



Global Business Tax Alert Sharp Insights

India signs multilateral instrument and submits provisional list of reservations and notifications

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Backdrop

India being part of G20 countries is committed to the Base Erosion and Profit Shifting [BEPS] project. India has gradually amended its domestic law to implement the actions under the BEPS project. The BEPS actions requiring amendment to tax treaties, are now being implemented by way of a multilateral instrument.

Pursuant to the approval of the Cabinet, India's Finance Minister on 7 June 2017 participated in the signing of the Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS [multilateral instrument / MLI] at Paris. The MLI was signed by 68 jurisdictions including Australia, Canada, China, Cyprus, France, Germany, Hong Kong, Japan, Luxembourg, Netherlands, Singapore and the United Kingdom. Interestingly, United States, has not signed the MLI, while Mauritius has committed to sign by 30 June 2017.

Multilateral instrument and provisional list of reservations and notifications

1. Background

India has been an active participant in G20 and OECD's BEPS project. To address concerns on BEPS India has adopted provisions such as country-by-country reporting and master file, the limit on interest deduction and equalisation levy in domestic law. A flavour of BEPS measures can also be found in some of the recent Indian tax treaties and protocols.

On June 7, the MLI was signed by India. The key provisions of MLI and the Indian approach are summarised in subsequent paragraphs.

2. Treaties covered

As per the provisional list¹ India has notified all its 93 double tax avoidance treaties indicating the intention of applying the selected MLI provisions to all these treaties. The MLI was signed by 68 jurisdictions and eight jurisdictions have expressed their intent to sign. Germany and China have not notified their tax treaties with India.

Various notifications / reservations made by India and other countries² are highlighted in subsequent paragraphs. It needs to be noted that generally speaking, a provision of MLI would get adopted in the Indian tax treaty only when matching action happens i.e. acceptance by both the parties to a MLI provision results in adoption of the same provision in the tax treaty. In absence of such matching, the existing provisions of the tax treaties would generally continue.

¹ The statement provided by India at the time of signature of MLI is referred to as "provisional statement", "provisional notification" or "provisional reservations"

² Provisional Notifications of very few countries other than India are analysed

3. Transparent entities (Article 3 of MLI)

3.1 MLI provision

As per this provision, 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 the jurisdiction. However this shall be only to the extent that the income is treated for purposes of taxation by that contracting jurisdiction as the income of a resident.

3.2 India approach

As per the provisional reservation, India would not adopt this provision in Indian tax treaties.

4. Dual resident entities (Article 4 of MLI)

4.1 MLI provision

As per this provision, the issue of dual residency for non-individuals is to be addressed by mutual agreement between competent authorities. In absence of such agreement the treaty benefit may be denied.

4.2 Approach of India and some of the treaty partner countries

As per the provisional notification, India would adopt while some other countries (Canada, Cyprus, France, Luxembourg, Singapore) would not adopt this provision in the tax treaties. Accordingly, this provision can get adopted in Indian treaties, subject to matching.

5. Application of methods for elimination of double taxation (Article 5 of MLI)

5.1 MLI provision

Article 5 of MLI addresses the situations arising from the exemption method followed by countries to avoid double taxation and situations where income paid on an instrument is deductible in the source country, but not subject to tax in the hands of the recipient as per the tax laws of the country of residence. Article 4 of MLI gives three options.

5.2 India approach

As per the provisional reservation, India would not adopt this provision in the Indian tax treaties.

6. Purpose of tax treaties (Article 6 of MLI)

6.1 MLI provision

Article 6 of MLI primarily seeks to insert a statement in the preamble of the tax treaties to the effect that the purpose of the treaty is not to create opportunities for double non-taxation or reduced taxation through tax avoidance or evasion including treaty shopping.

6.2 India approach

This is a minimum standard and accordingly, this provision would get adopted in Indian treaties.

7. Prevention of treaty abuse (Article 7 of MLI)

7.1 MLI provision

The *minimum standard* for avoiding treaty abuse can be implemented by adopting either of the following:

- Only Principal Purpose Test (PPT)
- PPT plus either simplified or detailed Limitations on Benefits (LOB) Provision³
- Detailed LOB supplemented by a mechanism that would deal with conduit arrangements not already dealt with in the tax treaties

Article 7 of MLI deals with PPT and simplified LOB.

7.2 Approach of India and some of the treaty partner countries

As per the provisional notification, India would adopt PPT and simplified LOB in the Indian tax treaties. Most countries (Canada, Cyprus, Luxembourg, France, Japan, Netherlands, Singapore, UK) have adopted only PPT. In other words, generally countries have not adopted simplified LOB.

8. Dividend transfer transactions (Article 8 of MLI)

8.1 MLI provision

Article 8 of MLI addresses abuse of beneficial tax treatment (say 5% rate) given to the dividend income under the tax treaties when the shareholder holds minimum 25% of the capital of the company distributing dividend. As per Article 8, such shares must be held for 365 days to avail the beneficial rate provided in the tax treaties.

8.2 Approach of India and some of the treaty partner countries

Certain tax treaties signed by India (e.g. Bangladesh, Belarus, Canada etc.) offer beneficial rate of tax on dividend income if the shareholder owns certain stake in the company. As per the provisional notification, India would adopt Article 8 of the MLI. As per the provisional notifications, countries such as Canada, Cyprus, Japan, Luxembourg, Singapore, UK, would not adopt this provision.

9. Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property (Article 9 of MLI)

9.1 MLI provision

Article 9 of the MLI addresses misuse of provisions based on Article 13(4) of the OECD Model, which gives taxing rights to a source country (i.e. the country where the immovable property is situated) to tax gains on alienation of shares of a company if the shares derive more than 50% of their value directly or indirectly from immovable property situated in the source country.

³ Simplified LOB provisions essentially provides that certain benefits of tax treaty are given to a resident of a Contracting Jurisdiction only if he satisfies the definition of "qualified person" or is engaged in "active conduct of business". Thus merely by satisfying the requirements of "resident of a Contracting Jurisdiction" the benefit of tax treaty may not be availed.

Article 9 of the MLI provides that the source country will get taxing right if the value threshold is met any time during the period of 365 days preceding the date of transfer. Article 9 also extends this provisions to interest in partnership or trusts.

9.2 Approach of India and some of the treaty partner countries

As per the provisional notification, India would adopt this provision in its tax treaties. As per the provisional notification, this provision would not be adopted by certain countries (Canada, Cyprus, Luxembourg, Singapore, UK) while certain countries (e.g. France, Japan, Netherlands) would adopt the provisions.

10. Anti-abuse rule for permanent establishment in third jurisdiction (Article 10 of MLI)

10.1 MLI provision

Article 10 of MLI addresses abuse of tax treaties in triangular situations.

10.2 Approach of India and some of the treaty partner countries

As per the provisional statement, India has not made any reservation as regards adoption of this article of MLI and hence it would get adopted in the Indian tax treaties, subject to matching. As per the provisional notifications certain countries (e.g. Canada, Cyprus, France, Luxembourg, Singapore, etc.) would not adopt this provision.

11. Application of tax agreements to restrict a party's right to tax its own residents (Article 11 of MLI)

11.1 MLI provision

Article 11 of MLI seeks to avoid an argument, according to which, the tax treaty impairs rights of a country to tax its own residents. Additionally, Article 11 also ensures that certain benefits granted to tax residents are not impacted.

11.2 Approach of India and some of the treaty partner countries

As per the provisional statement, India has not made any reservation on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching. As per the provisional reservations, certain countries (e.g. Canada, Cyprus, Singapore etc.) would not adopt this provision.

12. Artificial avoidance of PE through Commissionaire and similar arrangements (Article 12 of MLI)

12.1 MLI provision

Article 12 of MLI seeks amendment to Article 5 of the tax treaties, which defines the term 'permanent establishment' (PE), on the following aspects:

- scope of agency PE to counter the commissionaire arrangement entered into by foreign enterprise in order to avoid PE in the source state;
- Creation of agency PE when the agent habitually plays principle role leading to conclusion of contracts with routine approval of the principal;

- Agent will not be considered to be an independent agent if he acts exclusively or almost exclusively on behalf of a ***closely related enterprise***.

12.2 Approach of India and some of the treaty partner countries

As per the provisional notifications, India would adopt and certain countries (Canada, Cyprus, Luxembourg, France, Japan, Luxembourg, Netherlands, Singapore, UK, etc.) would not adopt this provision in the tax treaties.

13. Artificial avoidance of PE status through specific activity exemption (Article 13 of MLI)

13.1 MLI provision

The primary objective of Article 13 of the MLI is to ensure that the benefit of Article 5(4) [i.e. certain activities do not result in PE even when carried out through fixed place] is allowed only when the activities, carried on either individually or collectively, are preparatory or auxiliary in nature. Article 13 of MLI also contains an anti-fragmentation provision.

13.2 Approach of India and some of the treaty partner countries

As per the provisional notifications, India would adopt while countries such as Canada, Cyprus, France, Luxembourg, Singapore, etc., would not adopt this provision in the tax treaties.

14. Splitting-up of contracts (Article 14 of MLI)

14.1 MLI provision

Article 14 of MLI addresses avoidance of PE by splitting the contracts between related enterprises to circumvent the threshold of creation of PE.

14.2 Approach of India and some of the treaty partner countries

As per the provisional statement, India has not made any reservation against adoption of this provision. Under the provisional reservations, certain countries (e.g. Canada, Cyprus, Japan, Luxembourg, Singapore, UK, etc.) would not adopt this provision in the tax treaties.

15. Person closely related to an enterprise (Article 15 of MLI)

Article 15 of MLI gives definition of the term "person closely related". This term is used in Article 12, Article 13 and Article 14 of MLI and the definition of Article 15 would be relevant in this context.

16. Mutual agreement procedure (Article 16 of MLI)

16.1 MLI Provision

Some of the salient features of Article 16 of MLI are:

- The tax payer can approach competent authority of either of the contracting jurisdiction (under the existing provision of Article 25 of the OECD Model the tax payer can only approach the competent authority of the country of which he is resident / national)

- The tax payer needs to present his case to the competent authority within three years of the first notification of the action resulting in taxation, not in accordance with the provisions of the treaty (Article 25 of the OECD Model contains similar provision)
- The agreement reached among competent authorities shall be implemented irrespective of the time limits in the domestic laws (Article 25 of the OECD Model contains similar provision).

16.2 India Approach

As per the provisional reservation, India would not adopt a provision according to which the tax payer can approach competent authority of either of the contracting jurisdiction. However, as this is a minimum standard, India has opted for bilateral notification or consultation process.

17. Corresponding adjustment (Article 17 of MLI)

17.1 MLI provision

Article 17 of MLI is based on Article 9(2) of the OECD Model and requires compensatory or corresponding adjustment if there is double taxation arising out of transfer pricing adjustments.

17.2 India Approach

As per the provisional statement, India would adopt this provision except where such provision already exists in the tax treaty. As per provisional notifications, certain other countries with whom India has tax treaties that do not contain Article 9(2) of the OECD Model (such as Belgium, France, Sweden) would also adopt this provision.

Adoption of Article 9(2) in the Indian tax treaties would facilitate settlement of transfer pricing disputes through MAP and bilateral APA negotiations.

18. Arbitration (Article 18 to 26 of MLI)

18.1 MLI provision

These provisions deal with mandatory arbitration.

18.2 India Approach

As per the provisional notification India would not adopt mandatory arbitration provisions.

19. Extent to which MLI is binding?

India has currently notified 93 existing tax treaties and also given provisional list of reservations and notifications. Once MLI is ratified and comes into effect, it would be binding on India. The Indian tax treaties need to be read and interpreted along with the provisions of MLI. However, at the time of submission of final documents to the depository (i.e. OECD), India will have the option of making changes to what has been provisionally notified.

MLI offers various flexibilities to countries. Broadly speaking, a country can decide the countries to which the provisions of MLI shall apply; a country may decide which provision to apply from the options provided by MLI. Also, a country can opt out of a particular provision of MLI. Even in respect of certain minimum standards, MLI has offered options.

Ratification of the MLI does not impair India's powers to enter into new tax treaties and sign protocols to existing tax treaties. Even after ratification, it would be possible for India to make new notifications. Further, after ratification, India can also opt in with respect to optional provisions or withdraw reservations made earlier or replace an earlier reservation with a more limited version.

India can also completely withdraw from MLI by making appropriate notification.

20. Effective date

The date from which the MLI provisions would become effective with respect to Indian tax treaties will depend on (i) the date on which MLI *enters into force* for India and for the treaty partner countries (ii) the date of *entry into effect* of the MLI, which in turn could depend on the choices made by India and the treaty partner countries.

It is likely that the first modifications to covered tax treaties will become effective in the course of 2018.

Conclusion

The MLI is a big step in the BEPS implementation process. The provisional list of reservations and notifications made by India and by other countries, has provided insights on how Indian tax treaties will shape up in the BEPS world. It needs to be seen if India makes any further changes in the provisional list of reservations and notifications.

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