MULTILATERAL INSTRUMENT WITH CASE STUDIES

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Multilateral Instrument - Overview

Multilateral Instrument (MLI)

- Result of BEPS Action Plan 15 to modify the existing treaties to give effect to BEPS Action Plan
- The tax treaties to be modified by MLI are **Covered Tax Agreements (CTA)**
- Multilateral tax treaty is gaining traction especially in light of Pillar 1 and Pillar 2 project

Coverage of MLI

- BEPS Action Plan 2 – Hybrid entities and instruments
- BEPS Action Plan 6 – Principle Purpose Test & LOB
- BEPS Action Plan 7 – Permanent Establishments
- BEPS Action Plan 14 – Dispute Resolution

Articles Under MLI, Model Convention And BEPS Action Plan

Articles of MLI	OECD MC (2017)	BEPS AP
Part 1: Scope and Interpretation of Terms		
Article 1: Scope of MLI		
Article 2: Interpretation of MLI		
Part II: Hybrid Mismatches		
Article 3: Transparent Entities	Article 1(2) and 1(3)	BEPS AP 2 and BEPS AP 6
Article 4: Dual Resident Entities	Article 4	BEPS AP 6
Article 5: Methods for elimination of double taxation	Article 23A and 23B	BEPS Action Plan 2
Part III: Treaty Abuse		
Article 6:Purpose of CTA (Preamble)		BEPS Action Plan 6
Article 7: Prevention of Treaty Abuse	Article 29	BEPS Action Plan 6
Article 8: Dividend transfer transaction	Article 10(2)(a)	
Article 9: CG from alienation of share/interest deriving value from IP	Article 13(4)	

Articles Under MLI, Model Convention And BEPS Action Plan

Articles	OECD MC (2017)	BEPS AP
Article 10: Anti-abuse rule for PE in third state		BEPS AP 6
Part IV: Avoidance of PE Status through		
Article 12: Commissionaire Arrangements	Article 5(5) and 5(6)	BEPS AP 7
Article 13: Specific Activity Exemptions	Article 5(4)	
Article 14: Splitting up of contracts	Article 5(3)	
Article 15: Closely related enterprise	Article 5	
Part V: Improving Dispute Resolution		
Article 16: MAP	Article 25	BEPS AP 14
Article 17: Corresponding Adjustments	Article 9(2)	
Part VI: Article 18-26: Arbitration	Article 25(5)	
Part VII: Article 27-39: Final Provisions	Article 27 - 39	

Covered Tax Agreements

- India has a total of 94 tax treaties in force, out of which 93 are included in the MLI as CTAs
- India-China is not listed as CTA as the treaty has been amended in July 2019
- Impact on India's major treaties

Treaty partner	Whether signed MLI	Whether notified India as CTA	Whether India has notified as CTA
USA	No	NA	NA
Brazil	No	NA	NA
China	Yes	No	No
Mauritius	Yes	No	Yes
Germany	Yes	No	Yes
Switzerland	Yes	No	Yes

Mechanics Of MLI

Minimum Standards

- BEPS Action Plan 6
- BEPS Action Plan 14

Compatibility clauses

- Addresses conflict between MLI and provisions of CTA
- Discussed in next slide

Reservations

- Flexibility to opt out

Optional provisions

- Flexibility to choose alternative provisions
- Option to apply only if both the countries choose same option
- Asymmetric application for SLOB

Notification

- Notification of existing provision to be modified/replaced
- Notification of optional provisions

Mechanics Of MLI – Compatibility Clauses

Compatibility Clause	Application	Impact
"in place of"	There is an existing provision in CTA	Existing provision is replaced when countries notify the same existing provision.
"in absence of"	There is no provision in CTA	The new provision would be added when countries notify
"applies to or modifies"	There is an existing provision in CTA	The new provision modifies the existing provision without replacing it
"in the place of or in absence of"	There may or may not be provision in CTA	The existing provision would get replaced when countries notify. If the countries do not notify, such provision shall be added and superseded to the extent of incompatibility.

Checklist For MLI Applicability

① Whether both countries are signatory to MLI

② Whether two countries notified treaty with each other as CTA

③ Whether countries have opted in for same provision in case of optional provision

④ Check reservation of provision if any?

Interpretation Of MLI

- MLI provisions to be read along with the existing tax treaty – do not replace tax treaty
  - What if a protocol is signed after applicability of MLI?
  - What happens if amending instrument (India – Spain DTAA) is not notified by country

- **Article 2(2) of MLI:** In case any term is not defined under MLI, it shall have the meaning as defined in the treaty.
- Article 3(2) of OECD Model Convention,2017 states that in case term used in the treaty has not been defined, but defined in the domestic laws of the country, then such definition shall be used.
- Section 90 of the Act Explanation 4 states that in case term used in the treaty has not been defined, but defined in the Act, then such definition shall be used.
- Section 90 further states in case any term has not been defined in the treaty or the domestic act, the notification issued by the Central Government in the Official Gazette (if any) shall prevail.

Aids To Interpret MLI

Rules of interpretation applicable to tax treaty will be equally applicable to interpret MLI provisions

Vienna Convention on Law of Treaties

BEPS AP 15 – containing the text of MLI;

Explanatory Statement to MLI;

MLI Positions adopted and deposited by various MLI Signatories with OECD - draft MLI positions filed at time of signing MLI and final MLI positions filed at the time of depositing ratified copy of MLI with OECD;

Reports on BEPS AP 2, 6, 7 and 14 - based on which MLI text is developed;

The Synthesized text of MLI between parties to a CTA

OECD Model Convention of Tax Treaty and OECD Commentaries - used for interpretation of tax treaty;

MLI matching database available on OECD's Website

Determination Of Effective Date For Application Of MLI

India-Singapore DTAA

1st day of the month after expiry of 3 months from the date of deposit of ratified instrument

Deposit of ratification instrument

India- 25th June 2019
Singapore – 21st Dec 2018

Entry into force (EIF)

India – 1st Oct 2019

Singapore – 1st April 2019

Later of 2 EIF

1st Oct 2019

Entry into effect

India

Other Taxes

Taxable period beginning on or after 6 months
1st April 2020

WHT Taxes

1st day of next taxable year
1st April 2020

SINGAPORE

Other Taxes

Taxable period beginning on or after 6 months
1st Jan 2020

WHT Taxes

1st day of next taxable year
1st Jan 2021

What Is Synthesised Text

- Synthesised text is a single document or webpage that reproduce

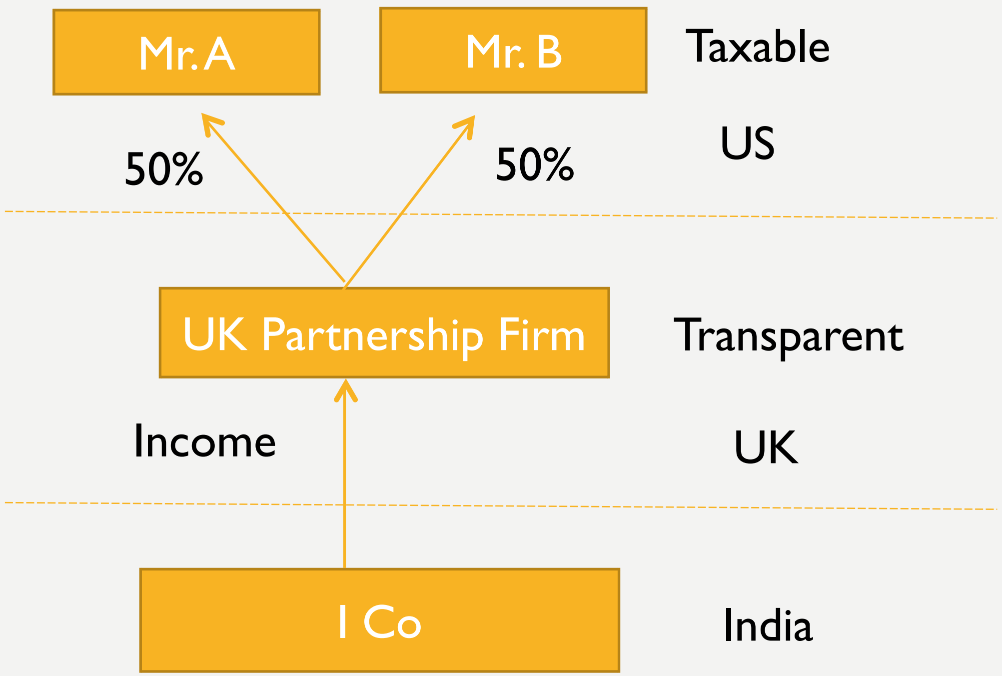
a) the text of each Covered Tax Agreement (including the texts of any amending protocols or similar instruments); and

b) the provisions of the MLI that will modify that Covered Tax Agreement in the light of the interaction of the MLI positions the Parties have taken

- OECD issued Guidance for the development of Synthesised Texts to facilitate the interpretation and application of tax agreements modified by MLI provisions
  - Synthesised texts to also include explanatory information in the form of a disclaimer, including information on the date on which the provisions of the MLI enter into effect
- Synthesised text has no legal value. The text of the MLI, applied alongside the CTA, would remain the only legal documents

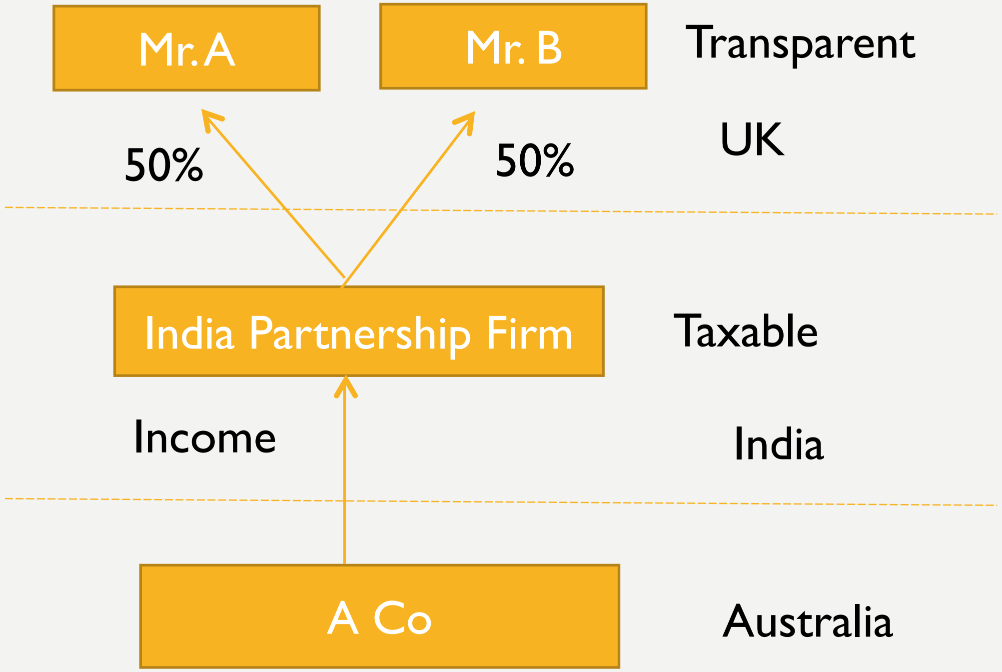
PART II: HYBRID MISMATCHES

Article 3: Transparent Entities



- Double Non-taxation or limited taxation
- **Article 3(1) of MLI provides that**
- income derived by or through an entity or arrangement
- that is treated as wholly or partly fiscally transparent under the laws of either contracting jurisdiction
- shall be considered to be ***income of a resident of a Contracting jurisdiction only to the extent that such jurisdiction treats the income as the income a resident of such jurisdiction***
- Paragraph 1 is intended to give effect to the recommendation in the BEPS Action 2 and ensure that the benefits of a tax treaty are granted only in appropriate cases and these benefits are not granted where neither contracting state treats, under its domestic law, the income of an entity as the income of its residents (i e neither contracting state considers transparent entity)

Article 3: Transparent Entities



- Article 3 (2) provides that a Contracting Jurisdiction shall not grant double tax relief either by way of exemption or deduction or credit of income taxes paid in other Contracting Jurisdiction if the income is taxed in other contracting jurisdiction solely because the income is derived by the resident of that other contracting jurisdiction
- In this case, India or UK shall not grant credit of taxes paid in respective state as the taxation is solely because partnership firm is resident of India and partners are resident of UK

India’s Position on Article 3

- India has reserved Article 3 entirely. Therefore Article 3 will not apply to India’s treaties.
- Further, similar to article 3 of the MLI, the India-United States Income Tax Treaty (1990) provides that the term “resident of a Contracting State” 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.
- Also, the India-United Kingdom Tax Treaty was amended through a protocol wherein the term “resident” was also amended to cover partnership, estate or trust to the extent the income derived by them 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.
- Similarly, Indian tax treaties with Norway and Sweden also include such clauses extending the treaty entitlement to members of fiscally transparent entities.
- Further, the recently notified China-India Tax Treaty contains a similar clause based on the MLI

Article 4 - Dual Resident Entities

- Paragraph 1 of Article 4 of the MLI provides that
- where, under the provisions of a CTA, a person other than an individual is considered to be a resident of more than one contracting jurisdiction, then - the competent authorities of the contracting jurisdictions shall endeavour to determine by mutual agreement the residency of such person for the purposes of the CTA
- Competent authorities shall give regard to the POEM of the person, the place where it is incorporated and any other relevant factors
- If the competent authorities are unable to decide on the jurisdiction of residence, such person shall not be entitled to any relief or exemption from tax provided under the CTA and shall be entitled to any relief or exemption from tax to the extent and in the manner agreed upon by the competent authorities

Article 4 - Dual Resident Entities – India's Position

- India has not made any reservations with respect to Article 4 and accordingly chosen to apply Article 4 to all its CTA, subject to reservations of treaty partners against Article 4
- Where India's treaty partners' also notify the same clause, such clause will stand replaced by the provisions of Article 4
- In the absence of notification by such treaty partners, provisions of such clause will apply to the extent that they are not incompatible with the provisions of Article 4
- India's treaties with Estonia, Latvia and Lithuania already had language similar to article 4 of the MLI. Treaties with Finland and Mexico provide mutual agreement based on criteria like in article 4 of MLI but without any disentitlement to treaty benefits upon failure of mutual agreement.
- The recently amended China-India Tax Treaty also contains the case-by-case approach for resolving the dual residency conflicts of taxpayers other than individuals.

Article 5: Application Of Methods For Elimination Of Double Taxation

Option A	Option B	Option C
• COR will not exempt income if COS has exempted as per treaty • If an income is taxed in COS, COR shall grant credit of lower of taxes paid in COS or tax in COR	• Addresses D/NI situations • COR shall not exempt dividend, which is deductible in COS • If COR taxes dividend, COR will provide credit for the taxes paid in COS	Credit method

- Double non taxation may arise in a case where bilateral tax treaty gives taxing rights to resident contracting state and domestic tax laws of resident state exempts such income
- While the income could be liable to tax in the source state, it may not be subject to tax.
- In such a situation, use of the exemption method may result in an obligation on the COR to exempt such income, and therefore result into double non taxation of income
- In order to prevent such instances of double non taxation, MLI has provided 3 options for contracting jurisdiction to choose
- India has chosen Option C for 4 CTAs – Egypt, Greece, Bulgaria, Slovakia

PART II: TREATY ABUSE

Article 6: Purpose of a Covered Tax Agreement

Preamble

- Contracting States intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements

PPT Rule

- Treaty benefit to be denied if it is reasonable to conclude, having regard to all facts & circumstances, that obtaining the tax benefit was one of the principle 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

LOB Rule

- Rules based on objective criteria such as legal nature, ownership in, and general activities of residents of Contracting States (i) simplified or (ii) detailed

- MLI allows to opt for any of the following

A) PPT
B) PPT+SLOB
C) DLOB + anti-conduit rule

Article 6: Purpose of a Covered Tax Agreement

- India has opted for PPT as interim measure
- India has also opted for SLOB. However, SLOB will only apply if the treaty partner has also opted for it or opted for asymmetric application
- It intends where possible to adopt LoB provision, in addition or replacement of PPT, through bilateral negotiations along with Simplified LoB

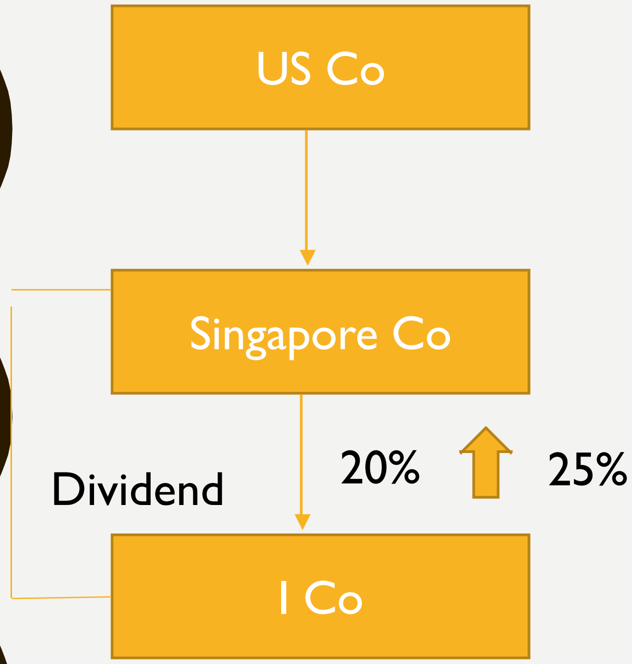
Article 7: Principle Purpose Test

- Non-obstante provision with mandate of denial of treaty benefit
- Extends to direct as also indirect benefit under CTA
- “Benefit” covers all limitations on taxation imposed on the COS as also treaty benefit obtained in COR
  - Example: tax reduction, exemption, tax sparing, UTC, etc.
- No impact on tax concessions admissible in domestic law (e.g. lower withholding rate admissible u/s 194LC/LD)
- Applies to an arrangement if its “one of the principal purpose” is treaty benefit
  - Obtaining treaty benefit need not be sole or dominant purpose
- “Reasonable to conclude”:
  - Having sound judgment, fair, sensible, logical (not unreasonable)
  - Alternative views need to be examined objectively
  - Looking merely at the ‘effect’ not sufficient –tax benefit purpose not to be assumed lightly
  - Self assertion by taxpayer not sufficient; also no conclusive evidence requirement

Evaluation of PPT

- Step 1: Identify the arrangement and related tax benefit under CTA
- Step 2: Compare the arrangement v. realistic counterfactuals
- Step 3: Whether obtaining treaty benefits is one of the principal purposes for transaction or arrangement?
- Step 4: Whether obtaining treaty benefit is in accordance with the object and purpose of the treaty?
- Step 5: Scale of treaty benefit and evidences of non-tax business purpose to substantiate that arrangement is not to obtain treaty benefit

Case Study 1

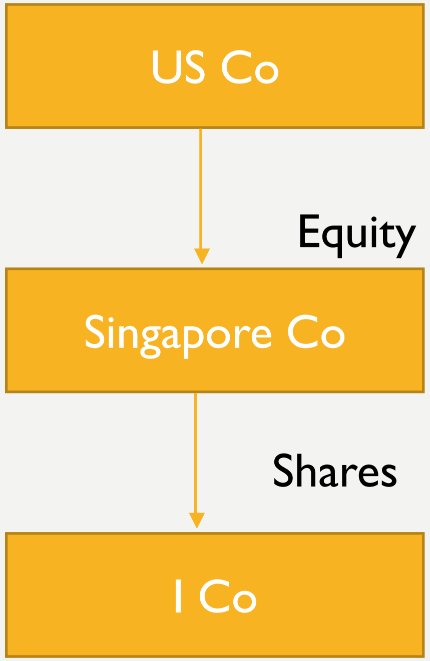


- US Co made investment in India through its subsidiary company in Singapore
- The Singapore Company had increased its shareholding from 20% to 25% during the current year.
- Article 10 of India-Singapore DTAA provides for withholding tax rate on dividend as under:
- 10% provided the recipient of dividend is a beneficial owner being a company which controls directly or indirectly at least 25% equity shares in the company declaring dividends
- 15% in all other cases
- **Issues**
- Whether Singapore Co. can be denied the benefit of lower tax withholding rate on dividend by contending that the increase in 5% shareholding was merely to avail benefit of treaty provisions?

Case Study 1

- Article 7(1) of MLI allows parties to a tax treaty to apply Principal Purpose Test ('PPT') to deny treaty benefit if obtaining such benefit was one of the principal purposes of any transaction entered into by a taxpayer
- However, such benefit not to be denied if it is established that granting the benefit would be in accordance with the object and purpose of relevant treaty provisions **(Object & purpose test)**
- India-Singapore DTAA is a 'Covered Tax Agreement'
- Article 7(1) of MLI to apply and supersede the provisions of India-Singapore DTAA to the extent the DTAA provisions are incompatible with Article 7(1)
- In the instant case, principal purpose of acquisition of additional 5% share is to avail benefit of lower withholding tax rate on dividend
- However, granting such benefit would be in accordance with the object and purpose of Article 10 of India-Singapore DTAA
- Article 10(2)(a) of India-Singapore DTAA provides for an arbitrary threshold of 25% for the purposes of determining which shareholders are entitled to the benefit of the lower rate of tax on dividends
- The same is consistent with the approach to grant the benefits of the subparagraph to a taxpayer who genuinely increases its participation in a company in order to satisfy this requirement
- Therefore the benefit to Singapore Co should not denied India-Singapore DTAA

Case Study 2



- Sing Co's made investments in shares of I Co in tranches
  - Before 1st April 2017
  - After 1st April 2017
- Sing Co transfers shares in 2 tranches - before 31 March 2020 (Tranche 1) and in 2021 (Tranche 2)
- I-S protocol triggers source taxation, if gains arise from alienation of shares acquired on or after 1 April 2017 [Article 13(4B)]
- Residence based taxation for shares acquired on or before 31 March 2017 [Article 13(4A)]
- Evaluate GAAR and PPT implications

Case Study 2

- **Issues**
- What is the dividing line between GAAR and PPT –Particularly, main purpose v/s. one of the main purpose?
- Whether treaty grandfathered capital gain merits special consideration under PPT?
- Does GAAR grandfathering/ non-applicability of GAAR foreclose PPT applicability?
- Can PPT recharacterize the transaction?

Shares Acquisition	Disposal	GAAR	PPT
Pre April 2017	Pre March 2020	No	No
Pre April 2017	In 2021	No	Yes
Post April 2017	Pre March 2020	Yes	No

Case Study 2

Particulars	GAAR	PPT
Applicability	• Main purpose is tax benefit; and • One of the tainted element tests is present	• One of the principal purposes is tax benefit; and • Such purpose is not in accordance with object and purpose of treaty/ article
Consequences	Re-characterization of transaction, re-allocation of income (includes denial of treaty benefit)	Denial of treaty benefit
Onus	Primary onus on tax authority	Primary onus on tax authority and rebuttal assumption for carve out
Administrative safeguards	Approving Panel	
Grandfathering	Yes	No
De-minimis threshold	Yes	No

Case Study 2 - Impact of PPT on treaty grandfathered investments

PPT will not apply to grandfathered investments under treaty

- Amended I-S treaty was in light of BEPS project and grandfathering was a conscious decision
- Object and purpose of grandfathering provision is to avoid disruptive transition and provide certainty to the investors
- Providing certainty to taxpayers is one of the object and purpose of the treaty
- Therefore, PPT will not apply as availing grandfathering benefit is in accordance with object and purpose

PPT applies to entire treaty including Article 13(4A) notwithstanding that acquisition of investment in I Co was on or before 31 March 2017

- PPT is a "non-obstante" provision and worded widely to cover all benefits
- PPT can apply to the investments prior MLI

Case Study 2 - Impact of PPT on GAAR grandfathered investments

- Main purpose vs one of the principle purposes
  - OECD Examples on expansion of business, establishing company with real assets and activities gives the flavour that PPT applies only when the principle reason is to obtain the tax benefit

- Whether taxpayer can contend non-applicability of PPT by virtue of s.90(2A) of ITA in respect of GAAR grandfathered investment ?

S. 90(2A) -"Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him."

- If arrangement/transaction is PPT tainted, treaty benefit is denied
  - GAAR invocation may not be necessary for denying treaty benefit

Will Re-characterised Arrangement Enjoy Treaty Benefit?

Yes

- PPT has absolute effect of denial of treaty benefit on abusive transactions, unless under discretionary relief mechanism
- PPT works on 'either or not' principle; it does not look beyond except when discretionary relief is granted
- The deterrent effect of PPT will be diluted if taxpayer is permitted to have consequential relief

No

- Clear text of PPT requires denial of the benefit from the tainted arrangement and does not contemplate harsher consequences
- If treaty consequence for domestic GAAR invocation is based on reattributed/ re-characterised arrangement, PPT as a treaty GAAR, no different

Interplay with LOB clause

- Where S Co. fulfils the LOB conditions as provided in India-Singapore DTAA, can S Co. be still denied treaty benefits under the Principal Purpose Test under MLI?
- Grandfathering benefits under Article 13(4A) are subject to the Article 24A of the India-Singapore DTAA, which requires the taxpayer to fulfil 2 conditions – Purpose Test and Expenditure Test
- Purpose Test ('Singapore PPT that requires the taxpayer to substantiate that affairs were not arranged with the primary purpose to take the grandfathering benefits of the treaty
- Expenditure Test is an objective test that requires the taxpayer incur an annual expenditure of at least SGD 200,000 in Singapore to justify that it is not a shell or conduit company
- Article 7(17)(a) of the MLI provides that where the Contracting Jurisdictions do not notify the existing article and paragraph of the Covered Tax Agreement that would be replaced by PPT under MLI, the PPT provisions of MLI shall supersede the provisions of the Covered Tax Agreement that are inconsistent to the PPT under MLI
- Since India and Singapore have not made such notification under Article 7(17)(a) of the MLI, the PPT under MLI shall supersede the Singapore PPT, i.e., Article 24A(1) of the India-Singapore DTAA, to the extent provisions of Article 24A(1) of India-Singapore DTAA are incompatible with Article 7 of MLI
- Therefore, the broad PPT shall apply

Case Study 2

- **Expenditure Test vis-à-vis PPT**

1. **If it is concluded that MLI PPT should not apply in case of grandfathered investments**

- Expenditure test needs to be satisfied – specific provision under India-Singapore DTAA which stipulates that benefit of grandfathering available provided expenditure test is satisfied

2. **If it is concluded that MLI PPT should apply even in case of grandfathered investments**

- Imperative to evaluate whether expenditure test in such case would be an additional test to be satisfied or whether MLI PPT would supersede expenditure test prescribed under LOB clause in the DTAA
- Also, it needs to be ascertained as to whether satisfaction of expenditure test would automatically imply satisfaction of MLI PPT or whether both tests need to be satisfied independently

Case Study 2

- Paragraph 95 of the Explanatory Statement to the MLI clarifies that where the treaty already contains any anti-abuse provision other than PPT, the PPT of MLI is not intended to restrict the scope or application of such existing anti-abuse rules
- Hence, Expenditure Test under the treaty may not be superseded by the PPT of MLI as it is not incompatible as per Article 7(17)(a) of the MLI
- LOB is SAAR with objective tests to determine treaty entitlement
- SLOB deals with eligibility of the entity to the treaty benefit
- If the Expenditure Test of the treaty is not fulfilled, then entity shall deemed to be shell entity in terms of the LOB provisions of the India-Singapore DTAA and consequently the basic criteria for grandfathering benefits of the treaty is not satisfied
- PPT under MLI provides for an exception that benefit may not be denied if it is established that granting the benefit would be in accordance with the object and purpose of relevant treaty provisions
- If the Expenditure Test is read as the above exception provision of PPT, then the entity may be eligible grandfathering benefits

OECD Guidance On Selection Of Location: "Location Test"

- Availability of skilled, multilingual work force and directors with knowledge of regional business practices and applicable regulations
- Extensive tax treaty network
- Reliable regulatory and legal framework; business friendly environment
- Developed international trade and financial markets
- Political stability
- Sophisticated banking industry
- Lender and investor familiarity
- Lower operating cost
- Difficulties/ limitations of home jurisdiction are ironed out in SPV jurisdiction [Example H of OECD Commentary 2017]

CBDT:

- FAQ 2:"GAAR will not interplay with the right of taxpayer to select or choose method of implementing a transaction."
- FAQ 4:"GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply"

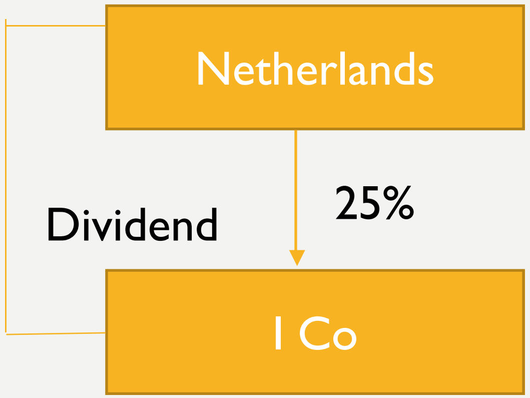
Article 8 - Dividend Transfer Transactions

- Article 8(1) of MLI introduces a minimum shareholding period of 365 days to avail benefit of lower tax on dividend paid on substantial participation holdings
- *"…………shall apply only if the ownership conditions described in those provisions are met throughout a 365 day period that includes the day of the payment of the dividends"*
- Meanings of "through out"-the whole time, all the time, right through
- Holding period of 365 days is not necessarily to be satisfied "before" the dividend is paid
- Condition can be satisfied before, after or spread over before and after the date of dividend payment
- While computing time threshold of 365 days, change in ownership due to corporate re-organisation (either of company receiving dividend or paying dividend) should be ignored
- Provision not to impact dividend clause that does not provide a condition of participation holding to claim lower rate of tax
- Lower rate for substantial participation is to "avoid recurrent taxation in (source) country facilitate international investments"

Article 8 - – Dividend Transfer Transactions

- India has opted to apply such provision (except in case of India-Portugal tax treaty, which has holding period of 2 years) and has notified 24 tax treaties
- With the recent amendments brought in Finance Act, 2020 abolishing Dividend Distribution Tax (DDT) payable by Indian companies and shifting the taxability of dividend income in the hands of shareholders, the anti-abuse provisions provided under Article 8 of MLI holds significant importance

Case Study

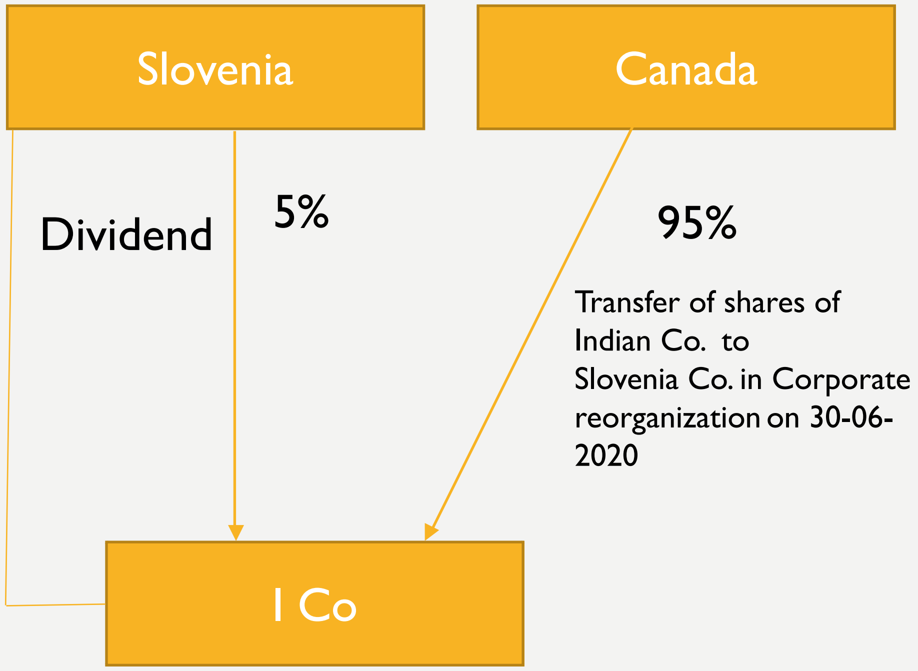


- Netherlands company has investment in I Co. I Co issued dividends.
- Article 10 in India-NH DTAA

"However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 10 per cent of the gross amount of the dividends."

- As per Delhi HC ruling in Concentrix case, lower tax rate 5% will apply through MFN clause
- Whether through MLI applicability on India-Slovenia DTAA, 365 day straddle period will apply to India-Netherlands DTAA?

Case Study



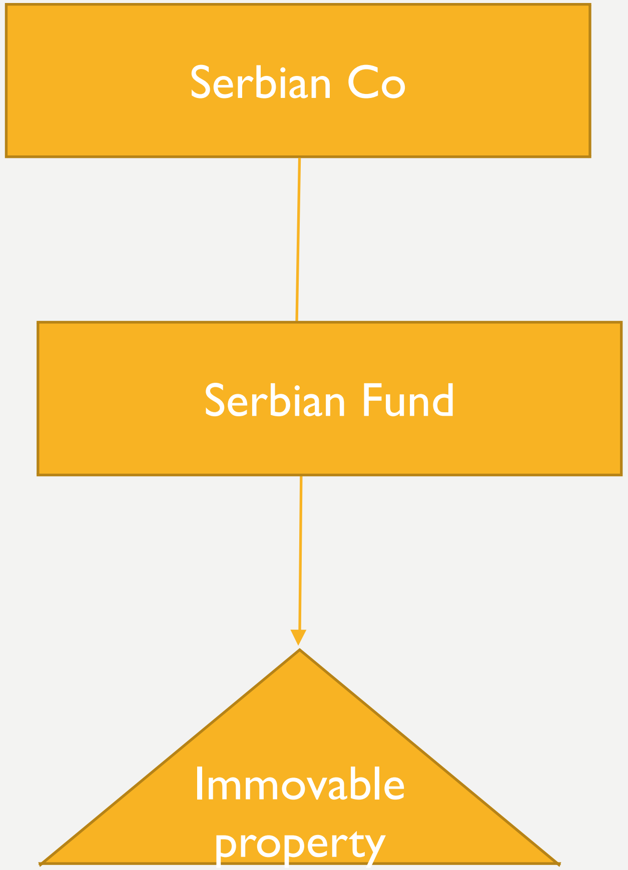
- WHT on dividend income
- India-Slovenia DTAA – (subject to 10% holding), else 15% WHT
- India-Canada DTAA – 15% (subject to 10% holding)

- Slovenia Co and Canada Co holds 5% and 95% shares in Indian Co respectively since 1-4-18
- Indian Co is contemplating to distribute dividend on 31-12- 20
- Canada Co. transfers shares of Indian Co. to Slovenia Co. in an intra-group corporate reorganization on 30-06-2020
- India and Slovenia MLI related changes become effective from 1 April 2020
- What rate do Indian Co need to WHT on dividend payments? – 5% or 15%?

Article 9 – Capital Gains From Alienation Of Shares Or Interests Of Entities Deriving Their Value Principally From Immovable Property

- Article 9 of MLI introduces anti-stuffing provision permitting indirect transfer of shares or interest in entity which derives value principally from immoveable property in source country.
- Principal value determination to be done at any time during 365 days preceding the alienation as against determination as of the date of transfer. (eg India Netherlands treaty, India-Australia DTAA)
- Substantial threshold at >50% to determine value derived from immovable property
  - India-France
  - India-Slovakia
- India has chosen to apply the option under article 9(4)
- The option only applies when the other contracting state has also opted for the same.
- India has made a policy choice to go for the minimum value and temporal thresholds explicitly laid down in article 9(4)
- It tightens the domestic position with respect to indirect transfer of shares deriving value from immovable property as the testing period is extended to the 365-day look-back period, unlike the domestic law which makes the evaluation at the time of the transfer or end of accounting period, preceding date of transfer.[

Case Study



Value of interest/initial assets in Serbian Trust ~ INR 150 Million on 13 October 2017 , Additional Serbian assets worth INR 175 Million were contributed to the Trust on 10 October 2018 , Serbian Co transferred its interest in the Trust on 13 October 2018

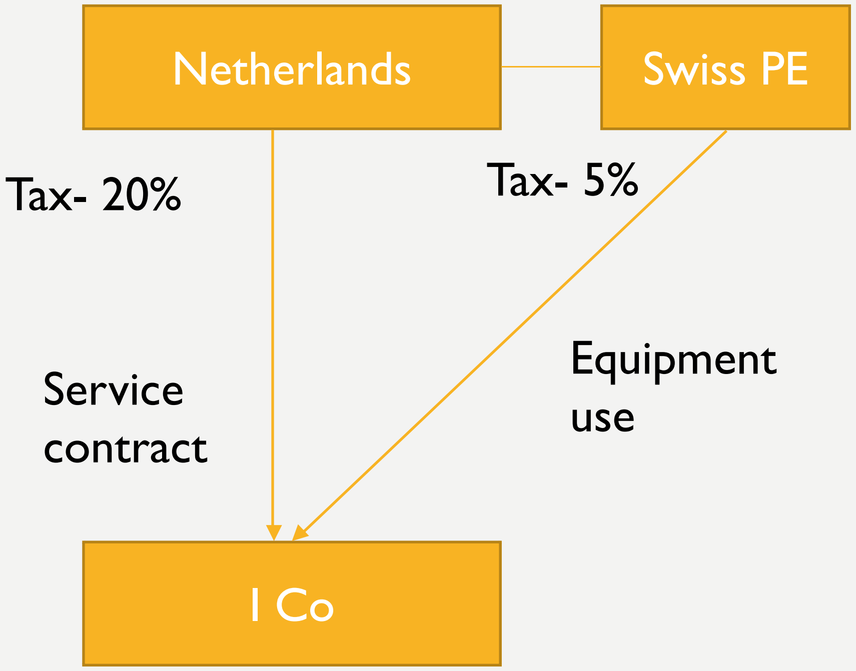
Value of immovable property ~100 Million

- Article 14(4) of India Serbia Tax Treaty reads as

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

- **Whether transfer of interest in Serbian Trust as on 13 October 2018 would be taxable in India under the amended provisions after MLI comes into effect for the India Serbia Treaty?**
- India Serbia are signatories to MLI, both have notified their treaty to be CTA, both have notified Article 14 4 of their treaty

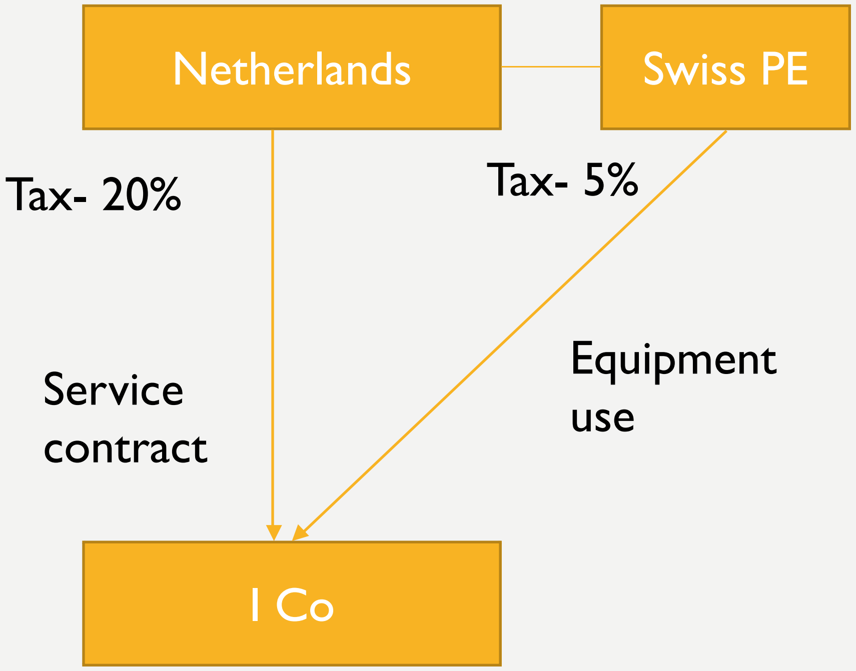
Article 10 - Anti-abuse Rule For Permanent Establishments Situated In Third Jurisdictions



S.115A-10%
India-NL DTAA – no equipment royalty

- NL Co, engaged in manufacturing and leasing of equipment,
- NL Co has a Swiss PE which maintains and manages equipments
- Swiss PE allows ICo right to use one of its equipments for which payment is made to Swiss PE
- "Royalty" Article of India-NL treaty does not cover equipment royalty
- NL Co has PE in Switzerland. NL grants exemption from tax in respect of PE income under NL-Swiss treaty (assumed)
- Tax rate in NL is 20% whereas tax rate in Swiss is 5% (assumed)

Article 10 - Anti-abuse Rule For Permanent Establishments Situated In Third Jurisdictions



S.115A-10%
India-NL DTAA – no equipment royalty

- As per Article 10 of MLI, the benefits of India-NL treaty shall not apply to any item of income -
- Where NLCo derives income from India and attributes such income to a PE in third jurisdiction (i.e. Switzerland);
- The profits attributable to the PE are exempt in Netherlands
- Rate of tax in Swiss is < 60% of the tax that would have been imposed if the PE was situated in Netherlands
- India will not grant benefit of India-NL treaty i.e. Royalty to become taxable @ 10% + SC under S. 115A
- Article 10 not to apply if income is derived in connection with or incidental to "active conduct of business" carried on through PE in Country B

Impact Of Article 10

- India has not made any reservation with respect to the applicability of this provision to its CTAs. Therefore, this article applies to those CTAs where the other treaty partners have not reserved or not notified this provision.

- By virtue of Article 10 of MLI, following aspects to be considered which determining tax taxability of NR in India:
- Does NR earn income in India through PE in third jurisdiction?
- If yes, what is taxability of such PE profits in NR's residence state?
- Also, at what rate is PE profits is being taxed in the PE state?
- The rationale behind Article 10 seems to:

"Where the State of residence exempts the profits attributable to such permanent establishments situated in third jurisdictions, the State of source should not be expected to grant treaty benefits with respect to such income"

- However, the hardships which such provision will put on source countries in terms of collection of information from NR with respect to taxability of PE profits seems not to have been considered

Article 11-Savings Clause

- Article 11 provides for a 'savings clause' which preserves right of resident State to tax its own residents
- Article 11 is not a minimum standard, countries free to opt out entirely by making reservation
- For countries that have not made any reservation on Article 11, the provision shall impact their CTAs
- India has not made any reservation on Article 11, there by implicitly accepting Article 11
- Article 11 will apply to all of India's CTAs unless specific reservations have been made by the other Contracting Jurisdiction
  - India-US already has this clause
  - India-China amended treaty also has this clause
- For instance, India's treaty with Japan, Singapore, Canada, South Africa, France not to be impacted by Article 11 by virtue of reservation placed by such countries
- However, India's treaty with UK, Australia, Russia, Belgium to be impacted by Article 11
- **Impact on Deemed residency provision?**

PART IV: AVOIDANCE OF PE STATUS

Article 12 - Artificial Avoidance of PE Status Through Commissionnaire Arrangements And Similar Strategies

- **Issue I : Commissionnaire arrangement**
- Contracts are concluded generally in the name of agent
- Foreign principle sells the goods directly to the customers
- The legal arrangement is between the customer and agent
- The foreign enterprise does not have PE as existing Article 5(5) relies on conclusion of contracts in the name of the foreign enterprise.
- Since the contracts are conc
- **Issue II : No final conclusion of contract in source state as they are finalised abroad even though contracts are substantially negotiated in the source State**
- **Issue III: Exception of "independent agent" applies even though it is closely related to the foreign enterprise on behalf of which it is acting.**

Article 12 - Artificial Avoidance of PE Status Through Commissionnaire Arrangements And Similar Strategies

Where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so,

- habitually concludes contracts, or
- ***habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise***

(sought to resolve Issue 2)

and these contracts are

- ***a) in the name of the enterprise; or***
- ***b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or***
- ***c) for the provision of services by that enterprise,***

(sought to resolve Issue 1)

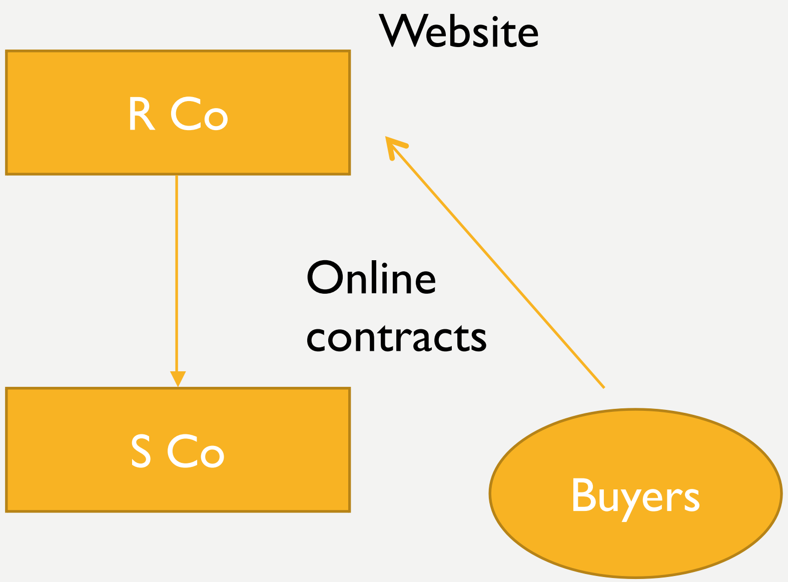
that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction

- A person will not be reckoned as an independent agent if a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related ***(sought to resolve Issue III)***

Article 12 - Artificial Avoidance of PE Status Through Commissionnaire Arrangements And Similar Strategies

- India has notified its treaties for the application of Article 12
- Indian treaty partners who have made reservation for not applying Article 12 to their Covered Tax Agreements
  - Austria
  - Australia
  - Finland
  - Georgia
  - Ireland
  - Luxembourg
  - Malta
  - Netherlands
  - Poland
  - UK
  - Switzerland
  - Sweden
  - UAE

Article 12



- Activities undertaken by SCO for sale of RCO's products:
- Emails, Telephone calls and personal visits
- Convince them to buy goods and services online
- SCO employees indicates the price that will be payable for that quantity, indicates that a contract must be concluded online with RCO before the goods or services can be provided by RCO
- SCO cannot makes any changes to the pricing or other terms of the contract

SCO's employees play the principal role leading to the conclusion of the contract between the account holder and RCO and such contracts are routinely concluded without material modification by the enterprise. The fact that SCO's employees cannot vary the terms of the contracts does not mean that the conclusion of the contracts is not the direct result of the activities that they perform on behalf of the enterprise.

Article 13 – Avoidance Of Pe Through Specific Activity Exemption

- Article 5(4) of the OECD Model Tax Convention allows an entity from state R to undertake specific exempted preparatory or auxiliary activities in state S without creating a PE in state S
- BEPS Concern:
- Activities performed in state S may in fact be value-added for the taxpayer's business
- Delivery of goods, Purchasing of goods or collecting information is core function
- Cohesive business activities are artificially fragmented

Option A

Activities listed under 5(4) → Exempted only if they are of a preparatory or auxiliary character

Option B → States that consider the activities listed in subparagraphs a) to d) of paragraph 4 to be intrinsically PoA and, therefore, should not be subject to that condition. Automatic exemption for such states

Article 13 – Anti-fragmentation rule

- OECD commentary (2014)

“27.1 Subparagraph f) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs a) to e) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. ***Places of business are not “separated organisationally” where they each perform in a contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.”***

Article 13 – Anti-fragmentation rule

- Anti-fragmentation provision covers situations where the combined activities of closely related persons at the same place or different places in the same country exceed what is considered to be preparatory or auxiliary
- Optional for parties to adopt, Article 13(4) may apply even if option A or B are not chosen

Condition 1:
Same enterprise or CRE carries on business activities at the same place or another place in the state

+

Condition 2
at least one of the places constitute a PE,
OR
overall activity resulting from the combination of the activities carried on by the two enterprises is not of a PoA character

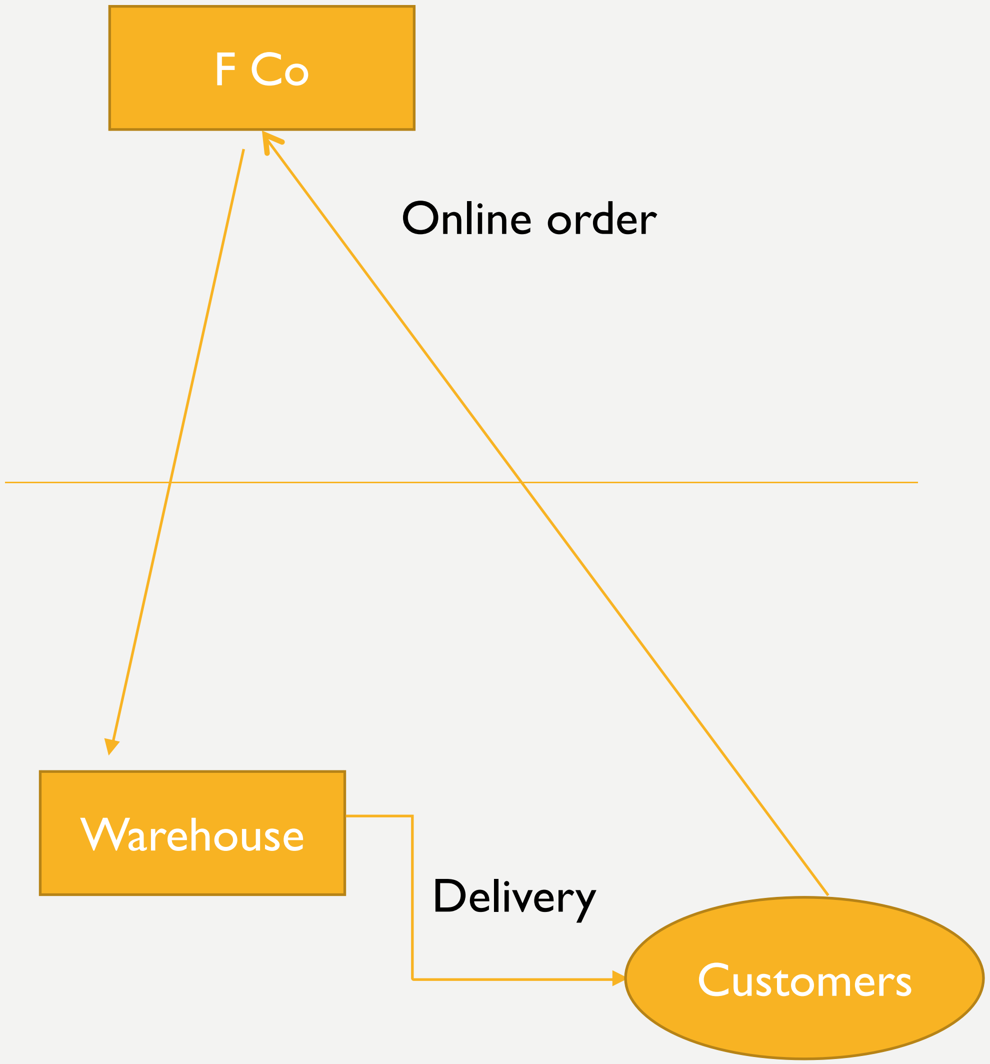
+

Condition 3
Aggregate business activities constitute complementary functions that are part of cohesive business operation

Article 13 – Avoidance Of Pe Through Specific Activity Exemption

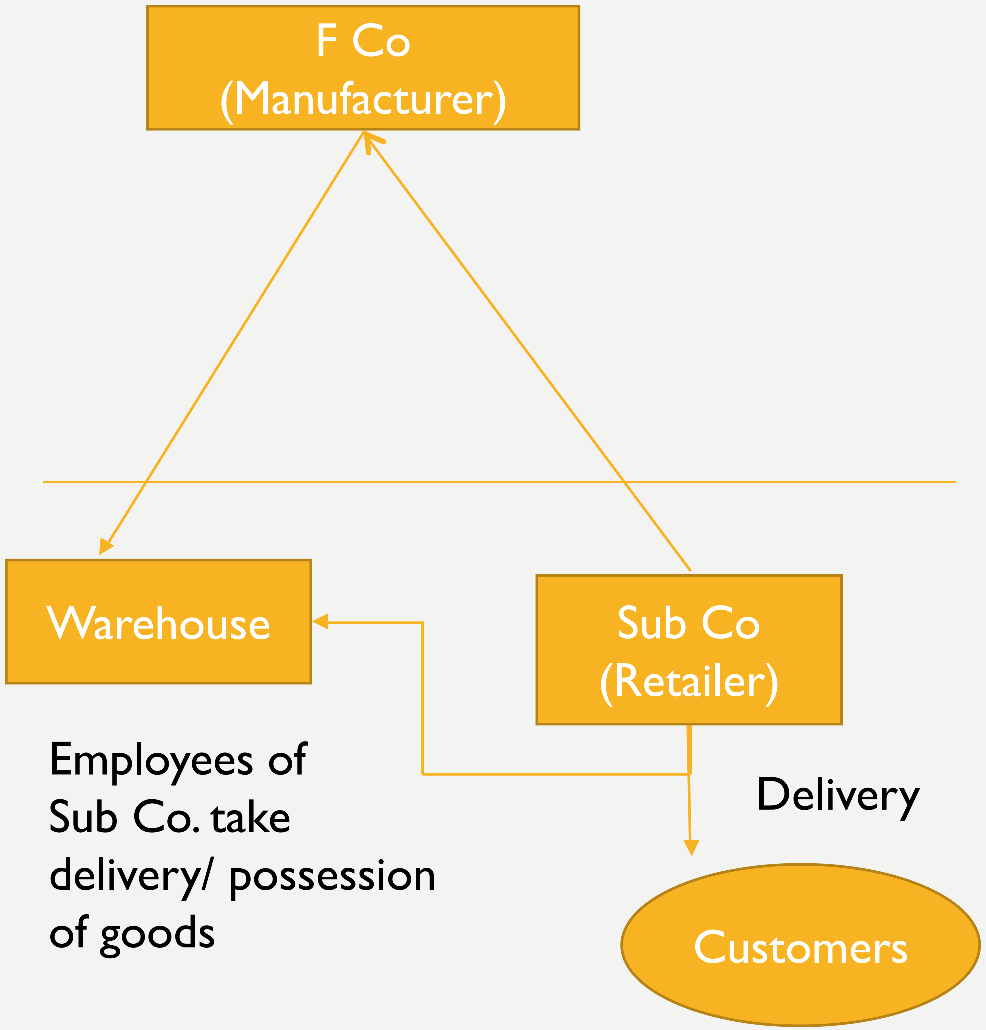
- India has opted for option A ie wherein PE exemption to listed activities under Article 5(4) shall be subject to activities being PoA in nature
- For Anti-fragment rule, India is silent, suggesting that the said anti fragment rule will be applicable
- Since the measure are optional and work only on symmetrical basis to modify CTAs, any option can apply on if both Contracting Jurisdictions to CTA make the "same" choice of option and/or anti-fragmentation rule
- Option A applies to following major treaties
  - Australia
  - Japan
  - Netherlands
  - Russia
- Anti-fragmentation rule applies to:
  - Australia
  - France
  - Netherlands
  - Japan
  - UK

Case Study



- F Co owns a website & online shopping app
- It acquires goods from unrelated suppliers and stores the same in a leased warehouse in India
- F Co's employees in the warehouse facilitate delivery of goods from warehouse to customers using independent delivery service providers
- F Co also has a WOS in India viz. Sub Co. carrying out merchandising and market research activities
- State R and India, both have opted for Option A [i.e. Article 13(2) of MLI]

Case Study



- F Co. is a manufacturer and trader of appliances;
- S Co., a WOS, owns a retail store in State S for selling appliances;
- F Co. also owns a warehouse in State S where a few high end appliances, identical to those sold by S Co., are stored;
- When a customer places large orders for such high-end appliances, employees of S Co. take delivery/possession of the same from the warehouse and in turn delivers the same to its customers

Article 14 – Splitting up of Contracts

(a) where an enterprise of State R carries on activities in State S at a place that constitutes a building site, construction project, installation project, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding 12 months

+

(b) where connected activities are carried on in State S at the same building site, construction or installation project, each exceeding 30 days, by one or more enterprises closely related to the first mentioned enterprise,

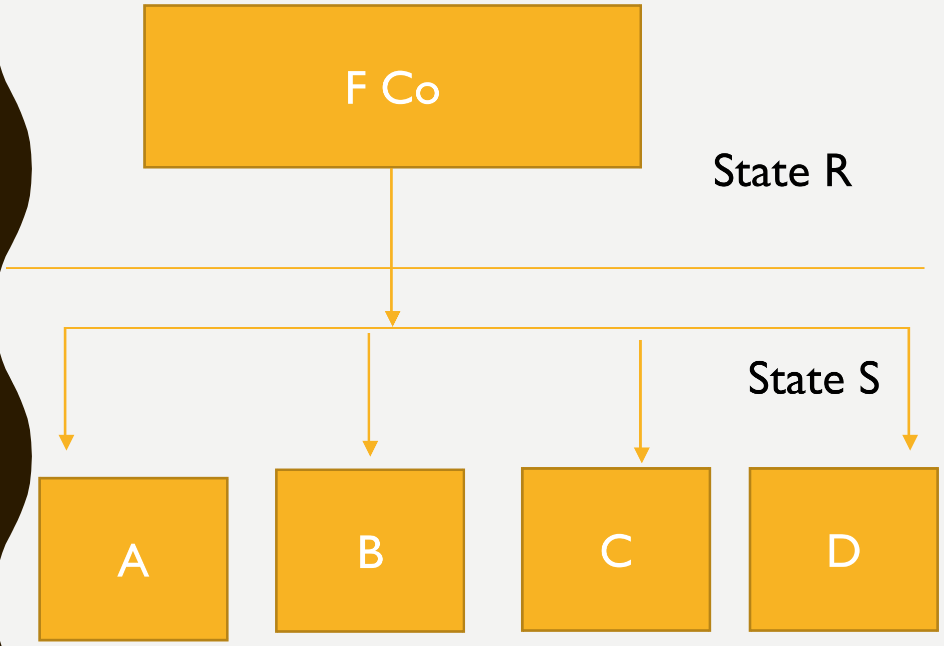
these different periods of time shall be added to the aggregate period of time during which the first-mentioned enterprise has carried on activities at that building site, construction or installation project,

India has neither notified this provision nor reserved its applicability. Therefore, this provision applies to India's CTAs to the extent the treaty partner has not reserved its applicability.

Article 14 – Splitting up of Contracts

- The determination of whether activities are connected will depend on the facts and circumstances of each case. Factors that may especially be relevant for that purpose include:
- whether the contracts covering the different activities were concluded with the same person or related persons;
- whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons;
- whether the activities would have been covered by a single contract absent tax planning considerations;
- whether the nature of the work involved under the different contracts is the same or similar;
- whether the same employees are performing the activities under the different contracts.

Article 14 – Splitting up of Contracts

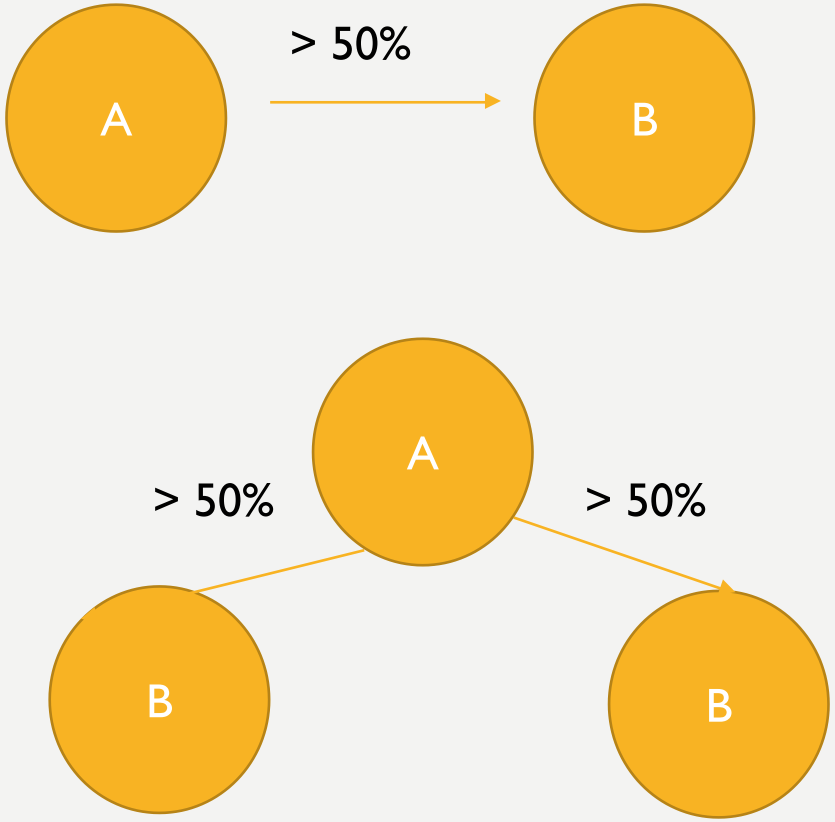


A	5
B	2
C	3
D	1

- F Co. is engaged in installation activities in relation to mineral oil exploration;
- It has executed four different contracts across State S with unrelated parties;
- As per Art. 5(3) of the R – S DTAA, "a building site or construction or assembly project or supervisory activities in connection therewith constitutes a Permanent Establishment , where such site, project or supervisory activity (together with other such sites, projects or activities, if any) continues for a period of more than nine months."

Article 15 – Closely Related Enterprises

- A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises.



MLI IMPLICATION ON WITHHOLDING TAXES

MLI Applicability on WHT

- **Whether the impact of MLI provisions to be considered at the time of discharging withholding tax obligations?**

- **Impact of MLI NOT to be considered**
- No specific onus on payer to apply anti-abuse provisions at the time of discharging WHT obligation except TRC / Form 10F
- Practical challenges for payer in terms of access to documents of payee, extent of verification - impossibility of performance

- **Impact of MLI to be considered**
- WHT obligation under section 195 is linked to taxability under section 5 and section 9 read with Section 90
- Potential consequences of WHT default i.e. disallowance of expenses, exposure of being treated as representative assessee, assessee-in-default, penalty
- Reference to Shome Committee Report on GAAR (Refer paragraph 3.23 of report)

Recommendations Of Shome Committee On GAAR

- Relevant Extract of Shome Committee's recommendations:

"In view of the above, the Committee recommends that, while processing an application under section 195(2) or 197 of the Act pertaining to the withholding of taxes,

(a) the taxpayer should submit a satisfactory undertaking to pay tax along with interest in case it is found that GAAR provisions are applicable in relation to the remittance during the course of assessment proceedings; or

(b) in case the taxpayer is unwilling to submit a satisfactory undertaking as mentioned in (a) above, the Assessing Officer should have the authority with the prior approval of Commissioner, to inform the taxpayer of his likely liability in case GAAR is to be invoked during assessment procedure.

There is a responsibility cast on the payer of any sum to a non-resident under Indian tax laws in the form of a withholding agent of the Revenue as well as representative assessee of the non-resident payee. The payer is required to undertake due diligence to ascertain the correct amount of tax payable in India and, in case of any default, it becomes the payer's liability to pay…"

Undertakings/Indemnities From Non-resident Payee

- Eligible to qualify as 'person' under Article 3 of Treaty
- Resident of contracting jurisdiction and has obtained Tax Residency Certificate
- Does not have / Do not intend to have a Place of Effective Management in India
- Does not have / Do not intend create Permanent Establishment in India
- Eligible to claim Treaty benefits and satisfies 'Principle Purpose Test'
- Indemnity Clause
- Beneficial owner of the income
- PE in third state

Maintaining robust documentation is the key!

WAY FORWARD!

- Future is going to be more complex with MLI 2.0
- The treaty interpretation is going to be based on synchronized reading of MLI 2.0 (Pillar 1), MLI 1.0, tax treaties and domestic tax law
- New rules are emerging under Global Minimum Tax that needs attention
  - STTR
  - IIR
  - UTPR
- Interesting times ahead for the international tax professionals
- An overhaul in interpretation of tax treaties

Thanks !

THANKS !

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