

TAX FLASH NEWS

13 February 2020



India releases synthesised text for the application of tax treaty with Luxembourg as modified by the MLI

Recently, the government of India has released synthesised text for the application of tax treaty with Luxembourg as modified by the Multilateral Convention (MLI) to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS). The synthesised text is prepared on the basis of the reservations and notifications submitted to Organisation for Economic Co-operation and Development (OECD) by both the countries.

Key highlights of the synthesised text is as follows:

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

- 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 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.

The MLI enters into Luxembourg on 1 August 2019 and thus has effect as follows:

- 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;
- With respect to all other taxes levied by Luxembourg, 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 preamble of the tax treaty:

‘Intending to eliminate double taxation with respect to the taxes covered by this Agreement 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 this Agreement for the indirect benefit of residents of third jurisdictions)’.

Limitation of Benefit

The existing Limitation of Benefit (LOB) clause under the tax treaty provides that an enterprise of a Contracting State shall not be entitled to the benefits of the tax treaty if the main purpose or one of the main purposes of the creation of such enterprise was to obtain the benefits under the tax treaty that would not otherwise be available. Further the case of legal entities not having bona fide business activities were covered by LOB provisions.

The above LOB provisions are replaced by the new LOB provisions under MLI. The new LOB provisions provide that the benefit under the tax treaty 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 tax treaty.

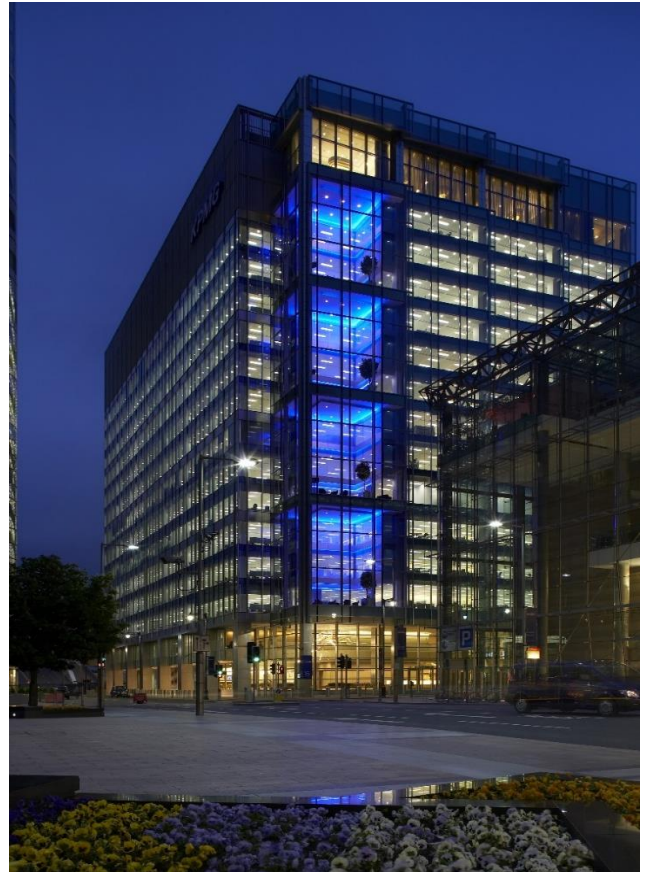
Our comments

The PPT clause under the synthesised texts of the Indian treaty with Luxembourg 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. GAAR provides threshold for its applicability which is absent in PPT. Further LOB clause does not provide for grandfathering provisions like GAAR.

The new preamble intends to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

In view of above changes, the transactions /arrangements between the Luxembourg and Indian entities need to be relooked at and appropriate steps should be taken to avoid tax litigations.



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