

## Multi-Lateral Instruments— Overview and Analysis



*Combating tax evasion and avoidance has become the prime objective of developed as well as emerging and developing economies. Organisation for Economic Co-operation and Development (OECD), at the request of the G20, has identified 15 actions to address Base Erosion and Profit Shifting (BEPS) i.e. to tackle tax avoidance strategies that exploit gaps and mismatches in tax rules that artificially shift profits to low or no-tax locations from high tax locations/jurisdictions. One of the major sources of artificial shifting of the profits from one jurisdiction to another is through the treaty shopping or abuse of Tax Treaties. The BEPS implementation would require an amendment to over 3,000 tax treaties whether based on OECD or UN model convention. This process could become cumbersome and time-consuming. BEPS Action 15 is to develop a multilateral instrument (MLI) to implement measures identified during the course of the work on BEPS and modify bilateral tax treaties in a synchronised and efficient manner without individually renegotiating each treaty bilaterally. It would modify only existing treaties and not future treaties. However, jurisdiction can choose BEPS measures to be part of future negotiations and agreements. OECD shall be a depositary for MLI and it would be tracking the ratification process by each jurisdiction/nations. The OECD secretariat is also developing various tools and guidance on MLI. Read on to know more...*

### Introduction

On 24<sup>th</sup> November 2016, the Organisation for Economic Cooperation and Development (OECD) published the 49-page Multilateral Convention to implement tax treaty related measures to prevent BEPS along with 86-page Explanatory Statement. The Convention has two main aims:

(a) to alter and modify a series of tax treaty measures from the OECD/G20 BEPS Project into existing tax agreements which are bilateral or multilateral, and

(b) to establish a new standard for mandatory binding arbitration in relation to resolving double tax disputes.

Explanatory statement provides interpretation support and guide. It also refers to the material that was developed during the course of BEPS project.

On 7<sup>th</sup> June 2017, 67 countries (including India) and jurisdictions signed and nine countries and jurisdictions formally expressed their intention to sign a multilateral agreement that will swiftly implement a series of tax treaty measures to update the existing network of bilateral/multilateral tax treaties to reduce opportunities for tax avoidance by Multi National Enterprises (MNEs). Signatories to the MLI cover 85% of the concluded treaties. However, some of the major economies e.g. US, had not signed the MLI. The MLI is developed by a group of 100 countries/jurisdictions including developing and emerging economies.



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**India has entered into 93 double tax avoidance agreements and has chosen all DTAA to be considered as Covered Tax Agreements (CTA). However 41 countries/jurisdiction have not signed MLI, 3 countries/jurisdiction have signed MLI but chosen agreement with India not to be part of CTA and 1 country in the process of seeking directions from their Parliament. List of countries signing MLI is expanding and accordingly, this figure may vary.**

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Covered Tax Agreement means an agreement for the avoidance of double taxation between two or more parties and/or jurisdiction and each party has notified to the OECD Depository about listing the agreement as well as any amending or accompanying instruments thereto (identified by title, names of the parties, date of signature, and, if applicable at the time of the notification, date of entry into force) as an agreement which it wishes to be covered by this Convention.

## Broad Coverage of MLI

MLI is divided into seven parts (as specified below) and has 39 articles (refer annexure 1 for details).

- Part I - Scope and Interpretation of Terms (Articles 1-2)
- Part II - Hybrid Mismatches (Articles 3-5)
- Part III - Treaty Abuse (Articles 6-11)
- Part IV - Avoidance of Permanent Establishment Status (Articles 12-15)
- Part V - Improving Dispute Resolution (Articles 16-17)
- Part VI - Arbitration (Articles 18-26)
- Part VII - Final Provisions (Articles 27- 39)

## Flexibility to Choose Options or Opt Out of Certain Articles or Not Apply Whole Treaty with Certain Country

MLI would not have blanket changes to all tax

treaties. It provides for the flexibility under the following premises:

- a. Specifying the tax treaties to which the Convention applies – it provides options to the parties to which convention shall apply. Parties may need flexibility for a variety of reasons e.g. recently conveyed/renewed treaty already incorporates the desired outcome.
- b. Flexibility with respect to provisions that relate to a minimum standard—Minimum standard could be achieved in multiple ways. The Convention does not give preference to a particular way of meeting the minimum standard.
- c. Opting out of provisions or parts of provisions with respect to all Covered Tax Agreements—in absence of meeting minimum standard, parties may be granted option to opt out of the particular provision of the convention.
- d. Opting out of provisions or parts of provisions with respect to Covered Tax Agreements that contain existing provisions with specific, objectively defined characteristics e.g. Hong Kong has chosen to exclude its treaties with Belarus and Pakistan from Article 7 on the basis that those treaties already contain a specified PPT rule.
- e. Choosing to apply optional provisions and alternative provisions e.g. Article on anti-treaty shopping provides for 3 different alternatives, some countries have chosen principle purpose test rule, while some have chosen PPT along with the simplified limitation of benefits.

## Applicability and Effective Dates

### a) Entry into force

As per Article 34, the multilateral instrument will enter into force from the 1<sup>st</sup> day of the month following the end of three calendar months beginning after five countries have ratified it.

For example, if the fifth instrument is deposited on 1<sup>st</sup> March 2018, the Convention will enter into force on 1<sup>st</sup> July 2018.

Each Signatory ratifying, accepting, or approving this Convention after the deposit of the fifth instrument, the Convention shall enter into force from the 1<sup>st</sup> day of the month following the end of a of three calendar months beginning after the deposit by such Signatory of its instrument of ratification, acceptance or approval.

### b) Entry in effect

Article 35 states that MLI shall have effect in each

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country/jurisdiction with respect to a Covered Tax Agreement on the basis of specific taxes:

- i. *Withholding of taxes:* 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 the first day of the next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; For example, if the Convention enters into force for the first country on 1<sup>st</sup> March 2018 and for the second country on 1<sup>st</sup> March 2019, the Convention will take effect with respect to all taxes which relate to an event occurring from 1<sup>st</sup> January 2020 onwards.
- ii. *Other taxes:* With respect to all other taxes levied by the countries, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of six calendar months (or a shorter period, if all Contracting Jurisdictions notify the Depository that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.

For example (unless shorter period notified):

- Latest date of entry into force of the Convention for each of the Contracting Jurisdictions to a Covered Tax Agreement - 1<sup>st</sup> September 2018
- Expiry of 6 month period – 1<sup>st</sup> March 2019- The provisions of the Convention will have effect with respect to all non-withholding taxes levied in respect of taxable periods beginning on or after this date. In the case of a taxable year that follows the calendar year, the provisions of the Convention would have effect with respect to the taxable period beginning 1<sup>st</sup> January 2020.

**Option has also been provided where party may reserve the right to delay the entry into effect of the provisions of the MLI until the Party has completed its internal procedures for this purpose. India has exercised this option and accordingly the trigger date for the rule on entry into effect would be 30 days after the Depository has received a notification from the last reserving Contracting Jurisdiction that it has completed its internal procedures with respect to that CTA.**

Option has been provided to a party to choose to substitute “taxable period” for “calendar year”.

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## Important Article of MLI

- MLI defines various terms. It further states that terms which are not defined would have same meaning as that was under covered tax agreement.

## Anti-Treaty Abuse

- As stated above, one of the major thrusts of MLI is to avoid treaty abuse. Articles 6 - 11 deal with the same. It provides that covered tax agreement to include following text in its preamble- “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)”.

Further additional preamble may also be included as under:

*“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters.”*

India has chosen not to include additional preamble. However, certain countries like Australia, China, Fiji, Hong Kong, Japan, Pakistan and Singapore have opted to include this additional preamble. Whereas New Zealand has opted not to include since additional preamble is already part of their treaties.

- Action 6 report states that countries should at least implement principle purpose test (PPT), a Simplified Limitation on Benefits (LOB) article combined with a PPT, or a more complex LOB supplemented by either an anti-conduit regulation or a PPT.

- Accordingly, Article 7 provides for the PPT, simplifies LOB. It states that notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement 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 Covered Tax Agreement. In countries like India, similar provisions are already contained under domestic tax laws in the form of GAAR.
  - Paragraph 8 to 13 of the Articles 7 provides for the simplified LOB, under which alternative tests have been provided to claim treaty benefit to qualified persons. Qualified persons comprise of individuals, government entities, certain listed companies, non-profit organisations, pension funds, entities that are engaged in active businesses or entities that meet specified ownership requirements. Simplified LOB includes certain restrictions, which are included in the US model convention.
  - Majority of countries have preferred PPT or exercising the option of opting out in lieu of existing PPT e.g. Hong Kong has chosen to exclude its treaties with Belarus and Pakistan from Article 7, since those treaties already contain a PPT rule. India along with a handful of other countries has chosen the option of PPT along with simplified LOB.
  - Countries or jurisdictions are permitted to opt out of the PPT, in case they prefer to address treaty abuse by adopting a detailed LOB provision. However, in such event, parties may accept the PPT in paragraph 1 as an interim measure.
- contracts, in the name of enterprise or for transfer of ownership or right to use property or for provision of services would constitute permanent establishment. It is provided that an enterprise shall not be deemed to have a permanent establishment in respect of an activity which an agent of an independent status undertakes for the enterprise.
- India has chosen to include these provisions pertaining to permanent establishment in CTA, while various EU nations have chosen not to adopt it.
  - MLI expands the scope of the creation of permanent establishment on account of dependent agent on various counts e.g. it now includes the contract for transfer of ownership or right to use property or provision of services; anti-fragmentation rule - agent shall not be independent agent when one works exclusively for the one or more closely related enterprises. India has adopted anti-fragmentation rule.
  - Article 13 provides two options for excluding certain activities from the ambit of permanent establishment.

### Option A

- a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character
- b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in a,
- c) the maintenance of a fixed place of business solely for any combination of activities mentioned in a and b.

Convention is drafted to apply the principles contained in the model text of Article 5(4) to the specific activities that are already listed in Covered Tax Agreements, rather than replacing those with the list of specific activities contained in the OECD Model Tax Convention.

### Option B

- a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not

## Permanent Establishment

- The work on Action 7 led to changes to the wording of Article 5(5) and (6) of the 2014 version of the OECD Model Tax Convention to address the artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies.
- Article 12 states that the agents other than independent agent who habitually concludes

to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the relevant provision of the Covered Tax Agreement provides explicitly that a specific activity shall be deemed not to constitute a permanent establishment provided that the activity is of a preparatory or auxiliary character;

- b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in a, provided that this activity is of a preparatory or auxiliary character;
- c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

The effect of applying Article 13(3) of the Convention would be to preserve the exceptions for activities described in Article 5(4)(a) through (d) of the Covered Tax Agreement, but to ensure that those exceptions will apply irrespective of whether the activity is of a preparatory or auxiliary character.

### India has adopted option A

- The splitting of the contracts happens to overcome the stipulated period leading to creation of permanent establishment. Article 14 takes care for artificially splitting of contracts. It provides for aggregation period spend at different point of time. Many countries including India have opted out of this rule.

### Improving dispute resolution - mutual agreement proceeding

- Article 16 & 17 deals with mutual agreement proceeding (MAP). Where a person considers that the actions of one or both of the contracting jurisdictions results or will result for that person in taxation not in accordance with the provisions of the CTA, that person may, irrespective of the remedies provided by the domestic law of those Contracting Jurisdictions, present the case to

the competent authority of either contracting jurisdiction. It also provides presenting time frame i.e. the case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement.

- The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting Jurisdiction, with a view to the avoidance of taxation which is not in accordance with the Covered Tax Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions.
- Article 17 provides for the corresponding adjustments. However India has opted out of article 17 for its 90 treaties, since it already contains provisions.

### Improving dispute resolution - Mandatory binding arbitration

- One of the two important objectives of the MLI is to provide for arbitration, Articles 18-26 deal with it. However, these provisions are optional. Mandatory binding arbitration would follow only after no headway is achieved under MAP. Various rights of reservation has offered to the Countries / jurisdictions e.g. any unresolved issue arising from a mutual agreement procedure case otherwise within the scope of the arbitration process provided for by this Convention shall not be submitted to arbitration, if a decision on this issue has already been rendered by a court or administrative tribunal of either contracting jurisdiction; or if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the contracting jurisdictions, a decision concerning the issue is

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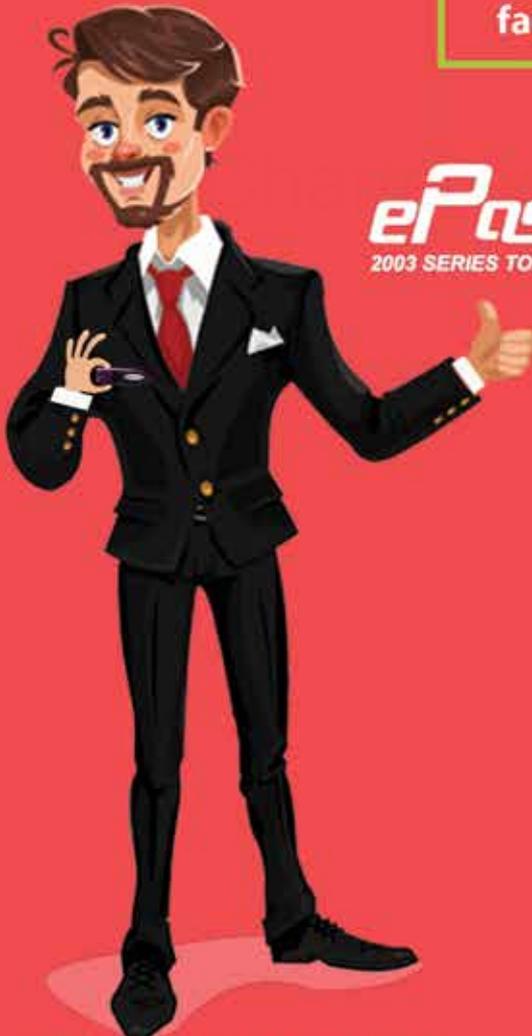


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**MLI is for the timely and effective implementations of BEPS project, relating to the treaty. However, success would depend upon number countries becoming a signatory to it and willing to implement. Further carve-out or reservation by countries/jurisdiction may lead to confusion and chaos. The countries developing innovative approach may lead to dilution of consistence approach.**

rendered by a court or administrative tribunal of one of the contracting jurisdictions, the arbitration process shall terminate.

- Arbitration panel shall select as its decision one of the proposed resolutions for the case submitted by the competent authorities with respect to each issue and any threshold questions, and shall not include a rationale or any other explanation of the decision. Arbitration panel has no authority

to provide its own solution or midway solution. This is also known as 'baseball arbitration' or 'either/or' arbitration.

- India has not agreed for mandatory arbitration proceedings.

## Conclusion

MLI is for the timely and effective implementations of BEPS project, relating to the treaty. However, success would depend upon number countries becoming a signatory to it and willing to implement. Further carve-out or reservation by countries / jurisdiction may lead to confusion and chaos. The countries developing innovative approach may lead to dilution of consistent approach. Taxpayers and tax professionals would require extensive exercise to evaluate existing structures and transaction, which would be affected. Further identification of commercial justification to the existing transactions may also be required. ■

## Annexure 1

### Clauses of MLI

#### Part I – Scope and Interpretation of Terms

- Article 1 – Scope of the Convention - The Convention shall modify all Covered Tax Agreements
- Article 2 – Interpretation of Terms

#### Part II – Hybrid Mismatches

- Article 3 - Transparent Entities
- Article 4 - Dual Resident Entities
- Article 5 - Double Tax Relief – Limitations on Using the Exemption Method

#### Part III – Treaty Abuse

- Article 6 – Purpose of a covered tax agreement
- Article 7 – Prevention of treaty abuse
- Article 8 – Dividend transfer transactions
- Article 9 – Capital Gains from alienation of shares or Interests of entities deriving their value principally from immovable property
- Article 10 – Anti-abuse rule for PE situated in third jurisdictions
- Article 11 – Application of Tax Agreements to restrict a party's right to tax its own residents

#### Part IV – Avoidance of Permanent Establishment status

- Article 12 – Artificial avoidance of PE status through Commissionaire arrangements and similar strategies
- Article 13 - Artificial avoidance of PE status through specific activity exemptions
- Article 14 – Splitting-up of contracts
- Article 15 – Definition of a person closely related to an enterprise

#### Part V – Improving dispute resolution

- Article 16 – Mutual agreement procedure
- Article 17 – Corresponding adjustments

#### Part VI – Arbitration

- Article 18 – Choice to apply Part VI
- Article 19 – Mandatory Binding Arbitration
- Article 20 – Appointment of Arbitrators
- Article 21 – Confidentiality of Arbitration proceedings
- Article 22 – Resolution of case prior to conclusion of arbitration
- Article 23 – Type of arbitration process
- Article 24 – Agreement on a different resolution
- Article 25 – Costs of arbitration proceedings
- Article 26 - Compatibility

#### Part VII – Final provisions

- Article 27– Signature and ratification, acceptance or approval
- Article 28 – Reservations
- Article 29 – Notifications
- Article 30 – Subsequent modifications of covered tax agreements
- Article 31 – Conference of the parties
- Article 32 – Interpretation and implementation
- Article 33 – Amendment
- Article 34 – Entry into force
- Article 35 – Entry into effect
- Article 36 – Entry into effect of arbitration provisions
- Article 37 – Withdrawal
- Article 38 – Relation with protocols
- Article 39 – Depositary.