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TAX FLASH NEWS

27 June 2019

India deposits instrument of ratification for MLI with OECD

India, amongst 67 countries, had signed the Multilateral Convention (the Convention/MLI) in Paris on 7 June 2017 to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS). The Convention is an outcome of the Organisation for Economic Co-operation and Development (OECD)/ G20 Project to tackle BEPS i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The Convention enables all signatories, inter alia, to meet treaty related minimum standards that were agreed as a part of the final BEPS package. The Convention will operate to modify tax treaties between two or more parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement (CTA). Instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures.

At the time of signature, India has submitted the provisional MLI position indicating the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories had the option to amend their MLI positions until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations.

On 25 June 2019, India has deposited its instrument of ratification for MLI. It has also deposited list of reservations and notifications made. The key changes in the instrument of ratification deposited by India are as follows:

Article 2 - Notification - Agreements Covered by the Convention

While signing India has provided a list of CTAs with 93 countries/jurisdictions. Now, India has removed China from and included Hong Kong in the list its CTA.

Article 5 of MLI - Application of methods for elimination of double taxation

Article 5 provides three alternative ways (Option A or B or C) for elimination of double taxation. It can address problems arising from the inclusion of the exemption method in tax treaties with respect to income that is not taxed in the state of source.

At the time of signing of the MLI, India had reserved the right for the entirety of the Article 5 not to apply to its CTAs.

However, now India has adopted Option C under Article 5 of MLI which is as follows:

- Where a resident of a Contracting Jurisdiction derives income or owns capital which may be taxed in the other Contracting Jurisdiction in accordance with the provisions of a CTA, the first-mentioned Contracting Jurisdiction shall allow:

  - as a deduction from the tax on the income/capital of that resident, an amount equal to the income/capital tax paid in that other Contracting Jurisdiction

  Such deduction shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable to the income or the capital which may be taxed in that other Contracting Jurisdiction.

- Where in accordance with any provision of the CTA income derived or capital owned by a resident of a Contracting Jurisdiction is exempt from tax in that Contracting Jurisdiction, such Contracting Jurisdiction may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

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The provisions under Option C shall apply in place of provisions of a CTA that, for purposes of eliminating double taxation, require a Contracting Jurisdiction to exempt from tax in that Contracting Jurisdiction income derived or capital owned by a resident of that Contracting Jurisdiction which, in accordance with the provisions of the CTA, may be taxed in the other Contracting Jurisdiction (exemption provision). The country which chooses Option C has to notify the list of its CTAs[1] which contain such exemption provision is to be notified. India has notified that Bulgaria, Egypt, Greece and Slovak Republic contains exemption provision.

Article 7 of MLI - Prevention of Treaty Abuse

In MLI, Article 7 provides three approaches for prevention of treaty abuse:

- Principal Purpose Test (PPT)
- Simplified Limitation of Benefits (LOB) provisions
- Detailed LOB provisions

At the time of signing the MLI, India had opted to apply the PPT with 'simplified LOB' provisions in respect of its CTAs.

Now, in addition to above, India has stated that while India accepts the application of PPT clause under Article 7(1) of the MLI alone as an interim measure, it intends where possible to adopt a limitation on benefits provision, in addition to or in replacement of Article 7(1), through bilateral negotiation.

Article 35 – Entry into Effect

The MLI shall enter into force on the first day of the month after the expiry of three months from the date of deposit of ratified copy of the MLI with OECD. As an ordinary rule, once MLI has come into force for both the treaty countries, the latter date of coming into force is relevant for determining the date of entry into effect of the MLI.

However, at the time of signing, India reserved the right for an optional provision under the MLI, pursuant to which, date of entry into effect for India's CTAs shall be determined from '30 days from latter of the dates on which OECD receives notification from India and its treaty partner about completion of its respective internal procedures'. Now, India has removed such reservation.

For India the MLI shall enter into force on the first day of the month after the expiry of three months from the date of deposit of ratified instrument of the MLI with OECD i.e. on 1 October 2019.

It is important to note that India has retained its option to substitute 'taxable period' for 'calendar year' to arrive date of entry into effect. Further India has retain its stand for not opting Part VI of the Convention [which deals with Mandatory Binding Arbitration].

Accordingly, effective date of entry into effect will be as under:

- For withholding taxes - 1st day of next taxable period that begins on or after the latest of the dates on which this Convention enters into force for each of the contracting jurisdictions to the CTA

- For other taxes - Taxable period that begins on or after expiry of six calendar months from the latest of the dates on which this Convention enters into force for each of the contracting jurisdictions to the CTA.

Our comments

India is 28th country which has ratified and deposited MLI instrument with the OECD. Accordingly, now the MLI will come into force in India with effect from 1 October 2019. Out of all the countries who have already ratified and deposited the instrument of MLI, 22 countries are forming part of India's Covered Tax Agreements (CTAs) and they have also chosen India in their CTAs for e.g. Australia, France, Japan, the Netherlands, Singapore, the U.K., etc. Thus in respect of such countries, the MLI will be effective from financial year 2020-21 with respect to withholding taxes as well as other taxes.

For those countries who will ratify and deposit instrument for MLI post 30 June 2019, one needs to carefully evaluate the entry into effect date vis-à-vis Indian tax treaties. In such cases, the entry into effect date may depend upon various parameters like the other country may have opted for '30 days period' clause. Further the difference can be due to India following a 'fiscal year' whereas the other country is following a 'calendar year'.

The PPT under the MLI is broader in scope than the General Anti-Avoidance Rule (GAAR) under the Income-tax Act, 1961 as the GAAR applies only if the 'main purpose' of the arrangement is to obtain a tax benefit whereas the PPT may apply if obtaining a benefit of the tax treaty was one of the principal purposes. Further, GAAR provides a threshold for its applicability which is absent in PPT.

[1] Including article and paragraph number of each such provision

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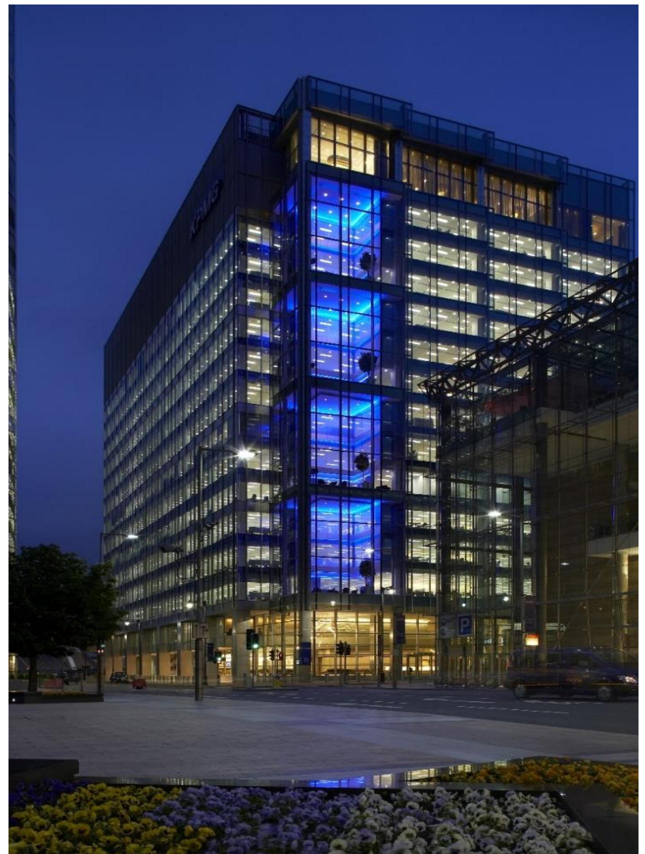
Further with respect to PPT clause, India has additionally provided that while India accepts the application of PPT clause alone as an interim measure, it intends where possible to adopt a limitation on benefits provision, in addition to or in replacement of PPT, through bilateral negotiation.

India intends to apply credit method to avoid double taxation under certain tax treaties where exemption method is available for e.g. Bulgaria, Egypt, Greece, etc. This is in line with the position of India under other tax treaties as India generally does not employ the exemption method of eliminating double taxation in its bilateral tax treaties and prefers to use the credit method.

In a short span the MLI will come into effect. However, mere ratification and deposit of the MLI by India along with its positions may not lead to modification of the tax treaties. Those treaty countries who have taken a position similar to India's position will undergo a change. Therefore, it is important to evaluate the impact of MLI provisions on each treaty by comparing India's position or reservations with the position taken by the treaty partner country.



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