
 - Partnership firms
 - Limited liability partnerships
 - Trusts

Historic litigation in India

- Linklaters LLP¹
- Linklaters & Paines²
 - Non-resident partnership firm eligible to India-UK tax treaty as long as entire income of partnership firm taxed in UK (whether in hands of partnership firm or partners directly)
- P & O Nedloyd Limited³
- Maersk Line U.K. Limited⁴
- Zee Telefilms Limited⁵
 - Non-resident partnership firm to be a ‘firm’ under section 2(23)(i) of the Income-tax Act, 1961 (the Act) and accordingly considered as a ‘person’ under section 2(31) of the Act eligible for India-UK tax treaty

¹ [2017] 79 taxmann.com 12 (Mumbai Tribunal); [2011] 9 ITR(T) 217 (Mumbai Tribunal);

² [2014] 49 taxmann.com 66 (Mumbai Tribunal)

³ [2014] 369 ITR 282 (Calcutta)

⁴ [2016] 68 taxmann.com 173 (Calcutta High Court)

⁵ [2015] 43 ITR(T) 506 (Mumbai Tribunal)

Historic litigation in India

- Chiron Bhering GmbH & Co⁶
 - For availability of India-Germany tax treaty, assessee should be a ‘person’, such person should be a resident and should be liable to pay tax by reason of domicile, residence, etc.
 - Partnership firm was liable to ‘trade tax’ in Germany (covered tax under India-Germany tax treaty)
- Canoro Resources Limited⁷
 - If requirements of section 184 of the Act are satisfied, assessee shall be considered as a firm as understood under Indian Partnership Act, 1932

⁶[2017] (ITA No. 2273 of 2010) (Bombay High Court); ITA No. 4633/Mum/2006

⁷AAR No. 779 of 2008

Historic litigation in India

- A.P. Moller⁸
 - Once a State has a right to tax firm's income (irrespective whether that the same is taxed in hands of partners), then firm is considered as fiscally domiciled in that State as per Article 4 of India-Denmark tax treaty
- Schellenberg Wittmer⁹
 - Swiss partnership firm is not a taxable entity in Switzerland and accordingly not a 'person' as per Article 3 of India-Switzerland tax treaty. Therefore, Swiss partnership firm cannot claim benefit of India-Switzerland tax treaty
 - Argument that partners are residents of Switzerland and their incomes from partnership are taxable in Switzerland is not valid for determining tax treaty eligibility of Swiss partnership firm

⁸[2013] 39 taxmann.com 27 (Mumbai Tribunal)

⁹[2012] 24 taxmann.com 299 (AAR – New Delhi)

India-UK tax treaty

ARTICLE 3

GENERAL DEFINITIONS

1. *In this Convention, unless the context otherwise requires:*

(f) the term "person" includes an individual, a company, a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

ARTICLE 4

FISCAL DOMICILE

1. *For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that:*

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

India-China tax treaty

ARTICLE 1

PERSONS COVERED

1. *This Agreement shall apply to persons who are residents of one or both of the Contracting States.*
2. *For the purposes of this Agreement, income derived by or through an entity or arrangement that is established in either Contracting State and that is treated as wholly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State only to the extent that the income is treated, for the purposes of taxation by that State, as the income of a resident of that State.*

ARTICLE 3

GENERAL DEFINITIONS

1. *For the purposes of this Agreement, unless the context otherwise requires,—*
 - (e) *the term "person" includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;*

**Article 1 substituted by Notification No. S.O. 2562(E) [No.54/2019/F.No. 503/02/2008-FTD-II], Dated 17-7-2019*

Base Erosion and Profit Shifting (BEPS)

BEPS Action 2 – ‘Neutralising the Effects of Hybrid Mismatch Arrangements’

- Addresses income earned through Transparent Entities
- Extends tax treaty benefit in appropriate cases
- Ensures Transparent Entities are not used to obtain undue benefits of tax treaties

BEPS Action 15 – ‘Multilateral Instrument (MLI)’

Part II - Hybrid mismatches

Article 3 – Transparent Entities

Article 3 – Structure

Paragraph	Particulars
1	BEPS measure
2	Elimination of double taxation
3	Unlimited right to tax own residents
4	Compatibility
5	Reservation
6	Notification

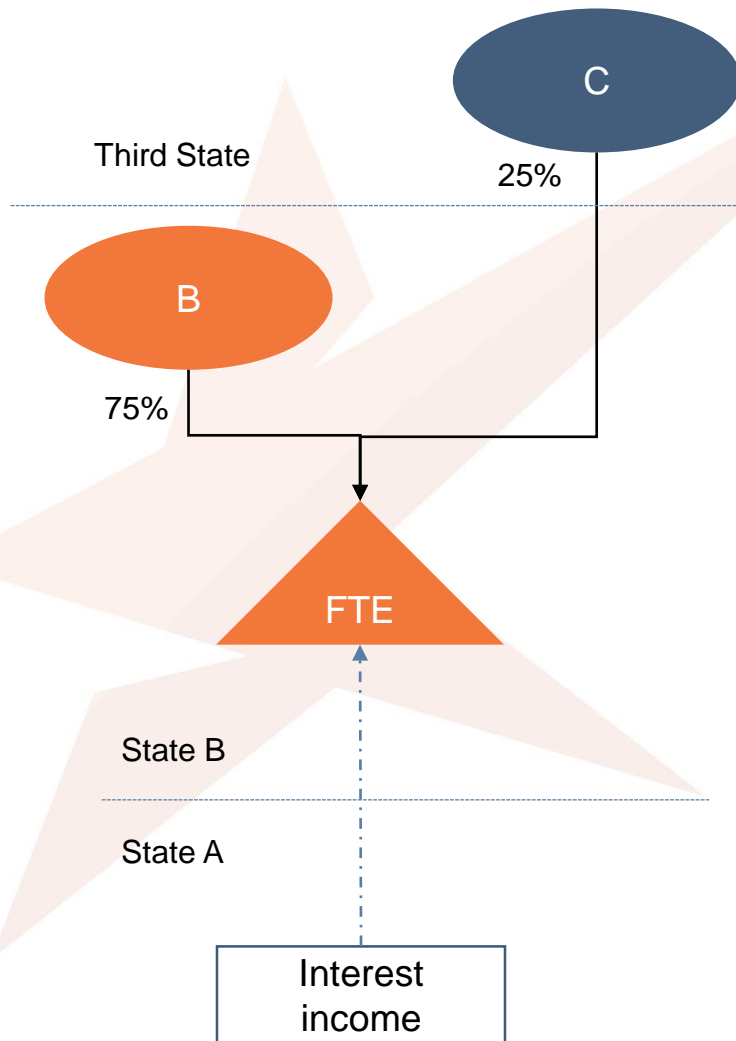
Article 3 – Transparent Entities

Paragraph 1

“For the purposes of a Covered Tax Agreement, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting Jurisdiction shall be considered to be income of a resident of a Contracting Jurisdiction but only to the extent that the income is treated, for purposes of taxation by that Contracting Jurisdiction, as the income of a resident of that Contracting Jurisdiction”

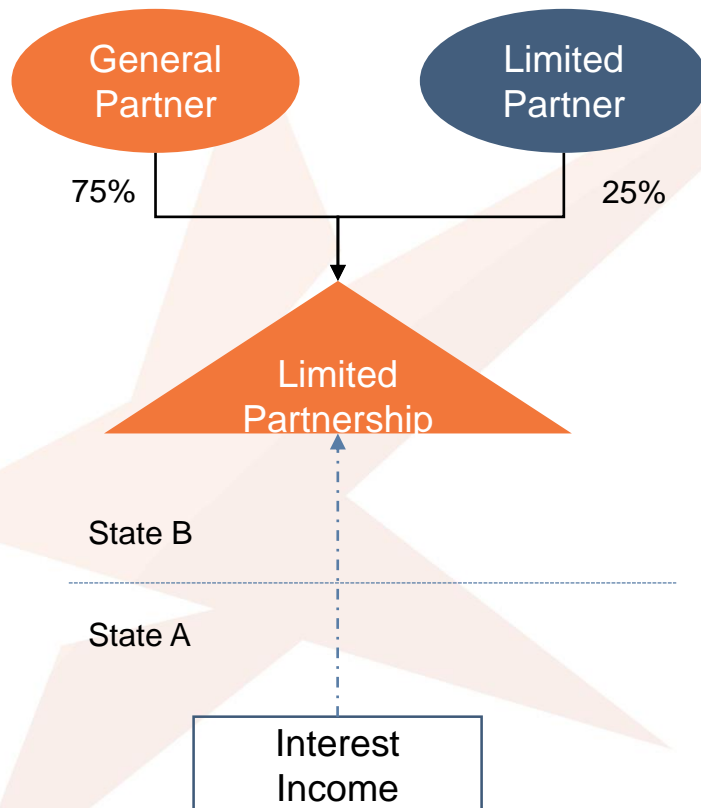
- Income derived by/ through an entity or arrangement
- Entity/ arrangement treated as (wholly or partly) fiscally transparent under tax law of either Contracting Jurisdiction
- Such income considered to be income of a resident of a Contracting Jurisdiction
- But only to the extent that such income is treated, for purposes of taxation by that Contracting Jurisdiction, as income of a resident of that Contracting Jurisdiction

Article 3 – Transparent Entities



- State A considers FTE as company
- State B considers FTE as partnership
- B is resident of State B and C is resident of Third State
- State A-State B tax treaty eligibility?

Article 3 – Transparent Entities



Partly fiscally transparent

- Income taxed in hands of General Partner as regards General Partner's share of Limited Partnership's income
- Limited Partner's share of income taxed in hands of Limited Partnership

Article 3 – Transparent Entities

Paragraph 2

- Income tax exemption or deduction/ credit by Resident State shall not apply to extent income taxed by Source State solely on basis of residence in Source State

Paragraph 3

- In no case shall provisions of this paragraph be construed to effect a Contracting Jurisdiction's right to tax residents of that Contracting Jurisdiction

Paragraph 4

- Compatibility clause states how tax treaty provisions will be modified by MLI
- MLI provisions would apply in place of or in absence of tax treaty provisions

Article 3 – Transparent Entities

BEPS Action 2 is not a minimum standard

Paragraph 5

India's Reservation

- *“Pursuant to Article 3(5)(a) of the Convention, India reserves the right for the entirety of Article 3 not to apply to its Covered Tax Agreements”*

Article 3(5)

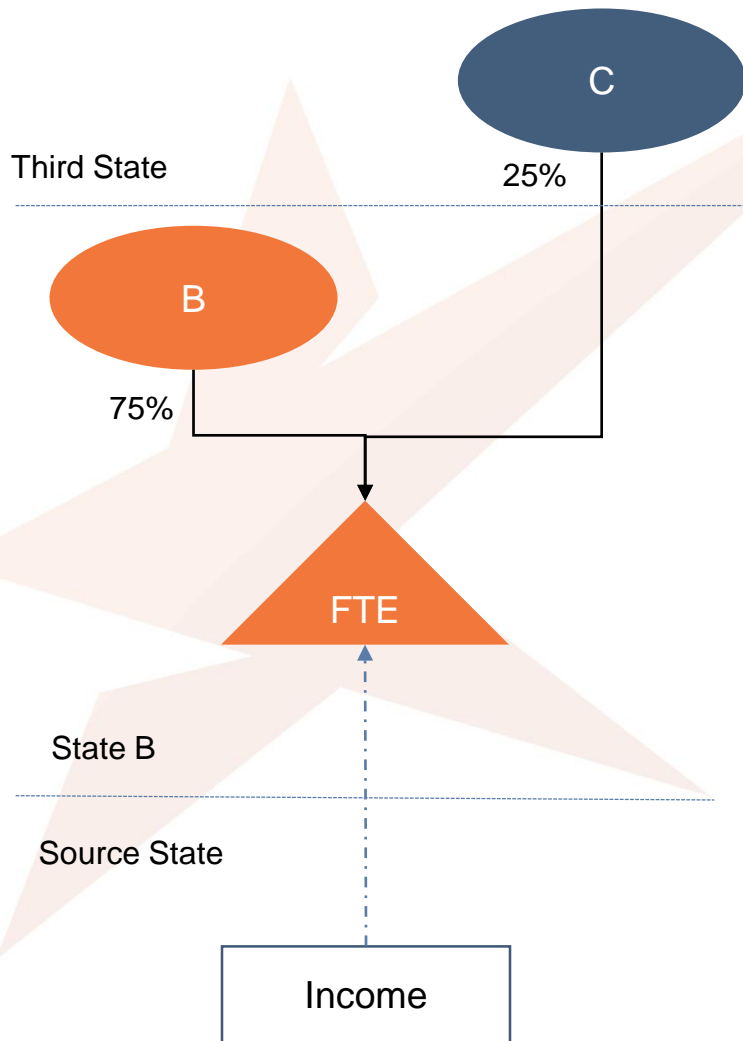
A Party may reserve the right:

- a) For the entirety of this Article not to apply to its Covered Tax Agreements;
- b) . . .

Paragraph 6

- Notification clause states which provisions of tax treaty will be superseded or modified by MLI

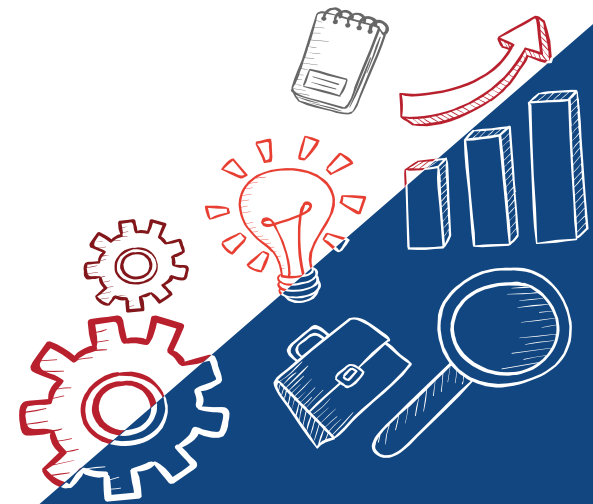
Issues for consideration



- Availability of tax treaty between Source State and Third State for share of income of partner resident in Third State
- Availability of foreign tax credit for taxes withheld by Source State to extent of share of income of partner resident in Third State

Issues for consideration

- Substantiation for FTE's income being taxed in State B
- Tax rate applicable to FTE





Thank You

CA. Prashant Bhojwani