



## India signs the Multilateral Convention

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India, amongst 67 countries, has 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). More countries are expected to sign the Convention in coming days.

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 MLI was developed by a group of over 100 countries and jurisdictions. Various developing countries have also shown great interest in signing the MLI and have started their technical preparations to sign.

The Convention enables all signatories, inter alia, to meet treaty related minimum standards that were agreed as 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<sup>1</sup> (CTA). Instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures.

The provisional MLI position of each signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI positions until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations. For example, while 25 Signatories have chosen to apply the MLI arbitration provisions, additional signatories can choose to apply those provisions later.

### **Key features of the provisional list of expected reservations and notifications which India has submitted are as follows:**

#### **I. Transparent entities**

Under MLI, Article 3 provides that income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either contracting jurisdiction shall be considered to be income of a resident of a contracting jurisdiction but only to the extent that the income is treated, for purposes of taxation by that contracting jurisdiction, as the income of a resident.

Most of India's tax treaties do not have specific provisions dealing with fiscally transparent entities.

#### ***India position***

India has decided that it will not apply this Article to any of its CTAs. Hence, this provision does not affect any of India's tax treaties.

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<sup>1</sup> Please find an Annexure providing the list of countries which have either listed or not listed India under the CTA.

## II. Dual Resident Entities

Article 4 is intended to modify the tie-breaker test under treaties for persons other than individuals. It provides that in cases where a person is a resident of more than one contracting state, its residency shall be determined by means of mutual agreement of the competent authorities of both the countries. In such cases, the competent authorities shall have regard to the place of effective management, the place of incorporation or other relevant factors. More importantly, it provides that in the absence of any agreement between the competent authorities, the dual-resident entity shall not be entitled to any relief or exemption from tax under the tax treaty, except as agreed by the competent authorities.

### **India position**

India has not made any reservation in respect of this Article. As per MLI, each party that has not made a reservation shall notify the depositary of whether each of its CTAs contains a similar kind of provision like above provision. Accordingly, India has given the list of its CTAs.

However, its applicability to India's treaties will depend on whether its treaty partners have chosen to accept this Article or to exclude its applicability altogether.

## III. Application of methods for Elimination of Double Taxation

Article 5 provides three alternative ways for elimination of double taxation. It can address problems arising from the inclusion of the exemption method in treaties with respect to income that is not taxed in the State of source.

### **India position**

India has decided that it will not apply this Article to any of its CTAs. Hence, this provision does not affect any of India's tax treaties.

## IV. 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

The MLI gives option to countries to adopt one of the above approaches.

### **India position**

India has opted to apply the 'simplified LOB' provisions in respect of its CTAs. Further India will also follow PPT approach in addition to simplified LOB provisions.

As per MLI, each party that chooses to apply the simplified LOB provision has to notify the depositary of its choice. Further, since India has not made any reservations, it has also given the list of its CTAs which contain a similar kind of provision like simplified LOB.

As per MLI, each party that has not made the reservation under Article 7(15)(a) shall notify the depositary of whether each of its CTAs contains a similar provision like a PPT provision. Accordingly, India has given the list of its CTAs.

However, its applicability to India's treaties will depend on whether its treaty partners have also chosen to adopt the Simplified LOB.

## V. Dividend Transfer Transactions

The MLI in Article 8 provides for exemption from tax or reduced rate of tax on dividends paid by a company in case where the beneficial owner or the recipient is a company and which owns, holds or controls more than a certain amount of the capital, shares, stock, voting power, voting rights or similar ownership interests of the company paying the dividends. This requires ownership conditions are met throughout a 365 day period that includes the day of the payment of the dividends.

### **India position**

India has reserved the applicability of this provision in the case of Portugal as there already exists a minimum holding period longer than the 365 day period mentioned in Article 8. India has further notified 21 countries where the restriction of the holding period has not been prescribed.

However, its applicability to India's treaties will depend on whether its treaty partners have also chosen to adopt these provisions.

## VI. Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

The MLI in Article 9(1) provides for a situation which exists in certain tax treaties where gains derived by a resident from the alienation of shares or other rights of participation in an entity may be taxed in the source state provided that these shares or rights derived more than a certain part of their value from immovable property situated in the source state and shall apply:

- If the relevant value threshold is met at any time during the 365 days preceding the alienation; and

- To shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions.

It is also provided in Article 9(4) that gains derived by a resident of a Contracting state from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the source state if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction. This provision will be applied in case of absence of this provision of a CTA.

### **India position**

India has opted to choose both the aforementioned provisions. As per MLI, each Party that has not made the reservation shall notify the depositary of whether each of its CTAs contains a provision as per Article 9(1) described. Accordingly, India has given the list of the CTA's.

Each Party that chooses to apply Article 9(4) above shall notify the depositary of its choice.

However, its applicability to India's treaties will depend on whether its treaty partners have also chosen to adopt these provisions.

### **VII. Artificial avoidance of PE status through commissionaire arrangements and similar strategies**

Article 12 addresses cases of artificial avoidance of Permanent Establishment (PE) status through Commissionaire Arrangements and similar strategies. It provides that a PE will include:

- where a person is acting in a contracting jurisdiction on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:
  - in the name of the enterprise; or
  - 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

- for the provision of services by that enterprise.

- Above paragraph shall not apply where the person acting in a contracting jurisdiction on behalf of an enterprise of the other contracting jurisdiction carries on business in the first-mentioned contracting jurisdiction as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent with respect to any such enterprise.

### **India position**

India has not made any reservations on this Article. India has accepted the above provisions. As per MLI, each party that has not made a reservation has to notify the depositary of whether each of its CTAs contain similar provisions like above. Accordingly, India has given the list of its CTAs.

However, its applicability to India's treaties will depend on whether its treaty partners have also chosen to adopt these provisions.

### **VIII. Artificial avoidance of PE status through the Specific Activity Exemptions**

Article 13 provides for two options to address artificial avoidance of PE status through the specific activity exemptions:

#### **Option A**

The term PE shall be deemed not to include:

- The activities specifically listed in the CTA as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character;
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in above point;

- The maintenance of a fixed place of business solely for any combination of activities mentioned in above points

provided that such activity or, in the case of last point, the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

## Option B

The term PE shall be deemed not to include:

- The activities specifically listed in the CTA as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the relevant provision of the CTA provides explicitly that a specific activity shall be deemed not to constitute a PE provided that the activity is of a preparatory or auxiliary character;
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in above point, provided that this activity is of a preparatory or auxiliary character;
- The maintenance of a fixed place of business solely for any combination of activities mentioned in above points, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

## India position

India has opted for Option A i.e. in addition to falling under specific activities listed in exclusions under PE Article, it will additionally be necessary to prove that these activities are of a preparatory and auxiliary character. As per MLI, each party that chooses to apply an Option has to notify the depositary of its choice of Option. It shall also include list of CTAs contain similar provisions like above. Accordingly, India has given the list of its CTAs.

However, its applicability to India's treaties will depend on whether its treaty partners have also chosen to adopt the same option.

## Our comments

The day, 7 June 2017, would probably go down in history as the turning point in the entire progression of international tax laws and the bilateral tax treaties. With the MLI being signed by around 67 countries and it involves around 2,360 tax treaties that could be modified under the agenda of BEPS, the MLI has seen a new dawn on the entire process of a tax treaty negotiation. This process was being carried out by all the countries involved in the last five months since the time the MLI opened up for signature on 31 December 2016.

The key to the success of the MLI could be the flexibility that is afforded to the countries to adopt the BEPS measures either through the MLI or through the bilateral tax treaties. Switzerland for instance has decided to implement the BEPS minimum standards into its tax treaties either within the framework of the MLI or by means of the bilateral negotiation of tax treaties. A 'one size fits all' provisions if mandated under the MLI would have been self-defeating to the very purpose of BEPS as most countries would not be expected to adopt all the recommended BEPS measures considering their economic global equation vis-à-vis their trading partners'.

In the context of treaty abuse, which is one of the most important BEPS Actions, many countries in the past including India have incorporated the anti-abuse provisions (LOB Article) in the bilateral tax treaties<sup>2</sup>.

In the context of treaty abuse, it would interesting to note that Mauritius has committed to sign the MLI by 30 June 2017, thus demonstrating its dedication to curb base erosion and fight international tax avoidance. What would be adopted by Mauritius would be keenly awaited by many stakeholders around the world.

Further, 12 signatories including India have chosen to supplement the provisions of the Principal Purposes Test with a simplified Limitation on Benefits test. Whether these will see the light of the day would depend on if the same are ratified by the corresponding country as well. It would be interesting to see how these amendments impact the grandfathering provisions in the existing bilateral tax treaties entered into by India with Mauritius.

<sup>2</sup> India-Mauritius, etc.

Now that the PPT will be introduced in a large number of treaties, the treaty shopping routes which typically involved the use of layered structures abusing the provisions of multiple tax treaties can be targeted effectively.

The MLI addresses challenges related to PE's only by modifying the PE definition in CTA. However, what the MLI does not change is the rules on the attribution of profits to PE's in Article 7.

It would also be interesting to see the extent of US participation in the MLI process as active action is yet to be seen from the US' end in the entire BEPS agenda and one could expect the US to step in sooner than later to tackle the global issues emanating out of BEPS.

With the MLI soon to be ratified in the days to come the OECD will play a major role in tracking the list of ratifications including the reservations and options, submitted by the countries, and this could set the path for the peer review process which is the next phase of the MLI process.

Though this is a new concept adopted to amend the bilateral tax treaties, one can hope that much is achieved through the MLI platform as it would be in the best interest of fair tax revenues of the governments of various jurisdictions across continents.



## Annexure A

### List of countries/jurisdictions which have listed India under the covered tax agreements

Armenia	Korea
Australia	Kuwait
Austria	Latvia
Belgium	Lithuania
Bulgaria	Luxembourg
Canada	Malta
Colombia	Mexico
Croatia	Netherlands
Cyprus	New Zealand
Czech Republic	Poland
Denmark	Portugal
Egypt	Romania
Fiji	Russia
Finland	Serbia
France	Singapore
Georgia	Slovak Republic
Greece	Slovenia
Hungary	South Africa
Iceland	Spain
Indonesia	Sweden
Ireland	Switzerland
Israel	Turkey
Italy	United Kingdom
Japan	Uruguay

## Annexure B

### List of countries/jurisdictions which have not listed India under the covered tax agreements

Andorra	Isle of Man
Argentina	Jersey
Burkina Faso	Liechtenstein
Chile	Monaco
China (People's Republic of)	Norway
Costa Rica	Pakistan
Gabon	San Marino
Germany	Senegal
Guernsey	Seychelles
Hong Kong (China)	

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