The Chamber of Tax Consultants
Multilateral Instrument (MLI)
Note for discussion

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Contents

Abbreviations:

BEPS	**:**	Base Erosion & Profit Sharing.
COS	**:**	Country of Source.
COR	**:**	Country of Residence.
DTA	**:**	Double Tax Avoidance Agreement.
DLOB	**:**	Detailed Limitation of Benefits.
ITA	:	Income-tax Act
MC	:	Model Convention (OECD / UN DTA model)
MLI	**:**	Multilateral Instrument.
OECD	**:**	Organisation of Economic Co-operation & Development.
P&A	:	Preparatory and Auxiliary
PE	**:**	Permanent Establishment.
PPT	**:**	Principal Purpose Test.
SLOB	**:**	Simplified Limitation of Benefits.
UN	:	United Nations

This note attempts to explain the MLI & how it operates. It does not discuss every issue in the MLI. Article 16 on Mutual Agreement Procedure is not discussed in this note. Arbitration provisions are also not discussed in this note.

The MLI should be read with the help of Explanatory statement to the MLI, and the tool kit (Flow charts, FAQs, etc.) available on OECD website - http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm. (See section D of this note.) Despite these tools, the language used in the MLI is complex. I believe the language should be simpler – especially if one wants all countries (the tax payers, tax departments, businessmen and judiciary) to understand & accept. In due course, I may revise some of my views as there is more clarity.

The final impact on the DTA will be known after the countries notify the final list of MLI provisions which they have adopted.

A. **Operation of MLI:**

OECD / G20 have worked upon BEPS measures and have started implementing the same vigorously. The measures involve amendments to DTA, domestic law, exchange of information about tax payers, exchange of advance rulings / tax reliefs given by other countries, peer review of countries who provide tax reliefs which erode other countries' tax base, etc.

There is an Inclusive Framework where in all countries can join on equal footing. Inclusive framework will look after implementation of BEPS package, peer reviews of countries, develop tool kits for low capability countries to implement BEPS measures, etc. There is a steering committee to look after the implementation, etc. About 129 countries are a part of Inclusive Framework.

The objective is that profits are taxed where economic activities generating profits are performed and where value is added.

In this note, only those BEPS measures which affect the DTA have been discussed. The DTAs are sought to be amended though a Multilateral Instrument (MLI) – officially called "MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING".

As countries have sovereign rights over collecting taxes, technically almost all the provisions are optional and voluntary – except for a few minimum standards.

1. **What is MLI and what does it do:**

1.1 Multilateral Instrument (MLI) is an agreement to implement the BEPS measures agreed to by over 100 countries. Currently MLI has been signed by about 87 countries.

1.2 BEPS measures have been agreed upon, to prevent tax avoidance and double non-taxation.

1.3 The objective of MLI is to modify the DTAs taking into account BEPS measures. To avoid negotiations between various countries with each other on a bilateral basis (which can take many years / decades), MLI has been considered. With one agreement, all the DTAs will be modified to the extent of agreement between the countries.

1.4 **MLI modifies the operation of the DTA to the extent of BEPS measures only.**

1.5 **It is not a renegotiation of division of tax between Residence and Source countries.**

1.6 MLI has an **Explanatory statement**. This is not exactly a commentary. It is only a statement explaining how will the MLI operate and be implemented. The MLI is intended to be a commentary only for Arbitration provisions under articles 18 to 26.

The commentary on the DTA continues to be the one given in OECD MC and the UN MC. OECD MC and the commentary has been modified to a large extent based on BEPS reports.

Some articles of MLI have been drafted in line with some OECD MC articles already amended by OECD in 2014. Some other articles and commentary have been amended in 2017.

1.7 **BEPS Action reports** are very useful to understand the background to the anti-avoidance measures. Everything discussed in BEPS Action reports are not incorporated in the MLI. However finally it is the MLI, the Explanatory statement to MLI and the OECD MC commentary which have to be considered for interpretation.

1.8 **MLI will not substitute the DTA (or parts of DTA) between two countries**. It will operate alongside (side by side) the DTA. Some parts of DTA articles may be replaced by the MLI articles. Fundamentally it is the DTA which will apply (as modified by the MLI).

A guiding analogy is the existence of Income tax Act and the DTA. In India, the DTA does not replace the Income tax Act or vice-versa. Both exist alongside and both have to be considered.

(In future if the country withdraws its agreement of a particular article (or part of the article) of the MLI, the DTA article as it stood before modification by the MLI, will apply in future.)

Legally there will be no "consolidated DTA" as amended by MLI. For practical guidance a country may come out with consolidated DTA as amended by MLI. Private vendors may come out with a consolidated DTA. Those will however not be legal texts. OECD has issued "Guidance for the development of synthesized texts" in November 2018. It is however clarified that countries are under no legal obligation to come out with synthesized texts.

1.9 The legal principle to interpret is **– Later in time agreement will prevail over an older agreement.**

Here there can be controversies about interpretation. Some interpretation issues could be:

- Is the provision of DTA overridden by MLI?
- Is only some portion of the DTA overridden by MLI?
- To what extent is the provision of DTA modified by the MLI?
- Two countries may refer to different clauses in their DTA which are affected by the MLI.
- And finally the interpretation of MLI itself as the language of the MLI is quite complex.

1.10 **MLI does not freeze the DTAs in time.** Countries can continue to renegotiate the DTA in future.

Countries can enter into fresh DTAs. It is expected that they will take into account BEPS measures while entering into new DTAs.

1.11 Many countries have notified their provisional list of DTAs which will be affected by the MLI. Provisional list of reservations and notifications have also been made. Some countries have even provided their final lists.

2. **Some features of operation of MLI:**

2.1 The countries have to notify which DTAs will be affected by the MLI.

2.2 Countries have to notify the specific DTA articles (including paras and sub-paras) which will be affected by the MLI. They may have **options** for some MLI articles to apply to a DTA. For some articles of MLI, there may be **alternatives** out of which one of the alternatives can be selected to apply to the DTA.

2.3 The MLI provision agreed to by a country will apply to all the DTAs which it has signed with other countries. It cannot select one article of MLI or one alternative in the MLI to apply to one country's DTA, and another alternative to another country's DTA. Thus for example, India has selected Option A under Article 13(1) of MLI (each activity should be Preparatory and Auxiliary character to be considered as exempt from being a PE). That option will apply to all DTAs.

However the other country should also accept Option A. If the other country selects Option B, then with that country neither Option A will apply nor Option B. In other words, there will be no change in the DTA with that country. There are several such options and permutations. In such situations, with some countries, MLI provision can apply in one manner. With some others, MLI provision can apply in another manner. And with some others, no provision of MLI will apply (i.e. there will be no change in the DTA. More details are given in para 3.4.2).

2.4 Countries can make **reservations** for some provisions (and not apply the MLI provision).

2.5 Minimum standard provisions are not negotiable (except marginally). These will apply for all countries (and all DTAs).

2.6 Some countries may modify the DTA bilaterally on the lines of MLI rather than though the MLI. (USA is one such country which will amend DTAs bilaterally. It is not a party to the MLI. It will prefer to have a Detailed LOB clause.)

2.7 As there are several options which had to be offered considering the variety of tax systems and policies of various countries, **the language of MLI has become very complex**. MLI provides flexibility through following provisions:

- Country may specify which DTAs it would like to be amended by MLI.
- Minimum standards can be adopted in different manners.
- Opting out of the MLI provision fully or partly by making reservations.
- Opting out of MLI provision where DTA contains specific provisions.
- Choosing options or alternatives available in the MLI provisions.

2.8 MLI will **enter into force** after the fifth country deposits the instrument ratifying, accepting or approving the MLI (i.e. after completing the internal country process). This is the final approval of MLI by a country. It will enter into force from the first day of the month following the expiry of 3 calendar months from the date the fifth country ratifies the MLI. MLI has entered into force from 1st July 2018 (after Slovenia became the 5th country to ratify the MLI on 22nd March 2018.) As per status updated by OECD till 25th February 2019, 21 countries have completed their ratification.

2.9 MLI shall **have effect** on the taxes as under:

2.9.1 In case of <u>withholding tax at source on amounts paid to non-residents</u> – 1st January of calendar year commencing after date of MLI entering into force. If both countries' date of entering into force are different, then the latest of the dates will be considered.

In case of <u>other taxes</u> - 1st January of calendar year commencing after 6 months of MLI entering into force. If both countries' date of entering into force are different, then the latest of the dates will be considered. Countries can agree for a shorter period.

The countries can defer the above dates to 30 days after the date of receipt of notification by the Depository that internal procedures have been completed.

i.e. MLI will take effect from the 1st day of the year beginning after the end of the 30 day period. India has opted for the same.

2.9.2 Country can choose "taxable period" instead of calendar year. The other country can chose calendar year.

India has opted for "taxable period".

India has not yet deposited the final instrument of ratification.

Two countries can opt for different years – taxable year or calendar year. For both, the MLI will apply asymmetrically.

2.10 BEPS package considers the following as best practices (not minimum standards):

Some elements in timely resolution to treaty related disputes – MAP and Corresponding adjustment (Articles 16 and 17 recommended in Action 14).

3. **Structure of MLI:**

3.1 MLI has been drafted to amend the DTAs. Technically it affects only some of the articles of the DTA.

3.2 As mentioned in the beginning, BEPS has some more measures regarding – changes in domestic tax law, co-operation amongst countries, exchange of information, revised guidance on Transfer Pricing guidelines, peer review. These are being implemented separately. MLI has some minimum standards. There are some more minimum standards in BEPS measures which will be implemented separately. (See paragraph 5 below.)

3.3 **Parts of MLI:**

Measures in 4 BEPS Action reports (2, 6, 7 and 14) have been implemented through the MLI. The MLI contains the following articles.

3.3.1 Articles 1 and 2 (in Part I) covers the **Scope of MLI** and **Definitions**.

3.3.2 Articles 3 to 15 (in Parts II to IV) are the **operative parts of the MLI**. These will directly modify the DTAs (if agreed by countries who have signed the DTA). These articles cover following BEPS Action reports:

i) Hybrid Mismatches (Action 2)
ii) Preventing Treaty Abuse including treaty shopping (Action 6)
iii) Artificial Avoidance of PE (Action 7).

3.3.3 Article 16 and 17 (in Part V) are also considered as **substantive provisions** (along with articles 1 to 15) as these articles propose to modify the DTA. These articles cover following BEPS Action Report:

iv) Improving Dispute Resolution (and Corresponding Adjustment as in Article 9(2) of OECD MC) (Action 14).

3.3.5 Articles 18 to 26 (in Part VI) cover **Arbitration**. This is also covered in Action 14 (Improving Dispute Resolution (and Corresponding Adjustment)).

3.3.6 Articles 27 to 39 (in Part VII) cover **procedural provisions** for signature, ratification, effective date, etc.

3.3.7 Action 15 discusses the development of MLI itself and the issues for having an MLI.

3.4 **Structure of the Articles of MLI:**

Each article of MLI may modify one aspect or more aspects of the DTA article. The MLI article may modify the specific clause (or sub-clause) of a DTA. The MLI article normally has following parts:

3.4.1 The **provision** itself based on BEPS measures. It states what happens in case of a particular situation. **This clause will normally replace the DTA clause or be in addition to the DTA clause as stated in para 3.4.2 below –** subject to other provisions.

The provision could contain **optional provisions or alternatives.** Normally when both countries exercise the same option, it will apply to their DTA.

3.4.2 **Compatibility clause –** This clause states how exactly will the DTA clause (or sub-clause) be modified by the MLI provision. It is linked to the notification clause (para 3.4.4 below). (The modification can take place in the following manners:

a) MLI provision applies **"in place of"** the DTA provision**.** If the DTA has a provision on any matter, MLI provision will replace the DTA provision. If there is no provision in the DTA, MLI provision does not apply.

Further, it will apply when both the countries make a notification with respect to the existing provision of the DTA (i.e. state the particular provision of DTA which will be replaced by the MLI clause).

If there is a notification mismatch (see para 3.4.4 of this note), the MLI provision does not apply.

b) MLI provision **"applies to"** or **"modifies"** an existing DTA provision**.** If the DTA has a provision on any matter, MLI provision will only modify the application of DTA provision without replacing it. If there is no provision in the DTA, MLI provision does not apply.

Further, it will apply when both the countries make a notification with respect to the existing provision of the DTA (i.e. state the particular provision of DTA which will be affected by the MLI clause).

If there is a notification mismatch (see para 3.4.4 of this note), the MLI provision does not apply.

c) MLI provision applies **"in the absence of"** DTA provision**.** If the DTA does not have a provision on the matter, MLI provision will apply. If there is a provision in the DTA, MLI provision does not apply.

Further, it will apply when both the countries make a notification stating that the particular provision of MLI does not exist in their DTA.

If there is a notification mismatch (see para 3.4.4 of this note), the MLI provision does not apply.

d) MLI provision applies **"in place of or in absence of"** the DTA provision**.** MLI provision will apply in all cases.

i) When both the countries make a notification with respect to the existing provision of the DTA (i.e. state the particular provision of DTA) MLI provision will replace the DTA provision.

ii) If both countries do not notify the existence of the DTA provision, MLI provision will apply and supersede the DTA provision to the extent of incompatibility. i.e. **MLI provision is added to the DTA**.

iii) If there is a notification mismatch (see para 3.4.4 of this note for the meaning of notification mismatch), the MLI provision supersedes the DTA provision to the extent of incompatibility.

iv) If there is no provision in the DTA, MLI provision is added to DTA.

This is the principle of - Later in time treaty prevails – under Article 30(3) of Vienna Convention.

3.4.3 **Reservation clause** – A country can make a reservation for the entire MLI provision (i.e. **opt out** of the MLI provision completely by not notifying the DTA of any country), or only for some portion of the MLI provision – (i.e. that provision of MLI will not apply). Not notifying a DTA is not exactly a

reservation. The effect is however similar to a reservation. Only those reservations can be made for MLI provisions which are stated in Article 28(1).

A country is required to submit a list of tentative provisions at the time of signing the MLI. Article 28(9) permits a country to withdraw the reservation or modify it. However the modification cannot be to put more restrictions. It can either withdraw the reservation or reduce the reservation. I.e. MLI applicability can be increased but not reduced.)

3.4.4 **Notification clause** – The country should state which provision of the DTA will be superseded or modified by the MLI provision.

Notification is to have clarity and transparency. It is linked to compatibility clause (para 3.4.2 above). The countries should notify which DTA provisions are being modified by the MLI. In case of mismatch, countries can discuss before finalising the notification list, or settle through MAP or through conference of the countries.

Notification Mismatch:
Notification mismatch can occur if:
- Notification is not in accordance with MLI provision.
- Countries notify the same DTA provisions but article no. & para no. of DTA are not same.
- Different provisions are notified by the countries.

OECD has come out with a MLI matching database tool (beta mode). It is available on –
http://www.oecd.org/tax/treaties/mli-matching-database.htm.

3.5 **Hierarchy to check whether a DTA is affected by MLI:**

i) Is the DTA notified by both the countries under article 2(1)(a)(ii)? If yes, then MLI applies to the DTA prima facie. If any of the countries has not notified the DTA, MLI will not apply.

ii) Has any country made a reservation for any provision of MLI? If yes, then that MLI provision does not apply. DTA is not affected. This is the position, even if the other county has not made a reservation. Thus, if no country makes reservation for the MLI provision, the MLI provision will apply.

iii) Have the countries selected the optional / alternative provision of MLI? If yes, have they selected the same option / alternative? If yes, the MLI will modify the DTA. If any one country does not select an option / alternative, or both countries select different options / alternatives, that MLI provision (the options) does not apply.

The only exceptions are:

- Article 5 (on Methods of Elimination of Double Tax). The option selected by the country will apply to its residents. (This article applies to residents and not to non-residents. Hence it does not affect the COS.) This can have asymmetric application of MLI.

- Article 23(5) - If information during arbitration is disclosed, the arbitration proceedings come to an end.

iv) How does the compatibility clause apply – i.e. how does MLI provision modify the DTA provision? (see para 3.4.2 above). Depending on the kind of compatibility, the DTA is modified.

Have the countries notified the DTA provisions affected by the MLI? This is linked to compatibility.

v) Has the MLI become effective? (See para 2.9 above). If yes, then the MLI will apply to the DTA.

3.6 **Asymmetric application –** In following situations, MLI provisions can apply asymmetrically. I.e. In one country it will apply in one manner and in the other country it can apply in another manner.

i) Different taxable years (para 2.9 above).
ii) Elimination of double tax (para 19.2 below).
iii) SLOB clause in specified situations (para 9.4 below).

4. **BEPS Action Reports which are not a part of MLI:**

Apart from the DTAs, BEPS measures consider the following matters which are being dealt with separately:

4.1 Digital Economy (Action 1). Some issues are dealt with in other reports like Artificial Avoidance of PE (Action 7) and Preventing Treaty abuse (Action 6). However more comprehensive action is required. **This is the only Action report where there is no concrete recommendation**. This report has permitted countries to take action for BEPS measures under three options – Introducing the concept of Significant Economic Presence, Withholding tax and Equalisation Levy. India has adopted Equalisation Levy. It has also brought in Significant Economic Presence concept in ITA. Other countries are also considering unilateral measures.

OECD has issued a consultative paper in February 2019. Several organisations have given their submissions. Many countries are pushing for Significant Economic Presence. This report is expected to be finalised in 2020.

4.2 Designing Controlled Foreign Corporation (CFC) rules (Action 3). Action report suggests measures to be carried out in domestic law to tax income of CFC on current basis which is parked abroad. In absence of CFC rules, the income parked abroad in CFC can be taxed only if it is brought within the country.

4.3 Base Erosion through interest and other financial payments (Action 4). Action report suggests measures in the domestic law to limit deduction of interest. India has enacted S.94 B in Income-tax Act.

4.4 Countering Harmful Tax Practices (Action 5). Some tax havens provide advance rulings or Advance Pricing Agreements on a negotiated basis. These provide for very little tax to be paid in those countries. The report suggests exchange of such rulings with the countries. It also suggests adoption of nexus approach for Intellectual Property regimes (countries can grant relief for IP only if substantial activity is undertaken in those countries). Monitoring of such regimes will be undertaken periodically.

4.5 Aligning Transfer Pricing Outcomes with Value Creation (Actions 8-10). This involves having better Transfer Pricing guidelines and rules to attribute incomes where value is created. The revised guidelines have been issued without a need to amend the DTAs.

4.6 Measuring and Monitoring BEPS (Action 11). This report suggests collection of more data and co-operation amongst OECD and countries to assess and monitor BEPS which reduce tax base of countries. The data collected as suggested under Actions Reports 5, 12 and 13 will also be used.

4.7 Mandatory Disclosure Rules (Action 12). The report suggests devising a framework for disclosure of aggressive tax positions by tax payers (including reporting by advisors and intermediaries). Co-operation amongst countries is also suggested.

4.8 Transfer Pricing Documentation and Country-by-Country Reporting (Action 13). This involves reporting by MNCs their country by country data and exchange of information by the countries. These require changes in domestic law. India has implemented these suggestions.

5. **Minimum Standards:**

BEPS provides for minimum standards which all countries have agreed to provide in the domestic law or the DTAs. These are as under:

5.1 Stating the purpose of DTA, and Prevention of treaty shopping (Articles 6 and 7). These directly apply to tax payers. This requires two steps:

i) All DTAs should provide in their **preamble** that DTAs are not designed to create opportunities of double non-taxation or reduced taxation.

ii) Action Report 6 suggests three alternatives. a) Countries will provide in their DTAs the **Principal Purpose Test (PPT)** clause (akin to GAAR). b) Countries may **supplement PPT with Simplified Limitation of Benefits (SLOB)** clause. c) Alternatively, countries may adopt **Detailed LOB clause along with - anti-conduit arrangement** clause, and PPT may be accepted as an interim measure. The MLI however has provided PPT and SLOB only.

Both above measures are expected to put an end to treaty shopping.

5.2 Country by Country reporting for Transfer Pricing risk assessment (Action 13).

5.3 Review of harmful tax practices and exchange of relevant information (Action 5).

5.4 **Mutual Agreement Procedure** (Action 14). It requires countries to resolve disputes within the specified time. There will be a monitoring mechanism. Some elements of MAP provisions are only best practices.

5.4 Apart from above, other provisions are not minimum standards. These are optional. However it is expected that countries will implement these to the best extent they can.

B. **Specific articles of MLI:**

6. The structure of MLI has been explained in para 3 of this note. The specific measures are as under:

Sr. No.	Article No. of MLI	Subject matter
A) Scope and Definitions		
1.1	1	Scope of MLI
1.2	2	Definitions
B) Action Report 2 (Hybrid Mismatches)		
2.1	3	Transparent Entities
2.2	5	Methods of Elimination of Double Tax
C) Action Report 6 (Prevention of granting treaty benefit in inappropriate circumstances)		
3.1	4	Dual Resident Entities
3.2	6	Purpose of DTA – preamble
3.3	7	Prevention of Treaty Abuse: i) Principal Purpose Test (PPT). ii) Country can grant DTA relief despite PPT if it considers it appropriate. iii) Simplified Limitation of Benefits (LOB) provision.
3.4	8	Lower rate of tax on dividend only under certain circumstances
3.5	9	Capital Gain on Alienation of shares / interest in entities which derive their value principally from immovable property i) testing period ii) applying the provision to interest in firm and trust iii) tax in COS if the entity derives more than 50% of value at any time during preceding 365 days from immovable property in COS
3.6	10	Anti-abuse rule for PE situated in third country
3.7	11	Country of Resident's right to tax its Residents
D) Action Report 7 (Avoidance of PE)		
4.1	12	Avoidance of PE through Commissionaire Arrangements
4.2	13	Avoidance of PE: i) Specific activity exemption (Preparatory and Auxiliary activities) ii) Anti-fragmentation rule
4.3	14	Splitting of Contracts (period of contract) between related parties to avoid Project PE
4.4	15	Definition of person Closely Related to an Enterprise (relevant for articles 12 ,13 and 14)

E) Action Report 14 (Improving Dispute Resolution)		
5.1	16	Mutual Agreement Procedure
5.2	17	Corresponding Adjustment (Article 9(2) of DTA) OECD MC.

The articles are discussed below. First the Scope and definitions are discussed. Subsequently, important articles are dealt with followed by other articles.

7. **Scope of MLI – Article 1:**

MLI will **modify the DTAs** and the amending instruments (Protocols, etc.) which the country will notify to the Depository. Country should notify the DTA and the protocol which it wants to be modified by MLI. (Secretary General of the OECD is the Depository for the MLI – Article 39.).

Countries have referred to the DTA and protocols by various descriptions and names. For the sake of uniformity, such DTAs are referred to as Covered Tax Agreement (CTA) in the MLI. (In this note, the term "DTA" has been used for ease of understanding.)

The MLI will modify only those provisions of the DTA which the country specifies (by way of (notifications) by way of reservations or selection of alternatives / options.

8. **Definitions – Article 2:**

8.1 There are only 4 definitions – Covered Tax Agreement (CTA), Party, Contracting jurisdiction and Signatory.

CTA means a DTA in force between two or more countries and which the country wants to be covered by the MLI. In this note, the term "country" has been used instead of Party, Contracting jurisdiction or Signatory.

MLI is not intended to apply to limited DTAs which apply solely to shipping and air transport or social security.

Notification – Para 1(a)(ii) – Each country which is signatory to the MLI has to notify which DTAs will be covered by the MLI. **Both the countries to the DTA (all countries in case of multilateral DTA) have to notify the DTA. If any country does not notify the DTA, MLI will not apply.**

India has notified 93 comprehensive DTAs in its provisional lists under this para. However China, Germany & Mauritius have not notified the DTA with India in their respective lists. Hence MLI will not apply to these DTAs.

So far 87 countries have notified their list of DTAs. Other countries should provide their lists in due course.

Other definitions are regular definitions and are hence not discussed here.

8.2 Article 2(2) states that any term not defined in MLI shall have the same meaning as in the DTA when it has to be applied.

Where the term is not defined in the MLI or the DTA, the meaning given in the domestic tax law will apply – unless the context otherwise requires.

Context would include the purpose of the MLI described in paras 1 to 14 of the Explanatory Statement to MLI, penultimate para in preamble to MLI, preamble in Article 6 of MLI, paras 21 to 23 and 76 of the Explanatory statement. (DTA cannot be used for non-taxation or reduced taxation). (See para 38 of the Explanatory statement.)

Where the rule (that reference can be made to domestic law if term is not defined in the DTA or MLI) is not present in a DTA, can we still consider the preamble and the above referred paras of Explanatory statement? The Explanatory Statement does not specifically clarify this. However in my view, considering the objective of BEPS, the answer is clear. The interpretation has to be with reference to the preambles and the Explanatory statement.

9. **Prevention of Treaty Abuse – Article 7 (Action 6):**

9.1 The article provides for three provisions:

(i) PPT, (ii) Country can grant DTA benefit despite PPT and (iii) SLOB.

DLOB is not offered in the MLI. (Action 6 provides for the guidance on DLOB) Countries should negotiate bilaterally as there can be several issues to be considered. OECD model commentary 2017 has given DLOB provisions and commentary.

PPT is the minimum standard. SLOB is not the minimum standard.

(i) **PPT– Paras of Article 7 applicable (Para 9.2 of this note):**
Basic provisions including compatibility clause – 1 & 2.
Reservations - 15(a) and 15(b).
Notification – 17(a) and 17(b).
PPT as temporary measure till introduction of DLOB – 17(b).

(ii) **Country can grant DTA benefit despite PPT - Paras of Article 7 applicable (Para 9.3 of this note):**
Basic provisions including compatibility clause – 3 to 5.
Reservations – 15 (b).
Notification – 17 (b).

(iii) **SLOB – Paras of Article 7 applicable (Paras 9.4 and 9.5 of this note):**
Basic provisions including compatibility clause – 6 to 14.
Reservations - 15(c), 16.
Notification – 17(c), 17(d) and 17(e).

9.2 **PPT:**

9.2.1 **Basic provision** - Para 1 – It starts with non-obstante clause – "Notwithstanding any provisions in the DTA…". It further states:

- The DTA relief will not be granted,
- if it is reasonable to conclude,
- that obtaining DTA benefit was **one of the principal purposes** of any arrangement or transaction,
- unless it is established that benefit is in accordance with the **object and purpose of DTA**.

This is the default option (para 1). This is the minimum standard.

It replaces any similar PPT provision in the DTA – whether the DTA PPT provision applies to the whole of the DTA or a part of the DTA (like dividend, interest, royalty). See para 94 of Explanatory statement to MLI.

Other anti-abuse provisions in the DTA will continue to apply.

If the DTA has provisions like consultation before applying the PPT clause, those also will be replaced by the MLI PPT clause.

9.2.2 **Compatibility clause** – Para 2 – PPT applies in place of or in absence of similar provisions in the DTA.

9.2.3 **Reservation** – Para 15(a) – It permits a country to opt out of PPT (para 1) if it intends to adopt a DLOB + (rules to address conduit arrangements or a PPT). The DLOB should be of the type referred to in BEPS/G20 BEPS package. It refers to paras 1 to 6 of article X (Entitlement to Benefits) in Action 6 report. The countries should endeavour to reach a solution to satisfy minimum standard.

No country has made any reservations.

Para 15(b) permits the country to opt out of PPT if there is already a provision similar to full PPT. **There is no option to opt out if the PPT in a DTA applies only to some of the DTA provisions**.

9.2.4 **Notification** – Para 17(a) – The country shall notify whether there is a PPT article in the DTA referred to in para 2 – provided it has not opted out under paras 15(a) and 15(b). If all countries to the DTA make such a notification, para 1 of Article 6 (MLI PPT) will replace the DTA provision. In all other cases, MLI provision will supersede the DTA provision to the extent the DTA provisions are incompatible with para 1. (In other words, MLI PPT provision will apply either through the DTA, or through the MLI wherever the DTA lacks in the matter.)

Country may also make a notification that it will apply PPT as an interim measure. Countries may enter into bilateral negotiations to adopt SLOB or DLOB in addition to PPT. Alternatively countries may negotiate to replace PPT with DLOB with anti conduit rules.

Thus PPT is the minimum standard. India has notified the DTAs which contain the PPT and will be replaced by PPT clause of MLI (provided the other country also has notified the same DTA provisions.)

Example: India & UK have notified article 28C of the DTA under para 2. But UK has also notified other articles. There is a notification mismatch. Hence MLI PPT will apply to the extent it in incompatible with DTA.

India-Indonesia DTA – MLI PPT will apply as both have notified same provisions.

Most countries have adopted the MLI PPT.

9.3 **DTA benefit can be granted by Competent Authorities despite PPT:**

9.3.1 **Basic Provision –** Para 3 - If the country has not opted out of PPT (i.e. it has not made any reservation under para 15(a)), the country can apply para 4.

Para 4 – If a person has been denied the DTA benefit, para 4 permits the country to allow Competent Authorities to allow the DTA benefit if it considers appropriate upon a request made by the tax payer. Before rejecting the request, the competent authority will consult the other contracting authority.

This is an optional clause.

9.3.2 **Compatibility clause –** Para 5 – Para 4 (Competent Authorities can grant DTA benefit) applies to a DTA which will have the PPT as per para 1 of MLI. **Thus para 4 will apply in conjunction with para 1**.

9.3.3 **Reservation –** Para 15(b) – It permits the country to opt out of para 4 (wherein Competent Authorities can give DTA relief) (para 4 along with para 1 – PPT) if there is already a provision similar to full PPT. The reservation is possible only in case of comprehensive PPT and not those PPT which apply only to few provisions of DTA.

9.3.4 **Notification –** Para 17(b) - Country shall notify that it adopts para 4. It will apply where all countries to the DTA adopt para 4. **India has not made any notification under this para.** Hence competent authority will not give a DTA benefit if PPT applies.

9.4 **SLOB option:**

The exact SLOB detailed provision is discussed in para 9.5 below.

9.4.1 **Basic Provision –** Para 6 – Country can apply SLOB as a **supplement to the PPT** provision by making a notification under para 17(c).

This is an optional provision. India has chosen to apply SLOB.

The SLOB will apply if all countries to the DTA have chosen to apply the SLOB. If one country applies SLOB and the other does not, then SLOB will not apply. Only PPT will apply.

E.g. U.K. has not opted SLOB. Hence SLOB will not apply to India-UK DTA.

Para 16 permits the country to opt out this MLI article entirely if the other country does not opt for SLOB. (See para 9.5.7 of this note below.). Para 7 of this MLI article still permits countries to apply SLOB in a specified manner so that risk of not applying this article is reduced. (see para 9.4.2 of this note below.)

9.4.2 Para 7 – If some countries to the DTA have not agreed to apply the SLOB, then normally only PPT will apply symmetrically. However SLOB can still apply – depending on further options which countries chose to apply. SLOB will be applied:

i) by all countries, if the countries which have not chosen to apply SLOB in para 6, opt to apply it by making notification to the Depository. (para 7(a)). This is **symmetrical application**. i.e. PPT and SLOB will apply.

(**Examples - Norway** has not notified SLOB but has chosen an opt-in under Article 7(7)(a) for symmetric application. As it has not notified any article in the India's DTA, SLOB provisions in paras 8-13 apply to extent of incompatibility.

Iceland has not notified SLOB but has chosen an opt-in under Article 7(7)(a) for symmetric application. As it has notified Article 24(1) to (5) in the India's DTA, SLOB provisions in paras 8-13 would replace such provisions.)

Thus the SLOB will apply to all the countries to the DTA – whether they apply the same under para 6, or para 7(a).

ii) only by those countries that have chosen to apply SLOB. Those countries which do not apply the SLOB should make the notification to the Depository that other countries can apply SLOB. (para 7(b)). This is **asymmetrical application**. The country which applies SLOB will thus apply PPT and SLOB. The country which does not apply SLOB will only apply PPT.

(**Example - Greece** – Greece has notified article 7(7)(b). Hence India alone is entitled to apply SLOB as per paras 8 to 13).

9.5 **SLOB detailed provision (Paras 8 to 13 of Article 7):**

SLOB provides that DTA relief will be available i) to persons who are **qualified residents** (Para 9.5.2 of this note); ii) for **active business income** (Para 9.5.3 of this note)**;** and iii) **equivalent beneficiaries** (Para 9.5.4 of this note).

Some parts of DTA will still apply even if the person is not entitled to DTA relief due to SLOB (Para 9.5.1 of this note).

9.5.1 **Benefits available to residents who may not be qualified person – Para 8:**

Resident of a DTA will be entitled to the DTA relief only if the person is a "**qualified person**".

However the resident will be entitled to the following DTA relief (some portion of DTA) even if the person is not a "qualified person".

i) Tie breaking status in case of dual residency in case of Non-individuals.

ii) Corresponding adjustment in the COR if the COS makes Transfer Pricing adjustment to the profits of the AE. (Normally Article 9(2) of OECD MC).

iii) Mutual Agreement procedure which allow the residents to approach the Competent Authority of the COR if the tax is not in accordance with the DTA.

Other paras under which resident is entitled to the DTA relief (full DTA) even if the person is not a "qualified person":

iv) the person is engaged in **active conduct of business** in his country of residence (COR) and the income in COS emanates from or is incidental to the active business. (Para 10 of Article 7). (Meaning of "active business" is also provided in Para 10 of Article 7). (Para 9.5.3 of this note).

v) the resident is owned directly or indirectly by **equivalent beneficiaries** to the extent of at least **75%** on **half the days in the 12 month period** in which the DTA relief would otherwise be available. (Para 11 of Article 7). (Meaning of "equivalent beneficiary" is provided in Para 13(c) of Article 7). (Para 9.5.4 of this note). India has stated in OECD model commentary of 2017 that it will consider only direct owners of the COR entity for considering the application of "equivalent beneficiaries".

9.5.2 **Qualified person - Para 9:**

A resident will be a qualified person, if at the time of application of DTA the person is:

a) Individual.

b) Country, political divisions, etc.

c) Company or Entity if its **principal class of shares** is **regularly traded** on one or more **recognised stock exchanges**.

- **Principal class of shares** means class or classes of shares of a company which represent the majority of aggregate of **vote and value** of the **company**.

In case of any other entity, it means class or classes of **beneficial interest** of the entity which represents majority **vote and value** of the **entity**. (Para 13 - (a) and (d)).

- **Recognised stock exchange** means:

i) any stock exchange established and regulated as such under the laws of either country; and

ii) any other stock exchange agreed upon by the competent authorities of the countries. (Para 13(b)).

d) Non-Profit Organisation of a type that is agreed to by the countries to the DTA.

Entity established to look after retirement benefits of individuals & is regulated as such; or

Entity to invest funds exclusively or almost exclusively of the entities which look after retirement benefits.

e) Person (Entity) which would normally be eligible for DTA relief for at least the half the days of 12-month period,

- is owned directly or indirectly by residents and qualified under clause (a) to (d) above (i.e. qualified persons)

- to the extent of at least 50% of the shares of the person.

(Under para 13(d), in case of non-company entities, shares means interests that are comparable to shares.)

9.5.3 **Active business income – Para 10:**

a) Active conduct of business shall NOT include the following:

- operating as holding company,
- providing overall supervision or administration of a group of companies,
- providing group financing (including cash pooling); or
- 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. (Para 10(a)).

b) If the resident of COR derives income from business activity in COS (business income), or derives income arising in COS from a connected person, it will be considered as active income only if:

- business activity by the resident in COR is substantial
- in relation to the activity carried on in COS by the resident himself or the connected person
- and the activity in COS is same activity or complimentary activity in relation to the activity in COR. (Para 10(b)).

c) Activities conducted by connected persons shall be deemed to be conducted by the resident. (Para 10(c)).

d) Two persons shall be "**Connected persons**" if:

- one person directly or indirectly owns at least 50% of the other; or
- same person owns directly or indirectly at least 50% in each person; or
- one person has control over the other; or
- same person or persons control both persons. (Para 13(e)).

Control has to be considered based on all relevant facts & circumstances.

9.5.4 **Equivalent beneficiary - Para 13(c):**

- A resident who is not a "qualified person" shall be entitled to DTA relief,
- if on at least half of the days of any twelve month period,
- equivalent beneficiaries own directly or indirectly at least 75% of the beneficial interest of the resident.

Equivalent beneficiary means a person:

- who would be entitled to benefits under the domestic law, DTA (between COS & residence of the shareholder - if the shareholder is not resident of COR), or any other instrument,
- which benefit is equivalent to or more than the DTA.

Whether a person is equivalent beneficiary in case of dividend, the person shall be deemed to hold same capital as the company (whose shares are held by equivalent beneficiary) claims to hold in the investee company. (Para 13(c)).

9.5.5 Competent authority can grant DTA relief even though the person may not be a qualified person, or may not be conducting an active business or may not be

an equivalent beneficiary – if the person demonstrates that it was not one of the main purposes to take DTA relief. Competent Authority should consult the Competent Authority of the other country. (Para 12).

9.5.6 **Compatibility** – Para 14 - SLOB will apply in place of or in absence of the DTA SLOB provision. This para does not restrict the scope of other anti-abuse provisions.

9.5.7 **Reservation** – Para 15(c) – Country may choose not to apply SLOB if the DTA already has a SLOB provision. If any country makes a reservation (i.e. chooses not apply SLOB), SLOB will not apply. **India has not made any reservation.**

Para 16 – If one country applies SLOB under Para 6, but the other country does not chose to apply the SLOB, then the first country may chose not to apply the entire article itself (i.e. neither PPT will apply not SLOB will apply). The countries should endeavour to reach an agreement which prevents treaty abuse.

If the country has chosen to apply SLOB under Para 7, then the SLOB shall apply accordingly as selected under Para 7.

So far no country has selected this option.

9.5.8 **Notification** – Para 17(c) **–** Country will notify that it adopts SLOB (para 6). Country may notify the DTA provision which will be replaced by SLOB.

India has notified the DTA provisions where in MLI SLOB will be replaced.

India-Indonesia DTA – SLOB will apply as both have opted for SLOB. But both have not notified any DTA provision (as there is no provision in the DTA for SLOB). Hence SLOB will apply & supersede provisions of DTA to the extent of incompatibility. i.e. MLI SLOB is added.

India-Armenia DTA – SLOB will apply as both have opted for SLOB. Both have notified Article 28 of the DTA. Hence DTA SLOB will be replaced by MLI SLOB.

Para 17(d) – Country which does not chose SLOB but applies paras 7(a) or 7(b) shall notify about the choice. (Further, it should not have made reservation under para 15(c). (This is discussed in para 9.4.2 of this note.)

Para 17(e) – If all countries to the DTA have made notification under para 17(c) or 17(d), the DTA provision will be replaced by MLI provision. Otherwise the MLI will supersede the provision to the extent it is incompatible with the DTA.

9.6 PPT versus SLOB versus GAAR:

How do the three provisions apply with respect to each other?

9.6.1 SLOB is a SAAR. If assessee overcomes SLOB, prima facie DTA relief is available.

PPT is a GAAR. It can apply alongside with SLOB. DTA relief can be denied if PPT is applicable (even though assessee has successfully crossed the hurdle of SLOB).

9.6.2 If DTA relief is not available, tax liability has to be considered only under the Income-tax Act.

Under the ITA, one has to see if GAAR will apply. If for example the tax amount involved is below Rs. 3 crores, GAAR will not apply. Normal provisions of ITA will apply.

If GAAR applies, one will have to apply counter facts and see the implication.

9.6.3 Even if SLOB and PPT is overcome by the assessee (i.e. DTA will apply), still GAAR can be applied. If GAAR is applied, it overrides the DTA.

Examples:

A) India-Mauritius DTA – Mauritius has not notified the Indian DTA. Hence MLI (& therefore even the PPT) does not apply.

Will Mauritius company (set up by non-residents of Mu.) get DTA relief for capital gain tax (50% reduction) on investment made in Indian company after 1.4.2017 (and sold on or before 31.3.2019)?

i) Under LOB clause of India-Mu DTA, if Mu. company incurs the specified minimum expenditure, it should get the DTA relief.

ii) If GAAR is invoked, then DTA relief will not be available despite the assessee satisfying the LOB clause.

iii) However, if Mauritius company earns Capital Gain on investment made before 1.4.2017, GAAR will not apply due to **grandfathering provision in GAAR itself**. Hence DTA relief will be available.

If PPT clause is there and is applicable, DTA relief will not be available.

B) India-Singapore DTA – Singapore has notified the Indian DTA. There is no reservation by any country for MLI PPT. The DTA does not have PPT. Art. 24 and Capital Gain SLOB articles are not PPT.

Hence MLI PPT will apply & supersede DTA provisions to the extent of incompatibility. It is effectively added to the DTA.

Will Singapore company (set up by non-residents of Sing.) get DTA relief for capital gain tax (50% reduction) on investment made in Indian company after 1.4.2017?

Will PPT provision apply despite the LOB in the DTA?

i) Assuming shares are sold on or before 31.3.2019 and it overcomes LOB clause, PPT can still be applied. PPT will override LOB.

ii) Assuming shares are sold after 31.3.2019, there is no need of LOB. PPT can be applied. DTA relief can be denied.

iii) However, if Singapore company earns Capital Gain on investment made before 1.4.2017, GAAR will not apply due to **grandfathering provision in GAAR itself**.

But PPT clause can apply and DTA relief can be denied. **There is grandfathering in case of PPT**.

C) **Indirect Transfer** – One German company (GCO1) invests in another German company (GCO2). GCO2 invests in an Indian company (ICO).

GCO1 is held by German residents.

GCO1 sells shares of GCO2. Will gain be taxable in India? Can PPT and GAAR be applied? (Assume that substantial value of GCO2 is derived from ICO.)

Germany has so far not notified the Indian DTA. Hence PPT will not apply. However assume that later Germany notifies Indian DTA and there is a PPT, will the DTA relief be available?

i) Basic legal position is:
- Under the ITA, gain can be taxed under Indirect Transfer Rules.
- Under the India-Germany DTA article 13(4), gain of shares of a company in India can be taxed in India. Sale of shares of a German company cannot be taxed in India. Article 13(5) will apply where only Germany can tax the gain.

ii) PPT and GAAR can apply if it is established that the main purpose of the arrangement was to obtain a tax relief.

iii) GCO1 is held by German residents. Hence it would be eligible for DTA relief. Even if SLOB clause was there, it would be eligible for DTA relief.

iv) However under the PPT test, if it is established that the purpose of GCO2 was – to take advantage of article 13(5) so that India does not get tax, then India can apply PPT and deny the relief.

v) Assume that PPT can be satisfied as shareholders as GCO1 and GCO2 are German residents. Hence there is no abuse of DTA. DTA relief will be available. However if GAAR is invoked, it will override the DTA, and DTA relief will not be available.

Facts of the matter will be important to decide on the matter.

10. **Purpose of DTA in preamble – Article 6 (Action 6):**

10.1 **Basic provision:**

10.1.1 Para 1 - Preamble will be added to state that:

DTA intends to eliminate double tax,
without creating opportunities for non-taxation or reduced taxation,
through tax evasion or avoidance (including treaty-shopping arrangements aimed at obtaining reliefs for indirect benefit of third countries).

This is the minimum standard.

Purpose of preamble:

DTA should be interpreted in line with the preamble (purpose of the DTA). Penultimate para of preamble to MLI is relevant for this purpose.

10.1.2 Para 3 – The country may also include in the preamble that it is the desire to further **develop economic relationship** and to **enhance co-operation in tax matters.**

This para is **not a minimum standard**. It is an **optional clause.**

India has not selected this option.

10.2 **Compatibility clause** – Para 2 – The preamble shall be included in place of or in absence of the existing preamble in the DTA. Even if the preamble of a DTA does not state that DTA is not meant to create opportunities for non-taxation or reduced taxation, MLI preamble will be added.

10.3 **Reservation** – Para 4 – A country may not apply the preamble as per MLI (Para 1) if it **already has such a preamble** – whether the language is similar or broad.

India has not made any reservation.

10.4 **Notification:**

10.4.1 Para 5 – The country shall notify whether the DTA contains the preamble and the text of the preamble. Where both countries notify the preamble and the text of preamble, MLI preamble will be replaced in the DTA. In other cases, the MLI preamble will be included in DTA preamble (MLI + DTA preamble will apply).

India – In most DTAs MLI preamble will be added to DTA preamble as other countries have notified the DTA. India has not notified any DTA.

10.4.2 Para 6 – Country shall notify if it chooses to apply language in para 3 (DTA is to further develop economic relationship and to enhance co-operation in tax matters). The text in para 3 will be added where both countries have chosen para 3 & make a notification of the DTA.

India has not made any notification. Hence text in para 3 will not be added to DTA preamble language.

11. **Avoidance of PE through specific activity exemption (Preparatory and Auxiliary Activities) – Article 13 (Action 7):**

This article amends two issues of the PE article.

i) **Exemption due to Preparatory and Auxiliary activities – Paras of Article 13 applicable (Para 11.2 of this note):**

Basic provisions including compatibility clause – 1 to 3, 5(a).
Reservations - 6(a) and 6(b).
Notification – 7.

ii) **Anti-Fragmentation rule – Paras of Article 13 applicable (Para 11.3 of this note):**

Basic provisions including compatibility clause – 4 and 5(b).
Reservations - 6(a) and 6(c).
Notification – 8.

11.1 **Exemption due to Preparatory and Auxiliary activities under a DTA** - The exemption (usually article 5(4)) in a DTA for PE, provides that even if the person has a fixed PE in COS, it will not be considered as a PE, if the activities of the PE are small and incidental. These are known as Preparatory and Auxiliary (P&A) activities. E.g. If PE is established only for purchase activities, it will not be a PE.

The objective is that each activity which is exempt from PE, should have the characteristics of being Preparatory of Auxiliary. Mere listing of activity in the exemption article is not enough.

Broadly there are **two kinds of clauses**.

i) One is where **each activity listed in the clause by itself should be P&A**. Thus in the example of purchase of goods, if that activity is incidental in the overall activities of the enterprise, it will not be a PE.

However if purchase is an important activity (e.g. in case of trading company where purchase could comprise 50% of the activities), it will not be P&A. Therefore it will be considered as a PE.

ii) The other is where **each activity listed in the clause is considered** as **exempt from PE – whether it is P&A or not is not relevant**. **It is presumed that the listed activity is P&A**. Thus purchase activity is exempt from PE – whether it is incidental or major activity.

iii) Under both the clauses, there is an additional clause for combination of activities. It states that if there is a **combination of activities** listed in the clause, then the same will **not be a PE**, **only if these are overall P&A**. For example, purchase activity and processing activity is individually listed as exempt. But the PE does both – purchase and processing activities. In that case, if the total activity of purchase and processing is P&A, then it will be exempt.

11.2 **Exemption due to Preparatory and Auxiliary activities under MLI -** MLI has provided the following.

11.2.1 **Basic Provision –** Para 1 – provides that the country may apply either of the two Options (A or B), or neither of them.

Both the options in MLI do not list the specific activities. Instead these refer to the activities already listed in the DTA (as DTAs would have several kinds of activities and listed in several manners).

11.2.2 **Option A –** Para 2 - Each activity listed in the DTA should be P&A. MLI does not refer to specific activities, instead it refers to activities already provided in the DTA.

If there is **any activity not listed in DTA**, it will be exempt **only if it is P&A**.

If there is a **combination of listed activities** then the overall activity must be P&A for it to be exempt.

11.2.3 **Option B –** Para 3 - Each listed activity in the DTA is exempt – whether it is P&A or not. (If there is any specific activity which is exempt only if it is P&A activity, then the requirement of P&A will continue to apply.) MLI does not refer to specific activities, instead it refers to activities already provided in the DTA.

If there is **any activity not listed in the DTA**, then it will be exempt **only if it is P&A**.

If there is a **combination of listed activities** then the overall activity must be P&A for it to be exempt.

11.2.4 **Compatibility clause –** Para 5(a) – Option A or B shall apply in place of the relevant parts of the DTA. Thus wherever an activity is stated to be exempt from being a PE, MLI will replace only those activities. However if there is a provision which states that the activity will be a PE if it crosses certain number of days, then that will not be covered by MLI clause. In other words, such an activity will be a PE only if it crosses the specified number of days.

11.2.5 **Reservation –** Para 6(a) – The party may opt out of the article entirely.

Para 6(b) – Option A will not apply if the DTA already has a similar clause (that activity will not be considered as a PE, if it is by itself P&A).

11.2.6 **Notification** – Para 7 – Country shall notify the Option which it has selected and the DTA provision pertaining to it. The MLI Option will apply if both the countries have selected the same Option & made a notification to that effect.

India has chosen Option A. Thus only if each activity is P&A, it will be exempt.

India has also specified the list of DTA provisions which contain exemption for P&A activities.

E.g. India-UK DTA – None of the options will apply as UK has not selected any option.

India-Australia DTA – Option A will apply as both have selected Option A & notified the DTA article.

11.3 **Anti-Fragmentation rule:**

A group should not be able to fragment its activities amongst different places or group companies into small activities and claim that each activity in each entity is P&A and therefore not a PE for any activity.

11.3.1 **Basic provision** – Para 4 – P&A exemption will not apply (i.e. fixed place of the enterprise will be considered as a PE); if the person carries on business at the same or any other place and:

- If the place becomes a PE for the enterprise or any other closely related enterprise, or

- If activities at two places by two enterprises or closely related enterprises result in overall activity which is not a PE,

- provided the activities at the same place or two places constitute **complementary functions** that are a part of **cohesive business operations.**

(It seems this will not apply to other kinds of PE – like agency PE or service PE. It will apply to fixed place PE.)

11.3.2 **Compatibility clause** – Para 5(b) – The anti-fragmentation rule shall apply to DTA which has PE exemption clause.

11.3.3 **Reservation** – Para 6(a) – The party may opt out of the article entirely.

Para 6(c) – The country may opt out of the anti-fragmentation provision.

India has not made any reservation.

11.3.4 **Notification** – Para 8 - Each country (that has not opted out of entire MLI article or anti-fragmentation article and has not selected any of the Options A or B), will notify the DTA clause which has PE exemption clause.

India has not made any reservation (as it has not opted out of entire MLI article, nor opted out of anti-fragmentation rule); and has selected an Option (A). Will the anti-fragmentation rule apply? Yes as it has notified the DTA provisions under para 7 (provided the other country also notifies the same provisions). If country has made notification under Para 7 (selection of options), it need not make notification again under Para 8 (to avoid duplication).

India-UK – UK has not selected an option. However, it has notified DTA provision pertaining to P&A activities under para 8. India has notified same DTA provision for Option A. Hence anti-fragmentation rule will apply.

11.4 **Example:**

A US company sells chemical products in India. It divides its activities amongst group companies. Each activity is by itself small enough to qualify as P&A. Appropriate compensation is paid under Transfer Pricing to these entities. In Chart A, the work is divided between Indian companies. In Chart B, work is divided between foreign companies and Indian companies.

Chart A

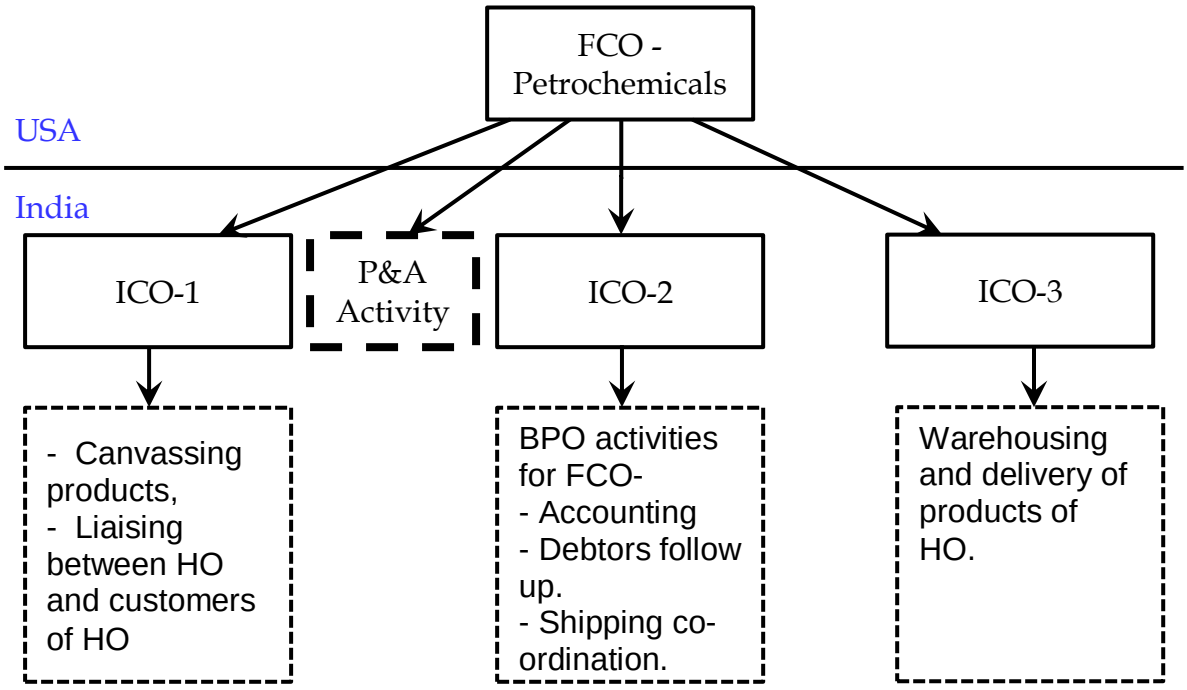
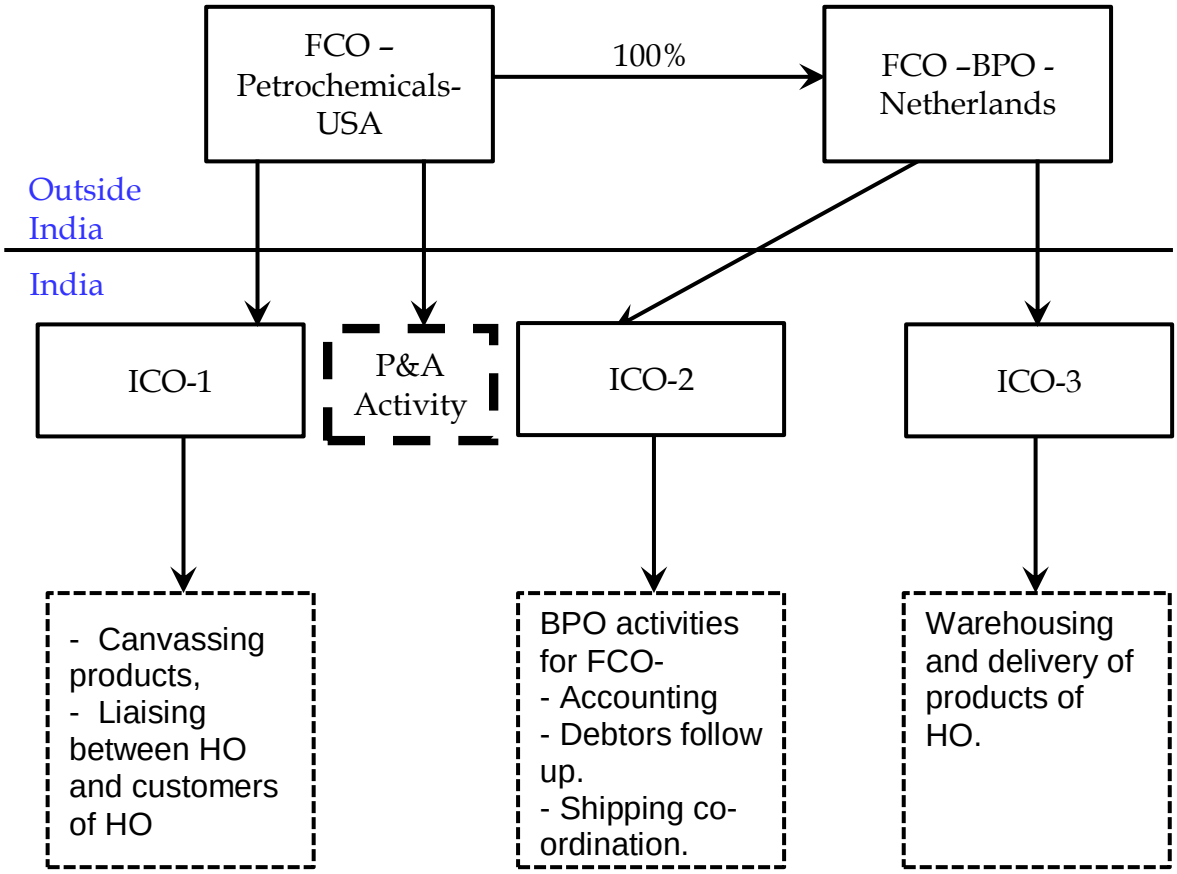


Chart B



Will these activities be caught by Anti-fragmentation rules?

Yes. PE does not mean that it should be a foreign entity. **PE in India can be of an Indian entity also**. In the above examples, Indian companies have PE in India. Taking these together, if the activities amount to substantial activities, then the US company will be considered to have a PE. (See example B on page 41 in Action 7 report, and OECD commentary on article 5, para 81.)

12. **Avoidance of PE through Splitting-up of Contracts – Article 14 (Action 7):**

An MNC can split the contracts of a project in a COS amongst several entities. Each entity can work for a period less than that prescribed in the DTA for becoming a PE.

This **avoidance can be dealt with under the PPT clause**. Those countries who do not wish to include PPT clause, or deal with splitting of contract specifically, can adopt this MLI provision.

12.1 **Basic Provision** – Para 1 – If the enterprise has carried on activities (including supervisory activities if DTA refers to such activities) at a building site, construction project, installation project or any specified activity in the DTA (project site) in COS,
exceeding 30 days in aggregate in one or more time periods, but less than the prescribed days in the DTA to become a PE,

And

Connected activities are carried on at the same project site,
For **more than 30 days for each period of time**,
By closely related enterprise,

Then the different time periods will be added up;
to determine the number of days the first enterprise has carried on activities at the same project site.

The **sole purpose of this para** is to determine whether the number of days to become a project PE has been exceeded or not.

Example:

FCO1 has worked for 40 days (in one time period or more i.e. aggregated) in India at a project site. The respective DTA with India states that if an enterprise works for 180 days or more, then it will be a PE.

FCO2 and FCO3 (closely related enterprises) have worked at the same Indian project site for 90 days and 70 days respectively (i.e. more than 30 days).

Then the number of days will be added – i.e. it will be 30+90+70=190 days.

It will be considered that FCO1 has a PE in India.

However if FCO1 has worked for less than 30 days, then this clause will not apply.

Similarly, if FCO2 or FCO3 have worked for 30 days or less in one time period, then those periods will not be added to the days of FCO1.

Again if FCO2 and FCO3 have worked for **multiple time periods with each period of 30 days or less**, then the same will not be considered for total days.

Independently, this clause could be considered for FCO2 and FCO3 also.

12.2 **Compatibility clause** – Para 2 – Para 1 of Article 14 of MLI will apply in place of or in absence of such a clause in the DTA.

There may be other activities in the DTA where anti-splitting rule may be present. Para 14(1) of MLI only applies to the activities referred to in that para – i.e. building site, construction project, installation project or any specified activity in the DTA (project site).

Example – There is a service PE clause in India-USA DTA which states that if services are rendered for more than 90 days in COS, it will be considered as a PE. If there was anti-splitting rule in the DTA for this clause, the MLI clause (para 14(1)) would not apply. (Such planning may however be covered by PPT clause.)

12.3 **Reservation** – Para 3(a) – Country may opt out of the article entirely. (E.g. **UK**).

Para 3(b) - Alternatively, the country may not apply this article to **exploration or exploitation of natural resources.**

India has not made any reservation.

12.4 **Notification** – Para 4 – Each country that has not made any reservation for opting out of the article under Paras 3(a) and 3(b), shall notify the clause which is modified by the MLI.

India has not made any notification. If the other country makes a reservation for not applying article 14 completely, then this article will not apply. Otherwise, Para 1 of MLI provision will supersede the DTA provisions to the extent the DTA provisions are incompatible with the MLI.

E.g. India-Australia – Article 14 will apply & supersede the DTA provision – Australia has made a notification but has not specified India. Australia has not made any reservation either.

13. **Avoidance of PE through Commissionaire Arrangements and similar strategies – Article 12 (Action 7):**

A Commissionaire agent is a person who sells the principal's goods in his own name, but on behalf of the principal. Agent does not become the owner of goods. He does not have to disclose the name of the principal. Technically it is possible to avoid PE status. In India, I understand the agent is required to disclose the name of the principal.

This article is relevant more for PE in civil law countries (mainly in Europe) of an Indian resident. In India we do not have the concept of Commissionaire agent. Hence for non-residents having PE in India will be less affected by this article.

13.1 **Basic Provision**:

13.1.1 Para 1 - The MLI provisions are based on articles 5(4) and 5(5) of OECD model 2014.

If a person acts in COS,
on behalf of an enterprise and in doing so,
- concludes contracts, or
- habitually plays the principal role leading to conclusion of contracts that are routinely concluded without material modification by the enterprise

and these contracts are:

- in the name of the enterprise, or
- for transfer of ownership of property owned by the enterprise, or grant of right to use property that the enterprise has the right to use, or
- for provision of services by that enterprise,

then the enterprise shall be deemed to have a PE.

The activities of the person (agent) undertaken through a fixed place will not become a PE, if they had been undertaken by the enterprise itself and would been considered as P&A activities.

13.1.2 Para 2 – If the activities are of Independent agent, it will not be a PE, if he acts **in the ordinary course of that business**.

If the person acts wholly or almost wholly for the enterprise or closely connected enterprises, he will not be independent.

13.2 **Compatibility clause –** Para 3(a) – MLI provision (para 1) will apply in place of existing DTA – but only in situations where the agent **has and habitually concludes contracts.**

MLI provision will apply only to situations where the agent has the authority to conclude contracts. It will not apply to situations where the agent secures orders or where he maintains stock from which he regularly delivers goods on behalf of the enterprise (as in some Indian DTAs). (Para 163 of Explanatory statement).

Para 3(b) – MLI provision (para 2) will apply in place of DTA which has exemption for independent agent activity.

13.3 **Reservation –** Para 4 – Country may opt out of the entire MLI provision.

13.4 **Notification –** Para 5 – Country should notify whether DTA contains provision described in para 3(a). (Dependent agent habitually concludes contract).

India has notified DTAs under this para.

Para 6 – Country should notify whether DTA contains provision described in para 3(b). (Independent agent activity.)

India has notified DTAs under the clause.

It seems many countries have made a reservation under para 4 – not to apply this article entirely. (e.g. Australia).

14. **Definition of Person Closely related to an enterprise – Article 15 (Action 7):**

This article is relevant for Articles 12, 13 and 14.

14.1 **Basic provision** - Para 1 - "Connected persons" means if:

- one person has control over the other; or
- both are under the control of the same person; or
- one person owns directly or indirectly at least 50% of the other; or
- another person owns directly or indirectly at least 50% in both persons.

14.2 **Reservation** – Para 2 – If a country has made any reservations in articles 12, 13 or 14 (where it has opted out of the entire MLI provision totally), then for those articles, it can opt out of application of this article also entirely.

India has not made any reservation as it has not opted out of the articles 12, 13 & 14.

15. **Dual Resident Entities - Article 4 (Action 6):**

This article applies to persons other than individuals. Normally under the DTA, the tie-breaking status is applied based on Place of Effective Management. The MLI has changed the application of automatic tie-breaking rule.

15.1 **Basic Provision** – Para 1 – If an entity is resident of both countries, then Competent Authorities shall endeavor to determine the residence by Mutual Agreement, having regard to place of effective management, place of incorporation or other relevant factors.

If agreement cannot be reached, then the entity shall not be entitled to the DTA relief – except to the extent and in the manner as may be agreed upon by the Competent Authorities.

If Competent Authorities cannot reach an agreement under this para (due to which DTA relief will not apply), it will not mean that tax is not in accordance with the DTA. **It will still mean that tax is in accordance with the DTA**. It will further mean that the matter cannot be referred to Arbitration – as it will be a case of tax levied in accordance with the DTA. Only if the tax is levied which is not in accordance with the DTA, Arbitration can be resorted to. (India has of course not agreed to Arbitration.)

15.2 **Compatibility clause – Para 2:**

Para 1 shall apply in place of or in the absence of DTA provision (subject to Reservation under Para 3).

Para 1 shall however not apply to DTA provisions which deal with dual listed company.

If any DTA has one provision for tie-breaking for individuals and non-individuals, the MLI provision will apply only to non-individuals.

15.3 **Reservation – Para 3:**

15.3.1 Country may opt out of the MLI article in totality. (Para 3(a)). (e.g. Austria).

15.3.2 Country may opt out of the MLI article if the DTA which contains a provision that Competent Authorities should endeavor to reach to an agreement where one residence is assigned to the person. (Para 3(b)).

15.3.3 Country may opt out of the MLI article if the DTA which contains a provision where dual resident entities are denied the DTA relief, and there is no need for Competent Authorities to reach to an agreement regarding the residence of the

person (Para 3(c)). (e.g. India-USA DTA for companies). USA of course has not signed the MLI.

15.3.4 Country may opt out of the MLI article if the DTA already has a provision on the lines of MLI – i.e. Competent Authorities will endeavor to assign a residence to the dual resident entity and if they cannot reach an agreement then what should be done. (Para 3(d)).

15.3.5 Country may replace the last sentence of Para 1 of MLI article with the following – If the Competent Authorities cannot reach an agreement about the residence, then the person will not be entitled to DTA relief. (Para 1 states that the competent authorities may agree as to the extent and the manner in which the DTA relief will be available.). (Para 3(e)).

This and the provision in para 15.3.3 of this note are amongst the harshest provisions. If dual residence cannot be sorted out, the person loses the DTA relief totally. It does not even permit the competent authorities to permit the extent and the manner in which DTA relief may be given.

15.3.6 If a country has made a reservation in Para 3(e) above, then the other country may opt out of the MLI article entirely. (Para 3(f)).

If the other country does not make a reservation in this sub-para (3(f)), then reservation in para 3(e) will apply.

India has not made any reservation under para 3. Australia has made reservation under para 3(e). India has not opted out of the article under para 3(f). (May be it will opt out at the time of final notifications.) Therefore para 1 will apply and if DTA relief is not available due to PPT, then competent authorities cannot consider granting the relief even if they consider it appropriate.

15.4 **Notification** – Para 4 – Country which has not opted out of the article entirely (para 3(a)), should notify which clause of the DTA will be affected by the MLI and is not affected by reservation under paras 3(b) to 3(d).

India has notified the DTA provisions which have rules for determining tie-breaking rules.

If other country notifies the same DTA provisions, then MLI article 1 will substitute the DTA provision.

(E.g. India – UK DTA]

This will be a harsh provision for entities like firm.

E.g. A UK firm is treated as Indian resident because it has slight control in India (6(2) of ITA). The firm will be treated as UK resident to the extent partners are UK residents. In such cases the residential status will be determined by Competent Authorities.

16. **Capital Gain from sale of shares or interest in entities deriving their value from immovable property – Article 9 (Action 6):**

Some DTAs provide that if the value of the entity (whose shares are sold), derives its value mainly from immovable property in COS, then it will be taxed in the COS.

Tax payers can contribute assets in the entity just before the sale, so that value of property goes down below 50% (or as may be prescribed in the DTA). To overcome this situation MLI has made following provisions.

The MLI article provides two changes in the DTA provision; & one clause complete by itself which can replace the DTA clause.

Changes in DTA:

i) It provides the period during which the value of immovable property has to be considered (testing period). (Para 16.1 of this note).

ii) It provides that the provision will apply to interests in entities such as partnership and trust also (ownership interest). (Para 16.2 of this note).

iii) **Complete clause -** If the entity derives its value from immovable property in COS exceeding 50% at any time during the preceding 365 days, the sale of shares / interest in the entity will be taxed in COS. (complete provision - OECD MC article proposed in Action 6 report) (Para 16.1 of this note).

16.1 **Period during which value of property has to be considered:**

16.1.1 **Basic provision** – Para 1(a) – If the DTA provides that if value of an entity is derived more than a certain portion from immovable property in COS,

then that DTA provision shall apply if the value is met <u>at any time during the preceding 365 days from transfer</u>.

How much value should be derived by the immovable property, will be considered as per existing DTA. Some countries use principle value or main value, etc. These have not been disturbed.

Other provisions are not disturbed i.e. scope of DTA provision is not expanded. For example, exemptions provided for listed companies if any, will continue to apply.

16.1.2 **Compatibility clause** – Para 2 – MLI provision (Para 1(a)) pertaining to deriving value from immovable property at any time during the preceding 365 days, will apply in place of or in absence of any time period stated in the DTA.

16.1.3 **Reservation** – Para 6(a) – Country may not apply Para 1 of MLI (clause (a) & (b)).

Para 6(b) – country may not apply Para 1 (a) of MLI provision (testing period).

Para 6(d) – Country may not apply para 1 (a) of the MLI provision if it already has a testing period in the DTA.

16.1.4 **Notification** – Para 7 - The country shall notify the DTA clause which contains provisions similar to para 1 of MLI (if it has not made a reservation in para 6(a)).

Para 7 does not exclude countries from making a notification of DTAs.

Where both countries have made notification under para 7, para 1 of MLI shall apply in place of DTA provision.

India has notified the DTAs and the provisions which contain provisions in para 9(1) of MLI.

16.2 **Provision applies to interest in entities such as partnership and trust also:**

16.2.1 **Basic provision** - Para 1(b) – If the DTA provides that if value of an entity is derived more than a certain portion from immovable property,

then the DTA provisions shall also apply to comparable interests such as in partnership or trust, if the DTA does not cover such entities.

16.2.2 **Compatibility clause** – Para 1(b) only refers to interests similar to shares in a company. Hence there is no compatibility clause.

16.2.3 **Reservation** – Para 6(a) – Country may not apply Para 1 of MLI (clause (a) & (b)).

Para 6(c) - Country may not apply Para 1(b) of MLI provision.

Para 6(e) – Country may not apply para 1(b) of MLI provision if it already has a similar provision in the DTA.

16.2.4 **Notification** – Para 7 - The country shall notify the DTA clause which contains provisions similar to para 1 of MLI (if it has not made a reservation in para 6(a)).

Para 7 does not exclude countries from making a notification of DTAs.

Where both countries have made notification under para 7, para 1 of MLI shall apply in place of DTA provision.

(India-Australia – Both have notified same DTA provision. MLI article 9(1) will apply.)

16.3 **If the entity derives its value from immovable property in COS exceeding 50% at any time during preceding 365 days, the sale of shares / interest in the entity will be taxed in COS:**

16.3.1 **Basic provision** – Para 3 – Country may chose to apply Para 4 to its DTA.

Para 4 – If a person derives gain from sale of shares or comparable interests such as interest in a firm or trust,
and the value derived is more than 50% from immovable property in COS,
gain will be taxed in COS.

This is based on the article in Action 6 report (article 13(4) of OECD MC).

It is an optional provision.

16.3.2 **Compatibility clause** – Para 5 – MLI provision (Para 4) will apply <u>in place of or in absence of</u> the DTA provision.

16.3.3 **Reservation** – Para 6(f) - Country may not apply the MLI provision (Para 4) if it already has a similar provision in the DTA.

If there is no similar provision as stated in para 5 (DTA provision), then para 4 (MLI provision) will apply.

16.3.4 **Notification** – Para 8 – Country shall notify the depository if it chooses to apply para 4 (i.e. tax in COS on sale of shares / interest in entities where more than 50% of the value is derived from immovable property in COS).

If both countries have chosen to apply para 4 of MLI, para 1 of MLI will not apply.

If country does not make a reservation para 6(f) (i.e. para 4 will apply); and has made a reservation in para 6(a) (i.e. para 1 of MLI will not apply), it shall notify the DTA provisions which are similar to MLI provision in para 4.

If both countries make notification under para 7 or 8, DTA provision will be replaced by MLI para 4. In other cases, para 4 will supersede the DTA provision to the extent of incompatibility.

India has chosen to apply para 4. (Normal OECD MC provision)

17. **Dividend Transfer Adjustment – Article 8 (Action 6):**

17.1 **Basic provision** – Para 1 – Dividend will be taxed a lower rate if the shareholder (**which is a company**) holds the minimum prescribed shareholding throughout the 365 day period including the date of payment. (The holding period of 365 days is not necessarily to be satisfied "before" the dividend. It can be satisfied before, after or spread over before and after the dividend payment. E.g. If shares are acquired on 1st January, dividend is declared in 1st June, and shares are held at least till 31st December, this condition would be satisfied. It is a different matter as to how will the company paying the dividend know whether the shareholder will hold the shares in future so that the holding is for 365 days.)

The condition of number of days will not apply in case of corporate reorganisation such as merger or demerger.

This para does not affect the existing provisions of the DTA if the country provides preferential rate of tax without the minimum shareholding requirement.

The para does not change the requirement of beneficial owner, even though it uses the term "recipient" of dividend.

The sole purpose of this para is to add the minimum period of shareholding of 365 days. It does not change other provisions – tax rate, ownership thresholds or forms of ownership (direct or indirect), etc.

In India, shareholder is exempt. DDT is paid by the Indian company. Hence this article has no significance at present. However in case India changes its tax system for dividend, then it will be relevant.

For outbound investment, India has to allow Foreign Tax credit. In such scenarios, MLI becomes relevant. If the other country levies lower rate, India gets more tax.

17.2 **Compatibility clause** – Para 2 – The minimum holding period shall apply in place of or in absence of the minimum holding period in the DTA.

17.3 **Reservation** – Para 3 –

The country may opt out of the MLI article entirely (Para 3(a)).

The country may opt out of the entire MLI article to the extent the DTA provides for – i) a minimum holding period, or ii) minimum holding period shorter than 365 days, or iii) minimum period holding longer than 365 days. (Para 3(b)).

The reservation in para 3(b) is on the existing holding period in a DTA – If the DTA provides for 2 rates of dividend, and for one rate minimum holding is prescribed and for the other rate the minimum holding is not prescribed, then the minimum holding will apply to the rate for which minimum holding is not prescribed.

India has made a reservation under para 8(3)(b)(iii). Only Portugal DTA is covered by the reservation.

17.5 **Notification** – Para 4 – Country shall notify the DTA provision that prescribes holding period, or does not have the minimum holding period (unless it has made reservation under para 3(a) and 3(b)).

If both countries notify same DTA provision, then only para 1 of MLI will apply (i.e. 365 day test will be added).

India has made notification under this para. Para 8(1) will apply if other country also notifies the same DTA provision.

(India-Australia – Both have notified the DTA provision of other DTAs, but none of them have notified the provision of each other's DTA. Hence para 1 (365 day test) does not apply.

18. **Other Provisions where India has not made any reservation or notification - (Discussed briefly):**

18.1 **PE in third country – anti-abuse provision – Article 10 (Action 6):**

18.1.1 Para 1 - If resident of COR derives income from a COS,
but the income is attributable to a PE in third country (COPE),
and COR exempts such income (as it follows exemption method),
then COS can tax income as per its domestic law if the tax in COPE is less than 60% of tax in COR.

18.1.2 Para 2 – Para 1 will not apply (i.e. COR will not tax the income),
if income in COS is derived in connection with or incidental to,
active business carried out through the PE.

Active business will not include making, managing or holding investments on own account.

However for banking, insurance and securities dealer – if investment activities are banking, insurance or securities activity respectively, then these will be considered as active business.

18.1.3 Para 3 – If the COR denies the DTA relief pursuant to para 1 (i.e. COR taxes its resident), the COS may provide relief if it considers appropriate.

18.1.4 Para 4 – Paras 1 to 3 will apply in place of or in absence of DTA provisions.

18.1.5 Para 5 – Country can provide various kinds of reservations.

18.1.6 Para 6 – Country can make notifications.

18.1.7 India has not made any reservation.
India has not notified any DTA which contains provisions as in the MLI (as India does not have such clauses in the DTA).

Therefore if the other country has not made a reservation, and
notification of same DTA provisions is not possible (as India has not notified any DTA),
then Article 10(1) to 10 (3) will supersede the DTA provisions to the extent these are incompatible with the DTA.
i.e. the MLI provisions will apply. (e.g. India-Austria)

If the other country has made a reservation, then paras 1 to 3 will not apply. E.g. India-UK DTA where UK has made a reservation.

18.2 **Right to tax its own residents – Article 11 (Action 6):**

18.2.1 Para 1 - A COR can tax its residents irrespective of what is stated in the DTA, except where DTA specifically permits that income of resident of COR is taxable only in COS. (e.g. pension paid by Government of COS to resident of COR is taxable only in COS).

In effect, exemption method of elimination of double tax is not applicable.

18.2.2 Para 2 - Para 1 shall apply in place of or in absence of DTA provisions.

18.2.3 Para 3 – Country can make various reservations.

18.2.4 Para 4 – Country can make notifications.

18.2.5 India has not made any reservation.
India has not notified any DTA which contains provisions as in the MLI (as India does not have such clauses in the DTA).

Therefore if the other country has not made a reservation, and
notification of same DTA provisions is not possible (as India has not notified any DTA),
then Article 11(1) will supersede the DTA provisions to the extent these are incompatible with the DTA.
i.e. the MLI provisions will apply. (e.g. India-Australia)

If the other country makes a reservation, then MLI provision will not apply. E.g. India-Austria DTA – Austria has made a reservation that this article will not apply.

19. **Other provisions where India has reserved the entire article from being applied / not opted for MLI provisions entirely - (Discussed briefly):**

19.1 **Transparent entities – Article 3 (Action 2):**

In case of entities where owners are taxed (transparent – usually partnership firms) and the entity is not taxed, COS will consider the income derived by the resident of other country, only to the extent it is taxed as income of the resident of COR.

As India has made a reservation, MLI article does not apply.

India's view is that DTA relief cannot be extended to fiscally transparent entity which is not a resident of either of the countries. How can DTA relief between two countries be applied to a person which is resident of a third country? DTA relief only extends to such income derived by or through entities which are resident of either of countries.

19.2 **Methods of elimination of double tax – Article 5 (Action 2):**

If COR follows exemption method whereby if income is taxable in COS, COR will not tax it (exempt it); AND if COS also does not tax it, it will be a case of double non-taxation. In such cases COR can tax the income. This article has possibility of asymmetric application of MLI.

In effect, exemption method of elimination of double tax is not applicable.

As India has made a reservation, MLI article does not apply. India follows credit system for eliminating double tax.

19.3 **Corresponding adjustments – Article 17 (Action 14):**

If one country makes any adjustment to profits of an enterprise in its country under Transfer Pricing, then the other country may make an adjustment in profits (reduce the profits) of the other related enterprise in its country (provided it agrees). This is in line with Article 9(2) of OECD MC.

This is considered as best practice and not minimum standard.

India has made a reservation (opted out) of this MLI article entirely as such a clause is present in its DTAs. It has listed the DTAs which has such a clause.

19.4 **Mutual Agreement Procedure – Article 16 (Action 14):**

Where a person considers that the actions of any of the Countries results or will result in taxation which is / will be not in accordance with the provisions of the

DTA, that person can approach the competent authority of any country. The MLI provision is based on article 25 of OECD MC.

This facility is available irrespective of the remedies provided by the domestic law of those countries.

The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the DTA.

19.5 **Arbitration – Articles 18 to 26 (Action 14):**

Where Competent Authorities are not able to come to an agreement under Mutual Agreement Procedure (MAP), the person who requested for MAP can request for arbitration.

This is considered as best practice and not minimum standard.

India has not opted for arbitration.

C. India-UK DTA as amended by MLI - Sample

UK has ratified the MLI and given its final position.

India has provided the tentative list of provisions which will be modified by MLI. It has not yet provided its final position.

Assuming that the tentative list of India is the final position of India, some articles of the DTA will be considered as under:

I. Article 4 of DTA – 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:

(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and

(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.

2. Where by reason of the provisions of paragraph (1) of this Article an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests);

(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode;

(c) if he has an habitual abode in both Contracting State or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;

(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. ~~Where by reason of the provisions of paragraph (1) of this Article a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.~~

Article 4(1) of MLI -
Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.

[*India and UK have notified same article. MLI article will replace the DTA article.]*

II. **PPT clause:**

II.1 **Article 28C of DTA – Limitation of Benefits (This is the PPT clause)**

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

2. Where by reason of this Article a resident of a Contracting State is denied the benefits of this Convention in the other Contracting State, the competent authority of that other Contracting State shall notify the competent authority of the first-mentioned Contracting State.

Article 7(1) of MLI -
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.

[*India has notified Article 28C of the DTA. UK has notified Articles 28C, 11(6), 12(11) and 13(9). There is a notification mismatch. DTA and MLI provision both continue to apply. MLI provision will supersede the DTA provision to the extent DTA provision is incompatible with MLI provision.*

Portion in italics of MLI article is compatible with DTA provision. Hence DTA provision applies.

The last portion (non-italics and underlined) is not there in DTA. Thus MLI provision applies. If there is any interpretation issue, MLI provision will be considered. In effect the MLI provision applies.]

II.2 **Other DTA clauses which have PPT:**

Article 11(6) of DTA – Dividend

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

Article 12(11) of DTA - Interest

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

Article 13(9) of DTA – Royalty and Fees for Technical Services

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

[*UK has notified these clauses under MLI. India has not notified these clauses. There is a notification mismatch. MLI provision should supersede the DTA provision if there is incompatibility. DTA provision applies only to these articles. MLI provision is wider. Hence MLI provision – Article 7(1) – will apply. In effect the DTA clauses of these three articles are redundant as MLI PPT article will cover all incomes. See Para 94 of Explanatory statement to MLI.*

However OECD matching tool does not state as above. Let us see the status when India gives its final list of MLI provisions.]

D. Documents relevant for BEPS and MLI

1. BEPS Action Reports of October 2015

   Plus several subsequent reports and follow on documents.

2. Multilateral Convention (Instrument) – MLI.

3. Explanatory statement to MLI.

4. Legal note on functioning of MLI.

5. FAQs on MLI.

6. Step by step tool for applying MLI.

7. MLI flow charts.

8. Matching database tool plus Database matching manual.

9. OECD Secretariat Note on Entry into force of Nov 2018.

10. Guidance on synthesized text of MLI and DTA.

11. List of signatories to MLI plus Country positions on MLI.

12. OECD Model commentary 2017.

13. Transfer Pricing guidelines of 2017.

14. Various Exchange of Information agreements.