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TAX FLASH NEWS

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Australia releases synthesised text for the application of the Australia-India tax treaty as modified by MLI

Background

Recently, the Government of Australia has released the synthesised text for the application of the tax treaty between of Australia and India as modified by the Multilateral Convention (MLI) to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS). This document was prepared on the basis of the reservations and notifications submitted to Organisation for Economic Co-operation and Development (OECD) under MLI by Australia on 26 September 2018 and by India on 25 June 2019 respectively.

Key highlights of the synthesised text are summarised as follows:

Applicability of MLI provisions

The MLI has come into force for Australia on 1 January 2019

- With respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after 1 January 2020; and
- With respect to all other taxes levied by Australia, for taxes levied with respect to taxable periods beginning on or after 1 April 2020

The MLI enters into force for India on 1 October 2019 and thus has effect as follows:

- With respect to deduction of tax at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the next taxable period that begins on or after 1 October 2019 i.e. for transaction on or after 1 April 2020.
- With respect to all other taxes levied by India, for taxes levied with respect to taxable periods beginning on or after 1 April 2020.

Preamble

The scope of the existing preamble is expanded to include MLI minimum standard (Article 6 – Purpose of Covered Tax Agreement). The following preamble text is now included in the tax treaty in addition to the existing:

'Intending to eliminate double taxation with respect to the taxes covered by the Convention without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Convention for the indirect benefit of residents of third jurisdictions.'

Limitation of benefits

The synthesised text introduced LOB provisions (Principal Purpose Test) in the tax treaty to provide that a benefit under the tax treaty shall not be granted in respect of an item of income 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 tax treaty.

Permanent Establishment

Spitting-up of contracts

The existing tax treaty under Article 5(2)(k) provides that the Permanent Establishment (PE) shall include a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than 6 months.

The synthesised text amended the said provision to provide that for the sole purpose of determining whether the period referred above (for determination of PE) has been exceeded or not:

- Where an enterprise of a state carries on activities in the other state at a place that constitutes a building site or construction or assembly project, or other specified project as specified in the Article 5(2)(k) or carries on supervisory activities in connection with such a place, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding specified period or periods under Article 5(2)(k); and
- Where connected activities are carried on in that other state at or, where Article 5(2)(k) applies to supervisory activities, in connection with the same building site, construction project, installation project or other specific project identified in Article 5(2)(k) during different periods of time, 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 or construction or assembly project, or supervisory activities in connection therewith.

Specific activity exemptions

The existing tax treaty provides the specific activity exemptions under the definition of PE which provides list of activities that do not amount to a PE if a fixed place of business is used solely for such activities.

The synthesised text provides to modify the said provisions to the extent that (i) all activities currently included in the tax treaty (whether or not they are preparatory or auxiliary nature); (ii) any other activity not already mentioned in the tax treaty and (iii) any combination of activities in (i) and (ii) shall fall within the specific activity exemptions only if such activity (or the overall activity of the fixed place of business from a combination of activities) is of a preparatory or auxiliary character.

Splitting-up of business activities in order to fall within specific activity exemption

Large multinational enterprises splitting up their business activities or altering their structures in order to fall within the specific activity exemptions.

The synthesized text provides that the specific activity exemptions that deem a fixed place of business to not amount to a PE shall not apply where the relevant enterprise, or a closely related enterprise, carries on business activities at the same fixed place or a different place in the same state and

- such place constitutes a PE; or
- the overall activity resulting from the combined business activities of either one enterprise or two closely related enterprises operating in two fixed places or two enterprises operating in one fixed place, is not of a preparatory or auxiliary character.

Provided that the business activities conducted by the enterprise or the two closely related enterprises must constitute complementary functions that are part of a cohesive business operation.

Definition of a person closely related to an enterprises

The synthesised text with respect to PE provides a phrase ‘a person closely related to an enterprises’ in various provisions. Accordingly, the synthesised text provides that a person is closely related to an enterprise if, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise:

- If one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or
- If another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) in the person and the enterprise.

Residence

The existing tax treaty provide tie-breaker test whereby if a person other than an individual is a resident of both states, then it shall be deemed to be a resident solely of the state in which its place of effective management is situated.

The synthesised text provides a new tie-breaker test to provide that where by reason of the provisions of the tax treaty a person other than an individual is a resident of both the states, the competent authorities shall endeavour to determine by mutual agreement, the state of which such person shall be deemed to be a resident for the purposes of the tax treaty, 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 tax treaty.

Capital gains

The existing tax treaty provides that income or gains derived from the alienation of shares or comparable interests in a company, the assets of which consist wholly or principally of real property referred to in Article 6 and, as provided in that Article, situated in one of the States, may be taxed in that State.

The synthesised text provides that the above provisions shall apply if the relevant value threshold is met at any time during the 365 days preceding the alienation; and shall apply 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 of the tax treaty.

Mutual Agreement Procedure (MAP)

The existing Article 25(3) dealing with MAP provides that the competent authorities of the Contracting States shall jointly endeavour to resolve any difficulties or doubts arising as to the application of this tax treaty. Now the following articles applies to the existing article:

The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the tax treaty. They may also consult together for the elimination of double taxation in cases not provided for in the tax treaty.

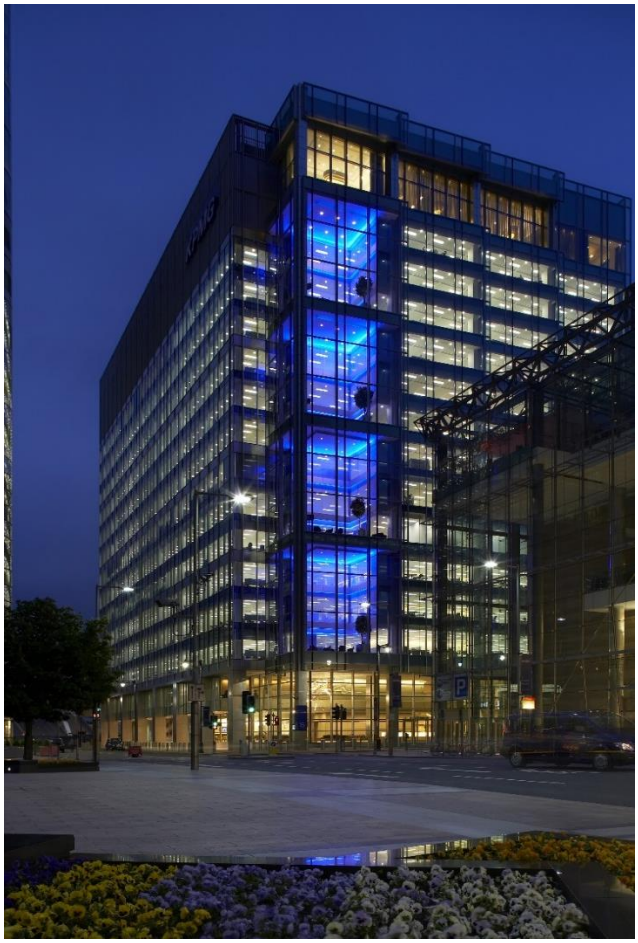
Our comments

The synthesised text introduces a new tie-breaker test for a person other than individual. It provides that in the absence of any agreement between the competent authorities which is likely in the case of dual resident entities, such entities shall not be entitled to any relief or exemption of the tax treaty. This may result into protracted litigation and unnecessary tax burden on the taxpayer.

The PPT under MLI and synthesised text of the Australia-India tax treaty is broader in scope than the General Anti-Avoidance Rule (GAAR) under the Income-tax Act, 1961.

The synthecised text has made changes in the PE clause with respect to specific activity exemptions that are likely to impact multinational companies who have been availing specific activity exemption under the Australia-India tax treaty. Further now the segregation of business activities within the group company will also be impacted.

In view of above changes in the India-Australia tax treaty, transactions between Australian and Indian entities need to be relooked at and appropriate steps should be taken to avoid any tax litigations in India.



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