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DECODING MLI – IMPACT ON INDIAN TAX TREATIES

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ABSTRACT

"Taxes are the lifeblood of government and no taxpayer should be permitted to escape the payment of his just share of the burden of contributing thereto." - Arthur Vanderbilt (Former American Judge and Judicial Reformer)

Businesses have been ever growing at a fast pace since the last decade or two. This has been a very positive sign for countries around the world as more business transactions would circulate more money leading to an encouraging economic growth. Further, with globalization and integration of markets, it has become very favorable for governments as they see increase in revenue with every cross – border transaction.

However, there are two prominent tax issues faced by international tax systems. One is about the problem of Double taxation which means taxation by both the countries; in the country where it resides and the country where it sells. Two, the problem is about double no taxation; where in neither of the jurisdictions entities pay tax though they accrue revenue leaving governments and other tax payers vulnerable to losses.

Both the problems are an impediment to the natural growth of tax systems and thereby effecting the overall economic development. The former problem is being addressed with various bilateral treaties between countries regarding Double Taxation Avoidance Agreement. However, the latter problem was not yet discussed or dealt with until the BEPS Project was launched by OECD. Later, to further the purposes of the BEPS Schemes, Multilateral Instrument (MLI) was formulated in order to specifically deal with this problem of double no taxation.

The paper tries to elucidate the purpose, meaning, origin and provisions of MLI while stating some of its drawbacks. The paper analyses its impact and how India has ratified the instrument with requisite changes.

INTRODUCTION:

Prevention of double taxation has always been on the international radar. Countries have been trying to encourage businesses around the world by ideally taxing once based on their place of establishment and various other agreements. However, this has led to a lot of Multinational corporations finding ways to circumvent high taxation countries or worse, find ways to evade tax altogether. This is the foundation of the concept Base Erosion and Profit Shifting (BEPS). It describes a situation wherein multinational enterprises exploit gaps and mismatches between different countries' tax systems affecting all countries and the entire economy. The BEPS Project, launched during the 2008 financial crisis had the following goal: revising the international tax framework to align it with developments in the global economy, and ensure that profits are taxed where economic activities are carried out and value is created.

The OECD Countries and G20 governments came together in 2013 to address the issue of tax avoidance, and agreed a series of actions to tackle it. Thereby, an action plan was released on Base Erosion and Profit Shifting (BEPS). Under this treaty, more than 125 countries are collaborating to put an end to tax avoidance strategies that exploit gaps and mismatches in tax rules to avoid paying tax.

In order to strengthen and implement tax treaty related measures of the BEPS project, Multilateral Instrument treaty has been entered into by the countries on 24 November 2016 when the OECD published a 49-page MLI as well as an accompanying 86-page explanatory statement. This treaty is called the Multilateral Convention to implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting and consists of 39 Articles under its structure. MLI allows governments to modify application of its network of bilateral tax treaties in a synchronized manner without renegotiating each of these treaties individually. It derives its power from Action 15 of the BEPS Action Plan. In the words of OECD Secretary-General, Angel Gurria, "*The entry into force of this multilateral convention marks a turning point in the implementation of OECD/G20 efforts to adapt international tax rules to the 21st Century.*"

Several territories have signed up for the MLI since 1 January 2017, but a formal signing ceremony took place only on 7 June 2017. At this ceremony, 68 territories signed the document and another 9 committed themselves to signing up in the future. More are expected to join over time, and according to the OECD, it is likely to organize another official event before the end of 2017[1]. India is among the 68 countries that signed the MLI on 7 June 2017. It has published a provisional list of notifications and reservations, and listed 93 tax treaties, which it intends should be covered by the MLI[2].

ACTION 15 OF BESPS ACTION PLAN – MULTILATERAL INSTRUMENT

The concept of formation of a Multilateral Instrument (MLI) has been scripted and taken from Action 15 of the BEPS. Recognizing the need for an efficient and effective mechanism to implement the tax- treaty related measures resulting from the BEPS Project, Action 15 of the BEPS Action Plan called for the development of a multilateral instrument. This action is read as "Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution"[3].

To promulgate this MLI instrument an Ad Hoc committee was set up. It was open to all interested countries, and 99 countries participated, as well as four non-state jurisdictions and seven international or regional organizations as observers. It established a sub-group to formulate the arbitration provisions. The text of the MC-BEPS, as well as an Explanatory Statement,

[1] The Multilateral Convention and BEPS Investment in and from India, PWC, October 2012.
[2] *Ibid.*
[3] BEPS OECD, Action 15 – Develop a Multilateral Instrument.

was published on 24 November 2016[4]. India Ratified MLI on 7th June, 2017[5].

In short, MLI is an instrument which aims to renegotiate and amend bilateral tax treaties between various countries to be in consonance with the BEPS strategies. This instrument aims at modifying around 3000 bilateral treaties and has been signed by almost 70 countries[6]. To accommodate differences across countries as to what elements of the BEPS standards are to be adopted, the MLI was made very flexible, and some see that flexibility weakening its value[7].

The next chapter of the paper delves and enlightens the reader about the various articles of MLI and the Indian actions in favor of implementation of the same.

PROVISIONS OF MLI

1. MECHANISM:

- Applicability of MLI – MLI will not automatically apply to all the tax related treaties of the ratifying states. It will only apply to "Covered Tax Agreements". This means that it will apply only to those tax treaties where both Parties to such tax treaty have conveyed their intention (by way of a notification) for such treaty to be covered by the MLI. Where both contracting jurisdictions to a tax treaty choose the tax treaty as a CTA, the MLI will be applied to the tax treaty[8]. For Eg, for India – Britain Tax treaty to be covered in MLI, both India and Britain have to, by way of notification, consent to such application, it will then become a CTA as per the definition and MLI provisions are then applicable.

- Covered Parties - The MLI will only apply to countries that have signed and ratified it, in accordance with their domestic laws and have deposited their instrument of ratification with the OECD's Depository.

- Framework of MLI – It is broadly divided into four main categories which are further categorized into articles. Furthermore, out of these four articles there are provisions which form the minimum standard and therefore have to be applied without fail and provisions which are optional on the preferences of the parties. The Four categories are[9]:

a. Hybrid Mismatch – Articles 3, 4 and 5 (Optional)
b. Treaty Abuse – Articles 6, 7, 8, 9, 10 and 11 (Minimum Standard)
c. Avoidance of Permanent Establishment (PE) status – Articles 12, 13 and 15 (Optional)
d. Dispute Resolution – Article 16 to 23 (Minimum Standard)

[4] A detailed analysis by the BEPS Monitoring Group is available at https://bepsmonitoringgroup.files.wordpress.com/2017/03/explanation-and-analysis-of-mc-beps-final-rev.pdf.

[5] Deloitte, Multilateral Instrument (MLI) Ratification Impact on Indian tax treaties, August 2019.

[6] J. P. Finet and Stephanie Soong Johnston, "Nearly 70 Jurisdictions Sign OECD's Multilateral Instrument," Tax Notes International, June 12, 2017, pp. 933-935.

[7] Institute for Austrian and International Tax Law, "The Multilateral Instrument: Legal Concerns and the Way Forward," Tax Notes International, May 29, 2017, pp. 805-811.

[8] KPMG, Japan Tax Newsletter, Multilateral Instrument, 28 September, 2018.

[9] PWC, The Multilateral Convention and BEPS Investment in and from India, October 2017.

Where an MLI provision reflects a BEPS minimum standard, Parties can opt out of such provision only in limited situations such as where the CTA already meets the minimum standards. Tax treaty partners ("Treaty Partners" / "Contracting Jurisdictions") may also choose to opt out of a provision reflecting a minimum standard if they decide to reach a mutually satisfactory solution which is consistent with the minimum standard in some cases. Whether or not a CTA meets the minimum standard will be determined in the course of the review and monitoring process within the inclusive framework on BEPS[10].

A party to the MLI may reserve its right that provisions of the MLI do not apply to its covered tax treaties in their entirety or a subset of its CTAs. Where one of the parties reserves the right that provisions of the MLI do not apply to one of its CTAs, the relevant provisions of the former will not apply to the latter, irrespective of whether the party's treaty partner has made a similar reservation. The MLI also generally provides in most articles that if a treaty partner neither reserves the applicability of a particular MLI article nor notifies the respective provisions, and does not state that the article is reserved in its entirety, this article will then be added to the CTA and will prevail over its relevant provision to the extent of the inconsistency

- Clauses: In order to further understand the structure, it is important to understand the below mentioned clauses:

a. Optional provisions: Under the Instrument there are some provisions which provide options. Either of the given options can be chosen. However, it has to be understood that both the countries of the contracting jurisdiction have to agree on application of the same option. Eg. MLI provision which deals with "Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions" provides for Parties to opt for either Option A or Option B to modify their CTAs[11]. One of the options will apply to a CTA only when both Treaty Partners have elected that option.

b. Notification Clauses: Where an MLI provision supersedes or modifies an existing provision of a CTA, the Parties are generally required to make a notification specifying which CTAs contain such provisions and identify the provisions. Further, the concept of provisional notifications has been introduced to deal with situations where a signatory to the MLI accidentally omits to notify a provision of a CTA, or Treaty Partners disagree regarding whether a particular provision is superseded or modified by the MLI, or where both Treaty Partners agree that there is a relevant provision but disagree about which one it is. In such a situation the exchange of provisional notifications with the other Treaty Partner will afford signatories an opportunity to discuss mismatches in the notifications and correct them prior to finalization of the lists. India has made use of this provisional notification while signing the treaty[12].

c. Compatibility Clauses: MLI provides for compatibility clauses whereby it integrates clauses in CTA treaties and MLI. There are four mechanisms of compatibility; Where MLI provision

[10] Nishith Desai Associates, India's MLI Positions - Impact on Availing Treaty Benefits, July 2017.

[11] Article 13 of the MLI.

[12] *Supra note 10.*

applies "in place of" CTA, Where MLI provision "modifies or applies" to existing CTA clauses, where MLI Provision applies "in absence of" existing CTA provision and where MLI Provision applies "in place of" or "in absence of" existing CTA provision. These have been further elaborated as specified in the form of a table in **Annexure 1** attached to the paper.

- Entry into force for different kinds of taxes – The entry into force date differs for different taxes as specified here forth:

a. For taxes which are withheld at source on amounts paid to non-residents, such as royalties, interest, capital gains etc: MLI will enter into effect where the event giving rise to such withholding tax occurs on or after the first day of the next calendar year that begins on the latter of the dates on which the MLI comes into force for each Treaty Partner. Eg. in case of India and Singapore, if the MLI enters into force for India on September 2017 and for Singapore on September 2018, the CTA Date is September 2018 and the MLI will come into effect for all withholding taxes under the India-Singapore tax treaty which relate to an event occurring on or after January 2019.

b. For all other taxes: MLI will come into effect for taxable periods beginning on or after an expiry of 6 calendar months from the CTA Date.

2. ANALYSIS OF THE MLI PROVISIONS:

Some of the major and ground – breaking provisions of MLI have been elucidated below with configuration of respective changes in the Indian tax treaties and in some cases, what the other countries believe has also been mentioned.

A. HYBRID MATCHES:

Article 3 to 5 of the MLI concerns itself with the treatment of hybrid mismatches. The provisions reflect BEPS Actions 2 and 6. The provisions aim to amend covered tax agreements to prevent double taxation as well as double non-taxation. These provisions are not minimum standards and parties have the option to opt out of it.

- **Article 3** – Article 3 states about "Transparent Entities" (hereinafter known as TE). It states that the income derived by or through a transparent entity will only be considered income of a resident of a treaty jurisdiction (and thus eligible for treaty benefits) to the extent that income is treated as income of a (another) resident by that treaty jurisdiction[13]. Based on the MLI, an income derived by or through a TE under the domestic tax laws of the parties' territories will be considered the income of a resident of either of the states, but only to the extent that this income is liable to tax in the residence state. In such cases, the TE can claim the benefits of the treaty.

Indian perspective – Generally, a partnership does not need to comply with the 'liable to tax' requirement in order to be eligible for treaty benefits to the extent that the partnership is treated as transparent in its jurisdiction of formation, and income is not

[13] Novio Tax, The Multilateral Instrument – Explanation document, August 2019.

taxed in the hands of the partnership. However, treaty benefits should be available to the extent the partners of such a TE are subject to tax (in their residence state) on the same income. But in India neither a TE nor a partner is entitled to a treaty benefit, since the country follows the entity-level approach to taxation[14]. However, such treaty benefits are provided to the TE or the partner only when any specific treaty provides for the same[15]. Therefore, it can be understood that, this provision of TEs is treaty specific and very substantive in nature. It was held by an Indian Court in cases that since *Linklaters LLP*[16] and *Clifford Chance*[17] hold a UK partnership and the partners were subject to tax in the country, they are eligible to claim the benefits of the India-UK treaty. However, in *Schellenberg Wittmer*, the Authority for Advance Rulings (AAR) took a contrary view and held that a Swiss general partnership was not entitled to treaty benefits since it is a TE[18].

India has reserved the right for the entirety of Article 3 to not apply to its CTAs. Accordingly, regardless of the positions adopted by India's bilateral tax treaty partners, Article 3 will not result in any amendments or modifications to India's bilateral tax treaties.

Other Countries: Sweden, France and Singapore have reserved the right for the entirety of Article 3 to not apply to their CTAs. Countries like Japan, Netherlands, and UK etc have partially accepted the Article and have reserved rights of implementation.

- **Article 4** – This article states about Dual Resident Entities. It states that the treaty residency of a dual resident entity is determined by mutual agreement between the treaty jurisdictions. Treaty benefits are in principle withheld from the entity until such mutual agreement is reached. This can be understood by the fact that if a person (companies, LLPs or other incorporated entities) is present in both the contracting jurisdictions, its Place of Effective Management, where it is incorporated or has been constituted and any other relevant factors will be considered in order to figure out to which state it is a resident. Where there is no way to determine the place of residency, such a person will not be entitled to the treaty benefit. This article stems from the recommendation of the Action 6 Report to replace the place of effective management test with the requirement for mutual agreement between the contracting states. To conclude, this article has two essentials:

a. requiring the competent authorities of the contracting jurisdictions to endeavor to reach mutual agreement on a single contracting jurisdiction of residence
b. denying treaty benefits, without requiring the competent authorities of the contracting jurisdictions to endeavor to reach mutual agreement on a single contracting jurisdiction of residence[19].

Indian Perspective: India has not made any reservations with respect to Article 4 and has opted for Article 4 to apply to all its CTA. India earlier introduced Place of Effective Management, effective from 1 April 2016, to determine the residence of corporate entities.

[14] *Supra Note 09.*
[15] Eg. India-US and India-UK tax treaties.
[16] Linklaters LLP v. ITO 132 TTJ 20.
[17] Clifford Chance v. DCIT 82 ITD 106.
[18] [2012] 210 Taxman 319 (AAR).
[19] *Supra Note 10.*

The problem with Place of effective establishment test comes when India has given residency status to a person for complying with place of effective management criteria. However, its country of incorporation considers place of incorporation as the residency criteria. Yet again the countries are at an impasse to decide the residency of the person. It may happen that, different countries use different tests to conclude the residency of a person. Therefore, in case competent authorities cannot reach a conclusion and benefits are denied due to a failure of the competent authorities of the contracting jurisdictions to reach agreement. Such denial results in unrelieved double taxation, such taxation then should be considered in accordance with the provisions of the covered tax agreement[20].

Other Countries: Countries such as France, Sweden, Luxembourg and Singapore have reserved the right for Article 4 to not apply to their CTAs. Ireland has chosen to apply the provision to treaties where the same provision is not present in any form.

- **Article 5** – Article 5 states about Methods for eliminating double taxation. There are three methods for country parties to choose from:

a. Option A - If an item of income is taxed in the source state, the residence state will not completely exempt it. Instead, the state of residence shall allow a deduction of an amount equal to the tax paid in the state of source against tax payable against the same income in the state of residence.
b. Option B - The exemption will not apply to dividends that are tax-deductible in the other country because a deduction is only allowed for tax paid on a net basis.
c. Option C – It reflects the credit method for the elimination of double taxation and is based on Article 23B of the OECD Model Tax Convention. This option relates to all types of income that is taxable in the other country. This restricts credit granted on the basis of the net income.

Article 5 operates in an asymmetrical manner. Accordingly, this article shall apply to residents of each country jurisdiction as per the options exercised by them, i.e. if they, by notification accept any of these options, it will apply domestically to such country jurisdiction.

Indian Perspective: Most of the Indian treaties have article on credit method i.e. Option C[21]. India has chosen to reserve the right for the entirety of Article 5 not to apply to its covered tax agreements for example in the India – France DTAA Paragraph 4 of Article 5 of the Convention shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State[22].

B. TREATY ABUSE –

[20] OECD, The Explanatory Statement to the MLI.
[21] Western India Regional Council of The Institute of Chartered Accountants of India, Multilateral Instrument (MLI) for Beginners.
[22] Synthesized text of the Multilateral Convention to Implement Tax Treaty related measures to prevent base erosion and profit shifting (MLI) and the convention between the government of the republic of India and the government of the French republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital - https://www.incometaxindia.gov.in/DTAA/synthesise

The MLI contains six provisions to address treaty abuse. Two of these provisions reflect the BEPS Action 6 minimum standard on treaty abuse and the four other provisions are specific anti-abuse rules that target specific avoidance strategies. Since these provisions are minimum standards, they apply to all the treaties under MLI[23].

- **Article 6** – This article talks about the Preamble. The article states that a treaty should have a suitable "preamble", which specifically excludes its use to reduce taxation through tax evasion or avoidance, or treaty shopping[24]. MLI has also given a default preamble where countries irrespective of what their present preamble is, have to incorporate the wordings given under MLI.

Indian Perspective: Since it is a minimum standard provision, it has to apply to all of India's treaties. India therefore has accepted the provision for amending all its treaties to include that the intention of the tax treaties is not only to eliminate double taxation but also to prevent non-taxation or reduced taxation through tax evasion or avoidance. It also has to be noted that, an optional inclusion was suggested to all the parties which provides that the treaty is also for development of economic relationship and co-operation in tax matters. India has refused to comply with this optional inclusion though it may have little impact on the present treaties. India has already signed treaties such as treaty with Russia and Mauritius which were done to promote economic ties between the countries according to their preamble[25].

The preamble of the MLI is likely to have a significant impact on interpretation of the position approved by the courts, since it has a specific provision for prevention of tax evasion through treaty shopping. Interpretation and language of the treaty and preamble is necessary and has been emphasized by Indian Courts in various cases. In *Cyril Eugene Pereira case*[26] in the context of the India-UAE tax treaty, the AAR held that the provisions of the tax treaty do not apply to a case if the same income is not liable to be taxed twice by the existing laws of both the states. Since there is no law in force in the UAE that makes income liable to tax, taxpayers cannot claim relief on account of double taxation unless there is a corresponding tax law in force in the country in respect of their income, which is taxable in India.

Also in the case of *Azadi Bachao Andolan case*[27], the Supreme Court referred to the preamble to the India-Mauritius tax treaty, which provides for "encouragement of mutual trade and investment" and held that entitlement of treaties is consistent with India's intentions at the time it entered the tax treaty with Mauritius.

- **Article 7** - This article talks about to prevention of treaty abuse. As a minimum standard, the Action 6 Report requires countries to implement at least one of the following anti-abuse measures in their treaties:

d-text-of-mli-and-india-france-dtac-indian-version.pdf.

[23] *Supra Note 13.*

[24] Artificially using conduit entities to structure arrangements in order to obtain treaty benefits.

[25] Ernest and Young LLP, India Tax Insights issue 17 December 2019.

[26] [1999] 105 Taxman 273 (AAR - New Delhi).

[27] Union of India v. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC).

(i) a principal purpose test (hereinafter known as "PPT") only, which is a general anti-abuse rule based on the principal purpose of transactions or arrangements

(ii) a PPT supplemented with either a simplified or a detailed limitation on benefits (hereinafter known as "LOB") provision, or

(iii) a detailed LOB provision, supplemented by a mutually negotiated mechanism to deal with conduit arrangements not already dealt with in tax treaties.

The **PPT** is an effective instrument to counter arrangements such as treaty shopping arrangements that have been put into place with the main arrangement to avoid taxation. Hence, if one of the principal purposes of transactions or arrangements is to obtain treaty benefits (i.e. a lower withholding tax rate), these benefits would be denied, unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty[28].

Thus, in order to trigger a denial of treaty benefit under the PPT, obtaining the benefit need not be the sole or dominant principal purpose of the transaction or arrangement. It would suffice even if one of its principal purposes was to obtain such benefit.

Parties to the MLI have an option to apply the **simplified LOB (hereinafter known as "SLOB")** as a supplement to the PPT by making a notification to that effect. The SLOB provisions limit the availability of tax benefits to "Qualified Persons" of a Contracting Jurisdiction. Qualified persons include:

a. Individuals
b. Local authorities in contracting jurisdictions
c. Companies or other entities
d. Persons other than individuals – Non – Profit Organizations, entities established solely for the purpose of providing retirement benefits etc.
e. Persons other than individuals, if on at least 50% of the days of the 12 month period during which the benefits were sought, at least 50% of the shares were owned, directly or indirectly by Qualified Persons.

Residents of a Treaty Partner involved in active conduct of business will not be required to fulfill the Qualified Person threshold to avail treaty benefits so long as the income earned from the other Treaty Partner emanates from or is incidental to such business. The following activities shall not be included in the term "active conduct of business":-

a. Operating as a holding company;
b. Providing overall supervision or administration of a group of companies;
c. Providing group companies (including cash pooling); or
d. Making or managing investments, unless these are activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such.

Detailed Limitation of Benefits is another option wherein instead of incorporating the default PPT as the subjective threshold, governing the grant of treaty benefits to residents of two Treaty Partners engaged in cross border operations, parties have the option to reserve the right with respect to PPT

[28] *Supra Note 13.*

and not apply it to their CTAs. Treaty Partners who have chosen this option shall endeavor to reach a mutually satisfactory solution which meets the minimum standard. **Indian Perspective:** In its provisional notification, India has chosen to apply the PPT with the SLOB across all its Notified Treaties. It is among the only 12 countries to have chosen to apply SLOB[29]. It is presumed that PPT is the test that most of the countries swore to.

Other Countries: USA has not ratified MLI. However, it has Limitation of Benefits clause in its treaties. The same is the case with Mauritius whereby it has included Mauritius LOB in its treaties. The Singapore LOB also has a general clause which denies the capital gains tax benefit if the affairs are arranged with the primary purpose of obtaining that benefit ("Singapore PPT"). The UK Treaty also has an overarching general anti-abuse provision under Article 28C which denies all treaty benefits if the main purpose or one of the main purposes of the creation of the resident or the transaction undertaken by him was to obtain benefits under the UK Treaty[30].

- **Article 8** – This article is called the Dividend Transfer Transactions. According to this article, the beneficial owners test is used for any entity to claim tax benefit/ exemption for payment of dividends in the source country. According to this test, treaty relief can only be claimed if the recipient of dividend is a "beneficial owner" i.e. holds/ owns more than certain amount of share/ capital/ rights/ voting power or similar ownership rights etc. And such holding must be met throughout 365 days of period which includes the date of payment of the dividends[31].

Indian Position: India has decided to apply the same to all its treaties except those where the testing period in the treaty is more than 365 days[32]. This article will not affect distribution of dividends, since India levies a Dividend Distribution Tax on Indian entities distributing their dividends[33].

- **Article 9** – This article states "Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property (Real Property)"

Generally, capital gains arising from sale of shares are taxable in the residence state. However, capital gains arising from sale of shares which derives value (more than certain amount or 50%) from the immovable property located in the other Country Jurisdiction, then such gain shall be taxable in the other Country Jurisdiction, where such immovable property is located[34]. However, it does not apply to businesses which primarily deal with land/ immovable property (Eg. Construction or developmental work) though the company is dealing with managing of immovable properties. Therefore, it can be understood that wordings and text of the each DTAA needs to be interpreted and analyzed carefully[35]. Shares here refer to shares or similar interests and not to Bonds/

[29] Other countries being Argentina, Armenia, Bulgaria, Chile, Colombia, Indonesia, Mexico, Russia, Senegal, the Slovak Republic and Uruguay.
[30] *Supra Note 10.*
[31] *Supra Note 21.*
[32] India and Portugal treaty.
[33] *Supra Note 09.*
[34] *Supra Note 21.*
[35] DIT (IT) Vs. Venenberg Facilities BV (AP HC).

debentures/ debt instruments. The applicability of Article 9 w.r.t sale of converted instruments viz. conversion of Bonds/ CCDs into shares is unclear.

Indian Position: India's stance as regards to this article is dependent on its counter party jurisdictions. The application of this article shall be optional based on the provision in the CTA agreed mutually with the treaty partners.

- **Article 10** – This article talks about triangular Permanent establishment. According to Article 23 of OECD Model Convention an enterprise in a Contracting State shall only be taxed in its state of residence ("Country of Residence") unless the enterprise carries on business in the other Contracting State ("Country of Source") through a permanent establishment (hereinafter known as PE). In case of latter, the profits that are attributable to the PE ("Attributable Income") are taxed in the Country of Source i.e. where the PE is located. Further, the amount of tax paid in the Country of Source on the Attributable Income is entitled to credit in the Country of Residence. This provision was being misused by a lot of taxpayers by way of deliberately transferring the assets such as shares, bonds or Intellectual property (income/profit generating assets) from the PE in the original Country of Source to the PEs in other unrelated states ("Third States") that offer a very favorable tax treatment[36].

The MLI provides that treaty benefits will be denied if an item of income derived by a treaty resident and attributable to a PE in a third jurisdiction is exempt from tax in the resident state, and the tax levied in the PE's jurisdiction is less than 60% of the amount that would have been imposed in its resident state if the PE were located there.

Indian Perspective: India's position is silent on this article. Accordingly, it would be applicable to Indian treaties unless other countries has reservations/ has not opted for this article.

C. AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

Changes have been brought to the permanent establishment definition develop through the work of BEPS Action 7. Many a times, entities and their agents have strategies and plans whereby where the person that habitually exercises a right to conclude contracts in the name of a foreign company claims to be an "independent" agent even though it is acting exclusively or almost exclusively for closely related enterprises. These problems have been elaborately addressed. These set of articles are optional in nature giving country jurisdictions a right to reserve.

- **Article 12** – This article is known as Artificial Avoidance of Permanent Establishment. It is targeted to curb the commissionaire arrangements and similar strategies, which currently many MNEs are using for avoiding agency PE status. This article aims to address the artificial avoidance of PE's through commissionaire arrangement and similar strategies by widening the scope of the types of arrangements that may be

[36] BEPS Actions Final Report 2015, Action 6, page 75, Para 50(See http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report_9789264241695-en#.WUjQyut94dU).

deemed PE's. Such agreements make it possible for a company to sell products in another country by having an agent conclude the transaction in his own name for a commission[37]. In such instances, the agent is not taxed on the sale itself as he does not own the goods (he may be taxed to the limited extent of the commission he receives for the services provided to the company), and the company avoids establishing a PE by ensuring that the transactions are not concluded in its name and therefore are not legally binding on it[38].

MLI covers two types of agents in order to prevent the above mishap:

a. Dependent Agency: There are two tests to find who a dependent agent is; an Authority to conclude contracts and in habitual exercise of this authority. So, if a person acts as an agent in his habitual capacity to conclude contracts under his authority on behalf of the permanent establishment, he is known as a Dependent Agent.
b. Independent Agency: A person acting in an independent capacity in its ordinary course of business is not eligible to be considered a Dependent Agency of the permanent establishment. However, when such a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, it will not be considered an independent agent.

According to Article 12, an MNE has a deemed place of permanent establishment if it performs certain activities in the contracting jurisdictions:

i. concluding contracts
ii. habitually playing the principal role leading to the conclusions of contracts that are routinely concluded without material modification by the enterprise; and such contracts are either; in the name of the enterprise, for the transfer of ownership or the right to use property belonging to the enterprise or for providing services by the enterprise.

However, a person acting in his independent capacity is not covered by this article.

Indian Perspective: India has chosen to opt for this option in all its CTAs. However, this provision is only applicable to CTAs if the other party agrees to do the same. India has similar provisions in the existing treaties with the counter party jurisdictions wherein it has used the tests of "authority to conclude a contract" along with arm's length principle[39], albeit Arm's length principle has not been a part of MLI. Countries like the Netherlands and France have also notified India with respect to both paragraphs under Article 12, thereby modifying India's tax treaties with these countries.

Other Countries: Countries like Singapore, Sweden, and the UK have chosen to reserve the right for the entirety of Article 12 not to apply mainly because all of their treaties have similar provisions existing with other countries.

- **Article 13** – This article talks about Artificial Avoidance of PE Status through the Specific Activity Exemptions. BEPS

[37] BEPS Action Plan 7 Final Report page 9.
[38] *Ibid.*
[39] Arm's Length principle – It means that any transaction without having any relationship as such and transacting independently.

Action Plan 7 confirms that when this list of specific activity exemptions was first introduced, the activities were generally considered to be of a preparatory or auxiliary nature[40]. This article gives a solution to the ever increasing problem of taxing e – commerce entities that don't really have a physical permanent place of establishment but accrue profits while transacting with the help of the internet and other virtual platforms.

This article gives us two options:

a. Option A deals with the fact that all listed activities shall not deemed to be PE subject to condition that overall result from such activities should be preparatory/ auxiliary in nature.
b. Option B deals with specific activity exemption i.e. Irrespective of preparatory/ auxiliary, there will be an automatic exemption to the listed activities.

However, there might be businesses where they divide their business process into small fragments in order to escape the permanent establishment tag. In order to deal with this, Article 13 (4) also provides for Option B deals with specific activity exemption i.e. Irrespective of preparatory/ auxiliary, there will be an automatic exemption to the listed activities[41].

In *Motorola Inc. v DCIT*[42] the Delhi Tribunal held that activities such as market survey, industry analysis, economy evaluation, furnishing of product information, ensuring distributorship and their warranty obligation, ensuring technical presentations to potential users, development of market opportunities, providing services and support information, procurement of raw materials and accounting and finance services, for one year by employees of a foreign company through an office located at the Indian subsidiary's office qualified as preparatory or auxiliary in nature. Further, in *Brown and Sharpe Inc. v. Commissioner of Income Tax*[43], the Allahabad High Court found that though the activities of a foreign company's liaison office ('LO') in India included preparatory or auxiliary services, the marketing services conducted from the LO could not be treated as preparatory or auxiliary and accordingly a PE was established.

Indian Perspective: India has ratified most of the treaties under Option A and has chosen to not exercise its right to reservation with respect to paragraph 4. In the event that a treaty partner reserves Article 13 or chooses to notify Option B, the tax treaty between India and such country will remain unchanged. In the case they notify with option A, then the CTA would be modified according to Option A.

Other Countries: Countries like the Netherlands have taken the same stance as of India. Sweden has reserved its rights with this article thereby meaning there won't be any change with respect to India – Sweden treaty. UK has not opted to choose either of the options under Article 13 nor has it made any particular reservation.

- **Article 14 –** This Article deals with Splitting up of Contracts. According to this Article, where any CTA mentions a time limit which becomes a threshold for a business to be considered a permanent

40 Action Plan 7 Final Report page 10.
41 *Supra Note 09.*
42 [2005] 95 ITD 269.
43 [2014]369ITR704(All).

establishment, business cannot be divided into smaller time frames to evade such thresholds in order to not be known as a PE. This article provides for a mechanism by which to determine whether the threshold referred to under the relevant provision of the tax treaty. According to this article, to assess whether the specified time period to constitute a deemed PE has been exceeded, 'connected activities' that are conducted by closely related persons at the same site or project during different periods of time (that each exceed 30 days) must be added to the aggregate period of time that a foreign enterprise has also conducted activities at the site or project. This is mostly relevant with respect to Construction and building industry where timelines of activity are divided just to disguise from the threshold time limit of being a PE.

Indian Perspective: As India has neither stated its reservation with respect to Article 14, nor do any of its treaties have existing language with respect to the splitting up on contracts, the provision should apply to all its CTAs, except where a treaty partner signatory has placed a reservation.

D. DISPUTE RESOLUTION

Dispute Resolution mechanisms have been strengthened to help aggrieved MNEs and other entities from seeking relief from not only competent authorities present in the contracting states but also authorities from treaty party after the 2017 update of BEPS Report. MLI only intents to further this initiative and has given mandatory provisions in this regard which have to be complied with in all treaties under the scope of MLI.

- **Article 16** – This Article is called Mutual Agreement Procedure (hereinafter known as MAP). Article 16 of the MLI is based on the minimum standards and best practices recommended under the BEPS Action Plan 14 for improving dispute resolution. It provides that if a person considers that the actions of one or both of the Contracting Jurisdictions results in taxation not in compliance with the provisions of the relevant tax treaty, then such person may approach the competent authority of either Contracting Jurisdiction regardless of any remedy provided under domestic law[44]. Parties may reserve their right with respect to this article if they intend to comply with the minimum standard for improving dispute resolution under BEPS Action Plan 14. However, the case must be presented within three years to the CA. If the contracting states are able to arrive at a satisfactory solution, they can resort to a Mutual Agreement arrangement. They may also consult with each other for resolution of cases not provided for in the tax treaty. This article will be applied either in place of or in the absence of the provisions mentioned in CTAs in this regard.

Indian Perspective: India has made a partial specific reservation against the first part of the provision on the basis that it intends to meet the minimum standard required under the BEPS Action Plan 14. India has not made any additional reservations, and has notified the relevant CTAs with respect to the remaining provisions under Article 16.

[44] *Supra Note 10.*

Hence, all treaties which have less than 3 years' time threshold to file a complaint and treaties where no time threshold is mentioned will get modified according to Article 16. However, treaties with threshold limits exceeding 3 years shall continue to remain the same as they are complying with Article 16.

- **Article 17** – This article covers the Corresponding Adjustments with regard to Transfer pricing concept. This article deals with the provisions of Corresponding adjustments which has resulted out of transfer pricing adjustments applicable in the case of transactions entered into between associated enterprises. Sometimes, Transfer pricing adjustments carried out in the context of transactions between associated enterprises may give rise to economic double taxation, insofar as an enterprise in a contracting state whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in the other contracting state. Action 14 of the BEPS Report and Article 9(2) of the OECD Model Convention provides that the other contracting state shall make an appropriate adjustment to relieve such double taxation. An Article 17 is a best practice, BEPS action plan required that as a minimum standard, countries should provide access to the mutual agreement procedure in transfer pricing cases and implement the resulting mutual agreements regardless of whether the relevant bilateral tax treaty contains a provision modeled after Article 9(2) of the OECD Model Tax Convention.

Indian Perspective: India has reserved the right for the entirety of Article 17 not to apply to its Covered Tax Agreements that already contain a provision. It has notified its treaties with inter alia, Netherlands, Ireland, Japan, Luxembourg USA, UK and Singapore as containing such a provision. Three countries, Belgium, France, Sweden, where corresponding adjustment is absent, will now be modified by MLI.

E. ARBITRATION

The provisions of Arbitration in the treaty range between Article 18 to 26. The provisions provide for mandatory arbitration policies that enable the country parties to include it in their respective treaties. However, Countries may reserve the right to apply the Arbitration provision of the MLI to some or all their DTAAs that already include an Arbitration provision. Arbitration rules allow a person to request arbitration if a Competent Authority has not been able to reach an agreement under MAP within two years. This ensures that the aggrieved has certainty that there will be a resolution (irrespective of whether it's in his favor or not) once the case is submitted to the MAP. While India has opted out of the Arbitration clause, 25 countries among the total number of signatories have signed up for the arbitration provisions in the MLI.

3. ISSUES WITH MLI:

Though, MLI has been a great addition to the existing tax systems and has been very helpful to plug the loopholes in the cross – border tax treaties, it is definitely not devoid of critical issues. This part of the paper aims at understanding some of the legal issues posed by MLI. The following are some of the problems with MLI:

a. **Concerns arising from Flexibility:** As discussed above some of the provisions of MLI are optional where the contracting states can reserve rights and some provisions are minimum standards. However, even these can be opted out by the contracting states by following certain norms and fulfilling certain criteria[45]. This might result in different rules for different treaties thereby vitiating the primary goal of uniformity amongst all the treaties in the world (this was the reason why around 3000 bilateral treaties were modified at once).

b. **Complexity:** The MLI entails a complicated reservation and option mechanism. It is highly technical, and the arrangements governing its application to CTAs are complex. The text and explanatory provisions provide different layers and make it difficult for interpretation. One of the biggest challenges of the MLI will depend in large part on the OECD and participating jurisdictions' ability to distinguish between which treaty provisions have been modified and which remain the same[46].

c. **Creates Uncertainty:** When countries negotiated their respective bilateral treaties, it was as per the socio – economic relationships between them. A universal application of MLI provisions may create ambiguity and uncertainty as far as some parts of the treaties are concerned because MLI might bring major changes to the treaty thereby negating the main purpose of such a tax treaty. The negotiation process may result in various concessions that are covered in other articles. The MLI creates uncertainties where it impacts on this interconnectivity and the equilibrium reached by the contracting countries during the negotiation, which may lead to situations which would have never been accepted in bilateral situations[47].

d. **Global acceptance of MLI:** The global acceptance of MLI was under question given that it is a product of OECD and G20 countries, though it is open for everybody to join and ratify. This implies that during the formation of the instrument, tax systems of developing countries were not taken into account. This puts additional burden on the administrative bodies of the developing countries who try to adopt this instrument in their domestic tax systems and treaties because they will be using an instrument which has not been tailored for their needs and purposes. Global acceptance of the MLI, was also hampered by the fact that whereas the United States of America was part of the ad hoc group that developed the MLI, it did not sign up. The reason given is that "the bulk of the multilateral instrument is consistent with U.S. tax treaty policy that the Treasury Department has followed for decades"[48].

e. **One – Way Agreements:** The 2020 peer review reveals that about 200 bilateral agreements, concluded between pairs of signatories to the MLI that are members

[45] Page 10, Provisions of MLI (1Mechanisms).

[46] Lewis A 2016, Alexander Lewis "Multilateral Instrument Faces Challenges on Way to Success, OECD Official Says" Tax Notes 2016.

[47] Silberztein C & Tristram J 2016, C Silberztein & J Tristram"OECD: Multilateral Instrument To Implement BEPS" International Transfer Pricing Journal September/October (2016).

[48] PWC, BEPS Global and Indian perspective, February 2016.

of the Inclusive Framework, would not be modified by the MLI because, at this stage, only one jurisdiction had listed the agreement under the MLI[49]. This may be due to renegotiations between country parties to the treaty or for any other reason. However, it is a downslide as this leads to delay in application of the new provisions and thereby giving more scope for misuse of treaties for no taxation. The same is the case with waiting agreements where agreements concluded between pairs of jurisdictions that are members of the Inclusive Framework where only one of them has signed the MLI.

f. **Fails OECD objectives:** The MLI provisions do not even seek to address many of the OECD's primary concerns about BEPS. As the BEPS Project actions indicate, many of the primary opportunities for BEPS are really the result of domestic laws rather than provisions in treaties[50]. However, the need for domestic laws to change in order to comprehensively reduce BEPS severely limits the effectiveness of the MLI at reducing BEPS. Either ways MLI is not really conforming itself to OECD working objectives.

SUGGESTIONS:

MLI like any other piece of legislation and policy has its own pros and cons. However, there is always scope of improvement that can benefit the parties subject to MLI. Firstly, it is always advised to ratify MLI only after due diligence by the respective countries in order to ensure that the instrument would not vitiate the main purpose of the bilateral treaty. Secondly, since developing countries couldn't get a chance to tailor the instrument highlighting their needs, international organizations like the UN, OECD G20 etc should consider convening a meeting specifically discussing the implications of MLI on developing countries that do not have an evolved tax system (who are observed to be mostly affected by No taxation). Until then, developing countries should scrutinize and integrate their needs with the instrument to make best use of the same. Thirdly, with respect to differences in implementation due to flexibility in ratification, it is advised that major provisions like transfer pricing policies, Permanent establishment, arbitration etc be mandatory provisions for all irrespective of the present position in the CTA. This would ensure uniformity in all the treaties which is expected through MLI. Fourthly, a system can be formulated whereby treaty parties or country jurisdictions of a CTA get their treaties ratified together in order to avoid one way agreements or waiting agreements. Finally, the language of the instrument can be improved and explanations can be a part of the main instrument itself instead of creating another layer of interpretation thereby adding to complexity.

The above suggestions are in a very raw and crude form. They need to be developed according to the technicalities involved.

CONCLUSION:

Clearly the MLI elicits many unanswered questions and more questions and challenges

[49] The MLI can only modify bilateral agreements that have been listed by both treaty partners under the MLI.

[50] Action Plan, supra note 3; see Michael V. Sala, Breaking Down BEPS: Strategies, Reforms, and Planning Responses, 47 CONN. L. REV. 573, 604 (2014).

will arise when the MLI is applied in practice[51]. However, it cannot be underestimated as MLI is a product and an art of work of OECD with heaps of effort and research. The intentions behind the instrument and BEPS are very encouraging but it all comes down to the implementation. However, the fact cannot be belittled that this is a positive development opportunity for most developing nations that can then use this tax to continue their own growth and development. But, as far as India is concerned businesses are going to have a tough time interpreting tax regime with the interaction of GST and MLI. It is believed by various scholars that once the implementation of MLI begins, will the actual problems be brought to light. Until then, it is a waiting game.

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[51] Silberztein C & Tristram J 2016, C Silberztein & J Tristram"OECD: Multilateral Instrument To Implement BEPS" International Transfer Pricing Journal September/October (2016).