BEPS & MLI – OECD / G20 Project & India Perspective

Harshal Bhuta
M.Com., F.C.A., A.D.I.T., LL.M. (Hons.) in International Tax Law [WU]

What is BEPS ?

- OECD FAQs → Base Erosion and Profit Shifting refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits "disappear" for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid
- Base Erosion → Base erosion refers to the reduction of the companies and amount of profits that a country can tax. If a company moves its residence to different country or causes its profit to arise in a different country another country then the ability of the original country to collect corporation tax will be diminished
- Profit Shifting → Profit Shifting refers to aggressive tax planning strategies focused on shifting profits out of a high tax country to a low tax country

Base Erosion and Profit Shifting

Transactions leading to BEPS

- **Low tax branch of foreign company**

Country A follows exemption system for foreign branches under domestic law

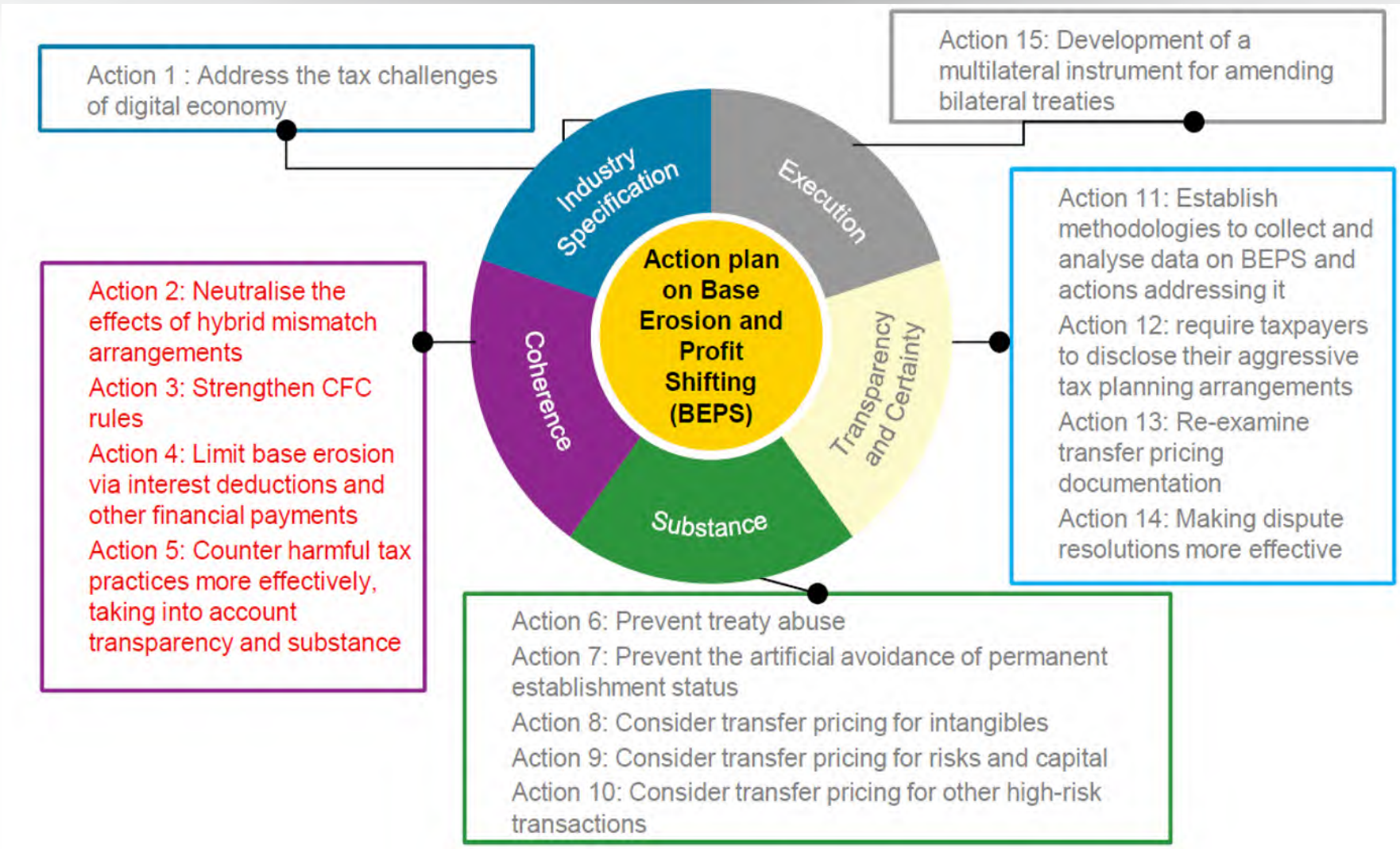
Low or No tax in country B since:
- Country B levies low/no tax; or
- Activities of branch not sufficient to create taxable presence; or
- Deduction for deemed interest on branch's capital in Country B

- **Conduit Companies**
  - Where one country does not have a treaty with another country, Conduit companies are interposed to claim treaty benefit and therefore reduce tax liability
- **Transfer Pricing**
  - Shifting of risks and hard to value intangibles to low tax jurisdictions
  - Low risk manufacturing and distribution arrangements and contract R&D arrangements with principal located in low tax jurisdiction and service provider located in high tax jurisdiction
- **Circumvention of Anti-avoidance Rules**
  - Channeling financing transactions through independent third party when thin-cap rules apply to borrowing from related parties only
  - Artificial Restructuring to avoid CFC rules
  - Use of hybrid entities

Base Erosion and Profit Shifting

- In order to put an end to BEPS practices, key priority measures were identified where action was urgent, as no action by some jurisdictions would have created negative spillovers (including adverse impacts on competitiveness) on others.
- Minimum standards were therefore identified to fight harmful tax practices **(BEPS Action 5)**, prevent tax treaty abuse, including treaty shopping **(Action 6)**, improve transparency with Country-by-Country Reporting **(Action 13)**, and enhance the effectiveness of dispute resolution **(Action 14)**.
- For the minimum standards, members have committed to rapid implementation of the measures, and to be subject to peer review to ensure consistent implementation and establishing a more level playing field.

OECD/G20 BEPS Project



Action 1 – Addressing the Tax Challenges of the Digital Economy

BEPS Action 1 – Digital economy

Potential options:

- Significant economic presence:
  - Intent to reflect situations where an enterprise leverages digital technology to participate in the economic life of a country in a regular and sustained manner without having a physical presence in that country
  - This option would create a taxable presence in a country when a non-resident enterprise has a significant economic presence in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools
- Withholding tax on digital transactions:
  - This withholding tax could be imposed as a standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online *or,* alternatively, as a primary collection mechanism and enforcement tool to support the application of the nexus option described above, i.e. net-basis taxation

BEPS Action 1 – Digital economy

Potential options:

- Introducing an equalisation levy:
  - An equalisation levy could overcome the difficulties raised by the attribution of income to the new nexus
  - Approach based on equal treatment of foreign and domestic suppliers
  - Scope could vary from levy on all transactions concluded remotely with source country customers *or* restricted to transactions by entities having significant economic presence *or* to transactions carried out through digital platform where contract for sale is concluded through automated systems *or* on data and other contributions gathered from in-country customers and users
  - Risk of double taxation remains high under this option

BEPS Action 1 – India's response

Chapter VIII of Finance Act, 2016 – Equalisation Levy:

- Equalisation levy of 6 % of the amount of consideration for specified services provided or to be provided by a non-resident not having permanent establishment ('PE') in India, to
  - a resident in India who carries out business or profession, or
  - a non-resident having permanent establishment in India
- Exemption from such levy has been provided to
  - resident persons who do not use such service in carrying on business or profession, and
  - aggregate amount of such consideration by persons resident in India carrying on business or profession does not exceed Rs. 1 lakh
- 'Specified services' is defined to include online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement

BEPS Action 1 – India's response

Chapter VIII of Finance Act, 2016 – Equalisation Levy:

- Corresponding income from providing such specified services is exempt u/s 10(50) of the Income Tax Act, 1961
- Disallowance of the expenses u/s 40(a)(ib) in case of failure to deduct and deposit the equalisation levy to the credit of Central government before due date of filing return of income. Subsequent allowance in the year of payment.
- EL to be paid in Challan No. 285
- Other forms also notified for filing statement of EL, form of appeal to CIT(A) and ITAT respectively
- No influence of ITA and subsequently DTAA since corresponding provisions contained under FA 2016
- No requirement of grossing-up

Action 4 – Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

BEPS Action 4 – Limiting Interest deduction

Overview of the best practice approach

***De minimis* monetary threshold to remove low risk entities**
Optional
Based on net interest expense of local group

+

Fixed ratio rule
Allows an entity to deduct net interest expense up to a benchmark net interest/EBITDA ratio
Relevant factors help a country set its benchmark ratio within a corridor of 10%-30%

+

Group ratio rule
Allows an entity to deduct net interest expense up to its group's net interest/EBITDA ratio, where this is higher than the benchmark fixed ratio
Option for a country to apply an uplift to a group's net third party interest expense of up to 10%

Option for a country to apply a different group ratio rule or no group ratio rule

+

Carry forward of disallowed interest/unused interest capacity and/or carry back of disallowed interest
Optional

+

Targeted rules to support general interest limitation rules and address specific risks

+

Specific rules to address issues raised by the banking and insurance sectors

BEPS Action 4 – Limiting Interest deduction

- Fixed ratio rule:
  - Limiting interest deduction claimed by an entity (or a group of entities operating in the same country) to a fixed percentage of earnings (recommended as EBITDA)
  - Benchmark fixed ratio corridor of 10% to 30% of EBITDA based upon empirical evidence
- Supplementary rule:
  - Adoption of Group ratio to provide additional flexibility for highly leveraged groups or industry sectors + possibility of uplift upto 10%
  - Group ratio rule is applied as follows:
    - Determining ratio of group's net third party expense / EBITDA
    - Applying this ration to entity's EBITDA
- Targeted rules:
  - Introduction of SAARs to deal with BEPS strategies such as entering into back-to-back structured arrangements with third party, making interest payment on funds used to finance production of tax-exempt income, etc.

BEPS Action 4 – India's response

Sec. 94B

- Interest expenses claimed by entity to its AEs shall be restricted to:
  - 30% of its EBITDA *or*
  - interest paid or payable to associated enterprise,

  whichever is less
- Provision applicable to (1) an Indian company & (2) PE of foreign company on debt issued by NR AE.
- Also, the debt issued by a lender would be deemed to have been issued by an AE where an AE provides an implicit or explicit guarantee to the lender or deposits a corresponding and matching amount of funds with the lender.
- C/F of disallowed interest expense to eight assessment years
- Threshold for interest expenditure of 1 crore rupees exceeding which the provision would be applicable
- Exclusion provided to Banks and Insurance business

BEPS Action 4 – India's response

Calculation of disallowance under Sec. 94B:

Calculation as per language of Memorandum and Chapter 6 of BEPS Action Plan 4 Report:

	Debt @10%	Interest paid
AE	300	30
Non AE	200	20
		50

Case 1 :

EBITDA	150
30% of EBITDA	45
or	
Int to AE	30
Therefore 30 is allowed	

Allowance: Whichever is lower

Case 2 :

EBITDA	50
30% of EBITDA	15
or	
Int to AE	30
Therefore 15 is allowed	

Allowance: Whichever is lower

BEPS Action 4 – India's response

Calculation of disallowance under Sec. 94B:

Calculation as per Finance Act provisions:

	Debt @10%	Interest paid
AE	300	30
Non AE	200	20
		50

Case 1 :	
EBITDA	150
Total Interest	50
Less: 30% of EBITDA	45
	5
or	
Int to AE	30
Therefore 5 is disallowed. Hence, 45 is allowed (50-5)	

Disallowance: Whichever is lower

Case 2 :	
EBITDA	50
Total Interest	50
Less: 30% of EBITDA	15
	35
or	
Int to AE	30
Therefore 30 is disallowed. Hence, 20 is alllowed (50-30)	

Disallowance: Whichever is lower

BEPS Action 4 – India's response

BEPS Action 4 Final Report vs. Sec. 94B

BEPS Action 4 Final Report	Factors	Sec. 94B
Corridor of benchmark between 10% to 30%	**Fixed ratio**	30%
Applies to net interest expense (i.e. after set off with interest income)	**Interest expense**	Gross interest
Carryback or carry forward	**Treatment of disallowed interest**	C/F for 8 years
Tends towards entities being part of multinational groups	**Lender**	AE + unrelated lender to be treated as deemed AE under certain circumstances

Action 5 – Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

BEPS Action 5 – Harmful tax practices

- Requiring substantial activity for preferential regimes
  - IP regimes

    Adopting "nexus approach". It allows a taxpayer to benefit from an IP regime only to the extent that the taxpayer itself incurred qualifying R&D expenditures that gave rise to IP income.
  - Non-IP regimes

    Various types of non-IP regimes could also be harmful.

    - Headquarters regime
    - Distribution and service centre regimes
    - Financing and leasing regimes
    - Fund management regimes
    - Banking regimes
    - Insurance regimes
    - Shipping regimes
    - Holding company regimes

    Substantial activity in case of Non-IP regimes would require to establish link between income and core income generating activities.

BEPS Action 5 – Harmful tax practices

- Nexus ratio:

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

- Qualifying taxpayers
- IP assets
- Qualifying expenditures
- Overall expenditures
- Overall income
- Outsourcing
- Treatment of acquired IP

BEPS Action 5 – EOI in rulings

Scope of the compulsory spontaneous exchange of summaries of rulings			
Categories of rulings		**Jurisdictions receiving the information**	
1	Taxpayer-specific rulings related to preferential regimes	1	For rulings 1-3: jurisdictions of residence of all related parties with which the taxpayer enters a transaction for which a ruling is granted or which gives rise to income from related parties benefiting from a preferential regime; and jurisdictions of residence or immediate parent company and ultimate parent company
2	Cross-border unilateral APAs and other cross-border unilateral tax rulings (such as ATRs) covering transfer pricing or the application of transfer pricing principles		
3	Cross-border rulings providing for unilateral downward adjustment to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial / commercial accounts	2	For PE rulings, the head office or jurisdiction of the PE; and the jurisdictions of residence of immediate parent company and ultimate parent company
4	Permanent establishment rulings	3	For conduit rulings, the jurisdiction of residence of any related party making payments to the conduit (directly or indirectly); and the jurisdiction of residence of the ultimate beneficial owner of payments made to the conduit; and the jurisdiction or residence of immediate parent company and ultimate parent company
5	Related party conduit rulings		
6	Any other type of ruling that in the abscence of spontaneous exchange gives rise to BEPS concerns (if and when agreed by the FHTP and IF)		
Applies to both past rulings and new rulings			

BEPS Action 5 – India's response

Sec. 115BBF

- Royalty income from patent developed and registered in India taxable @ 10%. No deduction allowed against this income.
- Developed in India: Expd in India for invention >75% of total worldwide expenditure on patent for invention.
- Patentee: True and first inventor of the invention.
- Royalty: Consideration (including lumpsum but excluding CG and embedded IP income from sale of products) for:
  - transfer of all or any rights (including the granting of a licence) in respect of a patent; or
  - imparting of any information concerning the working of, or the use of, patent; or
  - use of any patent; or
  - rendering of any services in connection with the activities referred to in above clauses.
- Option to be exercised by filing Form No. 3CFA on or before due date of filing return of income.

BEPS Action 5 – India's response

BEPS Action 5 Final Report vs. Sec. 115BBF

BEPS Action 5 Final Report	Factors	Sec. 115BBF
Royalty, CG, embedded IP income	**Income**	Royalty
Applied under nexus ratio	**Expenditure ratio**	Applied as part of threshold for entitlement
Resident, PE of Foreign companies + Subsequent acquirer (for further development)	**Eligible assessee**	Resident + First and true inventor
Tends towards allowing expenditure on third party outsourcing	**Outsourcing**	Expd on outsourcing not allowed

Actions 8 to 10 – Aligning Transfer Pricing Outcomes With Value Creation

Action 8 - Intangibles

Six-step analytical framework for transactions involving use or transfer of intangibles

- Identify the intangibles and economically significant risks with specificity
- Determine contractual arrangements between AEs
- Identify the parties performing functions, using assets and managing DEMPE
- Interpret the outcome of step 1 to 3 and determine whether the contractual assumption of risk is consistent with actual conduct
- Where the party assuming the risk does not control the risk or does not have the financial capacity to assume the risk, apply specific guidance on allocating risk
- Determine ALP for transaction consistent with each party's contribution to functions performed, assets used and risks assumed

Action 8 - Intangibles

Ownership of intangibles and transactions involving DEMPE functions:

D	Development of Intangibles
E	Enhancement of Intangibles
M	Maintenance of Intangibles
P	Protection of Intangibles
E	Exploitation of Intangibles

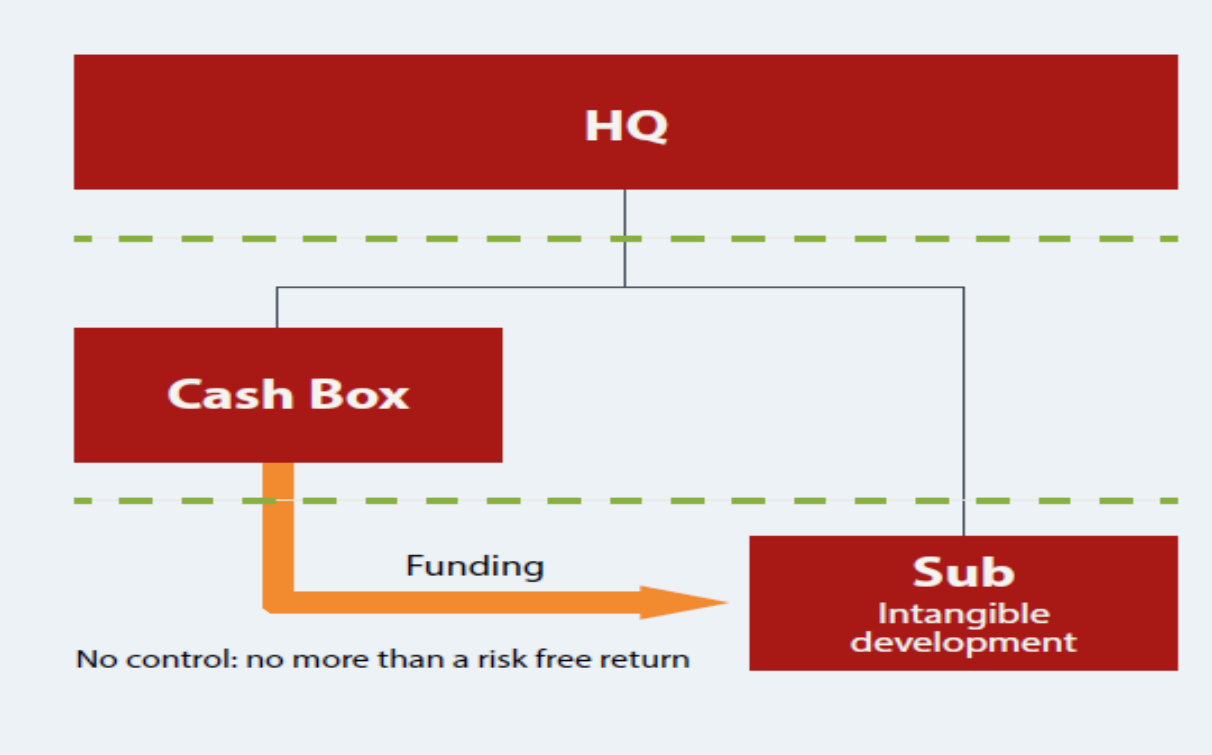
The new OECD guidance focuses on 'substance' over legal form for conducting transfer pricing analysis of intangibles

- Legal right and contractual arrangements form the starting point for any transfer pricing analysis
- Economic owner - performing important value creating functions/ DEMPE functions in relation to intangibles is eligible for retaining profits from exploitation of intangibles
- Legal owner who does not perform DEMPE functions eligible for only arm's length profits

Revised TP Guidelines issued by OECD on 10th July 2017

Action 8 – Intangibles

- Elimination of "Cash Boxes" with implementation of Action 8 to 10
- So-called "cash boxes" are entities holding valuable assets that fund intangible investments with little to no economic substance



Action 9 – Aligning Transfer Pricing Outcomes with Value Creation (Risk and Capital)

Guidance on application of the ALP – 6 step analytical framework for risk analysis

- Step 1: Identification of Economically Significant Risk
- Step 2: Determination of Contractual Assumption of Risk
- Step 3: Functional Analysis in Relation to Risk
- Step 4: Interpreting Steps 1 to 3
- Step 5: Allocation of Risk
- Step 6: Pricing the transaction, taking into consideration the consequences of risk allocation

Action 10 – Low Value-adding Intra-group Services

Definition of low value-adding intra-group services:

Includes

- Intra-group services are:
  - Of a supportive nature
  - Not a part of core group business of the group
  - Do not require unique/valuable intangibles & Do not lead to creating of unique/valuable intangibles
  - Do not involve or give rise to significant risk

Excludes

- Services constituting core business of the group
- Research & development services
- Manufacturing and production services
- Purchasing, sales, marketing and distribution activities
- Financial transactions
- Extraction, exploration or processing of natural resources
- Insurance/ reinsurance
- Services of corporate senior management

Examples

- Accounting & auditing • Processing and management of debtors/ creditors
- Activities in connection with human resources • Information technology support services • Internal and external communications and public relations support
- Legal, administrative, tax compliance and other clerical services

Action 10 – India's response

India Perspective: Revised Safe Harbour Regime

Receipt of low value-adding intra-group services in item (x) of rule 10TC	• Value of international transaction (including mark-up of <= 5%) to be <= 10 Crores • Documentation and calculations showing determination of cost pooling, selection and application of allocation keys is certified by an Indian chartered accountant or a specified foreign accountant

- Although the concept of LVAS is largely aligned with that introduced by OECD under BEPS Action Plan, the question widely remains open as to why the Safe Harbour Regime is applicable solely to "receipt" of LVAS and not otherwise
- Further, although the intent of introducing safe harbour guidelines for LVAS is to minimize the cost of compliance for benchmarking, it is unclear why an onerous requirement of absence of external comparability in such cases is mandatory. It is contrary to OECD guidelines which simply states that if an enterprise renders such similar LVAS to third parties, then the guidance would not apply since there would be reliable internal comparables in such a case. However, the new Safe Harbour guidelines take this further by stating that the concerned services should not have reliable external comparables in order for them to qualify as LVAS.
- It is not known why ITES, KPO and BPO services, being in the nature of support services, have been excluded from the definition of LVAS since the Safe Harbour guidelines for LVAS pertain to their receipt whereas the Safe Harbour guidelines for ITES, KPO and BPO pertain to provision of those services.

BEPS Action 8 to 10 – India's response

UN TP Manual (2017) - Country Practices – India

- India has committed to implementing the recommendations contained in the BEPS reports on transfer pricing.
- Accordingly, the Indian tax administration is of the view that the guidance flowing from the final report of the BEPS project on Actions 8, 9 and 10 should be utilized by both the TPOs and the taxpayers in situations of ambiguity in interpretation of the law.
- <u>Assumption of risks:</u>
  - India believes that the conduct of the parties is key to determining whether the actual allocation of risks conforms to contractual risk allocation. Allocation of risks depends upon the ability of parties to the transaction to exercise control over such risks.

BEPS Action 8 to 10 – India's response

- Assumption of risks:
  - Besides, financial capability to bear the risk is also important in establishing whether a party actually bears or controls the risk.
- Location Savings:
  - If good local comparables are available, the benefits of location savings can be said to have been captured in the ALP so determined.
- Marketing intangibles:
  - Application of DEMPE for alleging benefit to AEs
- Intra-group services:
  - Largely aligned with BEPA Action 10

Actions 13 – Transfer Pricing Documentation & Country-by-country Reporting

Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

Master file

High-level information about the MNEs business, transfer pricing policies and agreements with tax authorities in a single document available to all tax authorities where the MNE has operations

Local file

Detailed information about the local business, including related-party payments and receipts for products, services, interest, etc.

CbC report

CbC reporting applies to all MNEs with aggregate annual revenue in excess of €750m

High-level information about the jurisdictional allocation of profits, revenues, employees and assets

Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

Tax jurisdiction	Revenues			Profit (loss) before income tax	Cash tax paid (CIT and WHT)	Current year tax accrual	Stated capital	Accumulated earnings	Tangible assets other than cash and cash equivalents	Number of employees
	Unrelated party	Related party	Total							
1.										
2.										
3.										
4.										
5.										
6.										
7.										
Etc.										

- **Notes:**
- Flexibility in data sources allowed
- Entity data aggregated on the basis of tax residence
- Revenue defined to include sales, royalties, property, interest
- Revenue specifically excludes intercompany dividends
- Profit/loss before income tax includes extraordinary items
- Cash tax paid includes tax withheld by other parties on payments to the constituent entity
- Current year tax accrual is tax on current year operations only
- Number of employees may include external contractors

Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

Tax jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organization or incorporation if different from tax jurisdiction of residence	Main business activity(ies)											
			R&D	Holding or managing IP	Purchasing or procurement	Mfg or production	Sales, mktg or distribution	Admin., mgmt or support services	Provision of services to unrelated parties	Internal group finance	Regulated financial services	Insurance	Holding shares or other equity instruments	Dormant	Other
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														
Etc.															

- **Notes:**
- Constituent entities rather than legal entities
- Multiple activities may be chosen

<u>India Perspective</u>: Rule 10DA and Rule 10DB recently notified

Action 13 – India Response

CbCR

- Who needs to file:

- Indian resident which is parent entity of group (with consolidated revenue above Euro 750 million);
- Alternate designated reporting entity;
- Indian constituent entities of foreign MNCs;
  - If no exchange of information agreement exists between India and foreign parent entity's country; or
  - If overseas jurisdiction fails in furnishing report

- India has become a signatory to the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of CBC Report with the other signatories of the Agreement on 12 May 2016 and notified on 28July 2017

Action 13 – India Response

CbCR –Rule 10DB

- Indian Parent or Alternate Reporting Entity (ARE):
  - Due date: On or before due date of filing ROI
  - Form 3CEAD
  - For FY 2016-17 – due date is 31st March 2018

- Indian Cos with Non-Indian Parent to notify if it is ARE or details of its parent along with country,
  - 60 days prior to due date of filing ROI (1st October)
  - Form 3CEAC

- Designated constituent entity can furnish Form 3CEAD by filing intimation under Form 3CEAE

Master File –Rule 10DA

- Constituent Entity to file if:
  - Consolidated Revenue of the International Group for the accounting year as per the consolidated financial statements > INR 500 crores

AND

  - Aggregate value of International Transaction in Accounting Year As per Books of Accounts > INR 50 crores OR Aggregate value of International Transaction Accounting Year As per Books of Accounts in relation to purchase, sale, transfer, lease or use of intangible property> INR 10 crores

- Form 3CEAA:
  - Part A – Every constituent entity of an international group, whether or not the above conditions are satisfied
  - Part B – Constituent entity satisfying above thresholds

Master File –Rule 10DA

- Due Date for Form 3CEAA:
  - On or before due date of filing ROI (i.e. 30th November)
  - For FY 2016-17 – due date extended to 31st March 2018

- Designated Constituent Entity:
  - Where > 1 constituent entity is resident in India, then,
    - Entire Form 3CEAA; or
    - Part A of Form 3CEAA,

    may be furnished by the designated constituent entity only
  - Intimation of such designation in Form 3CEAB
  - Due date for Form 3CEAB:
    - 30 days prior to due date of Form 3CEAA (i.e. 31st October)

Multilateral Instrument

Group photo of the Signatories participating in the MLI Signing Ceremony held on 7 June 2017 at the OECD Headquaters in Paris

Key Features of MLI

MLI – Key Features

Jurisdictions involved

- Instrument developed by an Ad hoc Group of 100+ jurisdictions
- Signed by developed and developing economies around the world
- Instrument open for signature by any country

Measures included

- Includes measures against hybrid mismatch arrangements (Action 2) and treaty abuse (Action 6), strengthened definition of permanent establishment (Action 7) and measures to make mutual agreement procedures (MAP) more effective (Action 14), including provisions on MAP arbitration.

Tax treaties covered

- Parties can choose tax treaties to be modified by the MLI
- Parties remain free to make subsequent amendments to their modified tax treaties through bilateral negotiations

MLI – Key Features

Flexibility

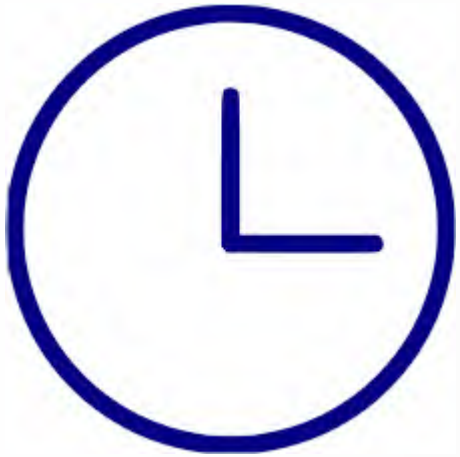
- Flexibility with respect to ways of meeting BEPS minimum standards on treaty abuse and dispute resolution
- Possibility to opt out of provisions which do not reflect a BEPS minimum standard with the possibility to opt in later
- Possibility to apply optional provisions and alternative provisions at any time where there are multiple ways to address BEPS

Clarity & Transparency

- Explanatory Statement available and additional materials
- Notifications of Covered Tax Agreements, reservations, options and affected existing provisions (MLI Positions) to identify modifications. MLI positions provided by each jurisdiction available on the OECD website
- Additional information material will be published on the OECD website, including interactive flowcharts of each substantive provision as well as an application toolkit

Languages

- English and French text authentic
- Translations being developed by individual countries and published on the OECD website (oe.cd/mli)



MLI Timeline

MLI Timeline

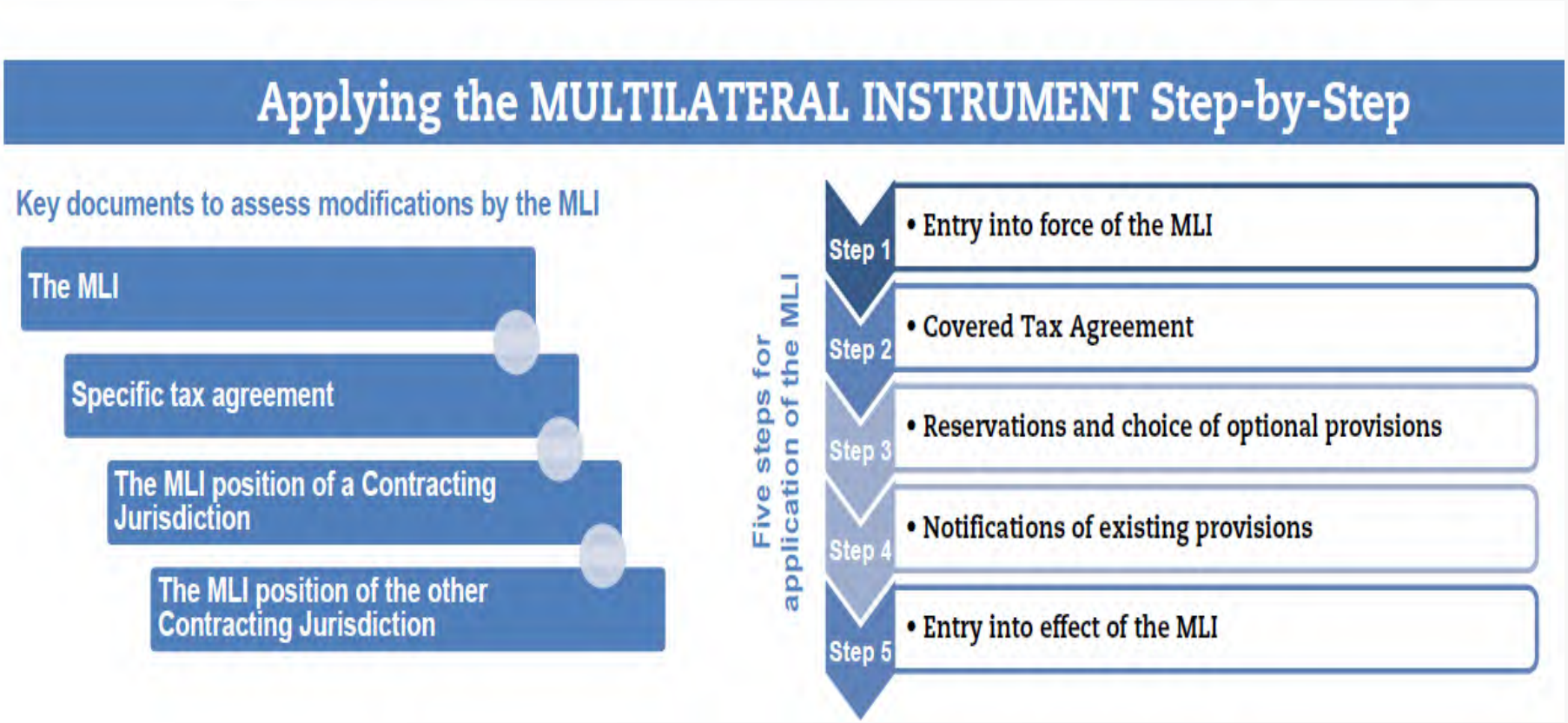
February 2013	On 12 February 2013 the report Addressing Base Erosion and Profit Shifting was published recommending the development of an action plan to address BEPS issues in a comprehensive manner.
July 2013	In July 2013, the OECD Committee on Fiscal Affairs (CFA) submitted the BEPS Action Plan to the G20 identifying 15 actions to address BEPS in a comprehensive manner, and set out deadlines to implement those actions.
September 2014	On 16 September 2014, the Action 15 interim report of the BEPS Action Plan called for the development of a multilateral instrument to implement tax treaty-related BEPS measures developed in the course of the work on BEPS and modify bilateral tax treaties.
February 2015	Based on the Action 15 interim report, a mandate to set up the Ad hoc Group for the development of a multilateral instrument was developed by the CFA in February 2015 and endorsed by the G20 Finance Ministers and Central Bank Governors, open to the participation of all interested countries on an equal footing.

MLI Timeline

October 2015	On 5 October 2015, the final BEPS package was published and subsequently endorsed by the G20 Finance Ministers and Leaders comprising reports on each of the 15 actions identified in the BEPS Action Plan.
November 2016	On 24 November 2016, the ad hoc Group concluded the negotiations and adopted the Text of the MLI as well as its accompanying Explanatory Statement.
June 2017	On 7 June 2017, a high-level signing ceremony took place in Paris.
2017-2019	• Completion of steps to undertake to sign the MLI by many other jurisdictions expected to sign the MLI. • Signatories ratify the MLI in accordance with their domestic procedures. • The MLI will enter into force three months after the deposit of the fifth instrument of ratification, acceptance or approval. Six months after the MLI has entered into force, it will take effect for taxes levied (with the exception of taxes withheld at source). • Preparation of consolidated versions of tax treaties modified by the MLI by individual jurisdictions (either due to domestic requirements or in order to ensure clarity and transparency for tax administrations and taxpayers).

Applying MLI

Applying MLI



Applying MLI – Step 1 & 2

Step 1 • **Entry into force of the MLI: Verify if the MLI has entered into force**

(i) Is the MLI itself in force? (Have five jurisdictions deposited the instrument of ratification, acceptance or approval?)	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply.*	More information:
(ii) Is the MLI in force for both Contracting Jurisdictions to the tax agreement? (Are both Contracting Jurisdictions Parties to the MLI?)	☐ YES: *The MLI could apply to the tax agreement. Go to* ***Step 2*** ☐ NO: *The MLI does not apply.*	▪ Article 34 ▪ Explanatory Statement, para. 320-323

Step 2 • **Covered Tax Agreement: Verify if the tax agreement is a Covered Tax Agreement**

(i) Do both Contracting Jurisdictions list the tax agreement in their MLI positions as an agreement to be covered by the MLI?	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply to the tax agreement.*	More information:
(ii) Is the tax agreement in force?	☐ YES: *The MLI can apply to the tax agreement (The tax agreement is a Covered Tax Agreement). Go to* ***Step 3*** ☐ NO: *The tax agreement will be a Covered Tax Agreement after entry into force.*	▪ Article 2(1)(a) ▪ Explanatory Statement, para. 25-33 ▪ Flowchart on Article 2

Applying MLI – Step 3

Step 3 • **Reservations and choice of optional provisions: Identify which MLI provisions apply**

This step must generally be followed to identify which MLI provisions apply to a Covered Tax Agreement.
For detailed information and specificities of each Article, please see the MLI flowcharts.

Reservations:

Does either Contracting Jurisdiction to the Covered Tax Agreement make a reservation on the application of a provision of the MLI?

☐ YES: *The MLI provision for which the reservation is made does not apply and does not modify the Covered Tax Agreement.*

☐ NO: *The MLI Article could apply and modify the Covered Tax Agreement.*

More information:

- Each MLI provision and its Explanatory Statement
- Flowchart on each Article

Note: Each Contracting Jurisdiction is allowed to make a reservation unilaterally, while the effect of reservation applies symmetrically (see Article 28(3)). Accordingly, a reservation made by a Contracting Jurisdiction with respect to a provision generally blocks the application of the provision, whether or not the other Contracting Jurisdiction has also made the reservation.

Optional provisions:

Do both Contracting Jurisdictions to the Covered Tax Agreement choose to apply an optional provision of the MLI?

☐ YES: *The optional provision chosen could apply and modify the Covered Tax Agreement.*

☐ NO: *The optional provision does not apply.*

More information:

- Each MLI provision and its Explanatory Statement
- Flowchart on each Article

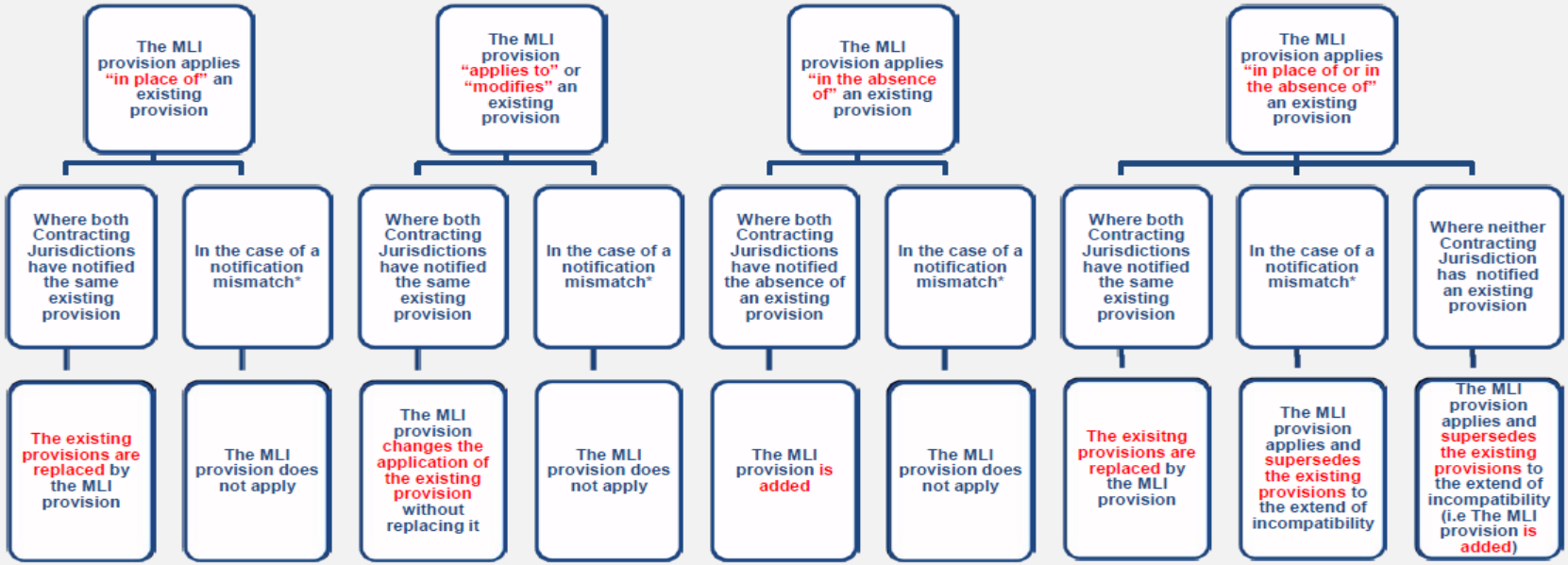
Note: Contrary to reservations, both Contracting Jurisdictions are required to choose to apply the same optional provision in order to apply the provision (except for Article 5 and 23(5)).

Applying MLI – Step 4

Step 4

- **Notifications of exsiting provisions: Identify which existing provisions are modified**

To ensure clarity and transparency about the application, the MLI requires Parties to notify existing provisions to be modified by the MLI provision. In addition, each Article contains provisions describing details on how the applicable MLI provisions modify a Covered Tax Agreement (compatibility clauses). The effect of notificaitons depends on the type of compatibility clause which could provide that the MLI provision applies "in place of", "applies to" or "modifies", "in the absence of", or "in place of or in the absence of" (see also the Explanatory Statement, para. 15-18).



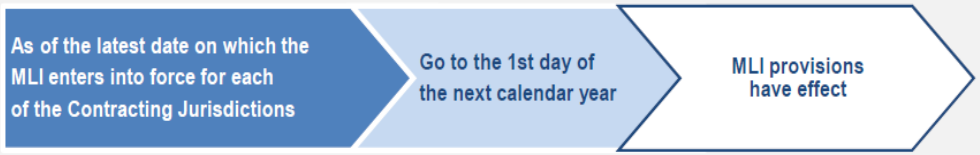
** Notification mismatches are cases where one Contracting Jurisdiction has notified an existing provision but the other has not, or where the Contracting Jurisdictions have made a different notification with respect to existing provisions in their MLI positions (except for minor differences).*

Applying MLI – Step 4

Step 5 • **Entry into effect of the MLI: Verify if the MLI provisions have effect**

The MLI provisions will generally have effect in the Contracting Jurisdictions with respect to a Covered Tax Agreement at different moment with respect to taxes withheld at source and with respect to all other taxes levied by a Contracting Jurisdiction.

With respect to taxes withheld at source:



With respect to all other taxes levied by a Contracting Jurisdiction:

More information:

- Articles 35 and 36
- Explanatory Statement, para. 324-350

Note: The MLI provides exceptions to the above general rules of entry into effect. Please see Articles 35 and 36 as well as the MLI positions.

Articles under MLI & India position

Articles under MLI

BEPS Action	Part	Article	India Position
-	Part I : Scope and Interpretation of Terms	Article 1 & 2	-
Action 2	Part II : Hybrid Mismatches	Article 3, 4 & 5	Not to apply to India's CTAs
Action 6	<u>Part III: Treaty Abuse</u> • Purpose of the CTA (Preamble) • Prevention of Treaty Abuse • Dividend Transfer Transactions • CG from alienation of share/interest deriving value from Imm Prop • Anti-abuse rule for PE in third state • Taxing rights for own residents	• Art 6 • Art 7 • Art 8 • Art 9 • Art 10 • Art 11	Article 6 & 7 - Minimum Standard – India has opted for PPT + Simplified LOB Article 8 to 10 – Optional India has opted for Article 8 and 9(4)

Articles under MLI

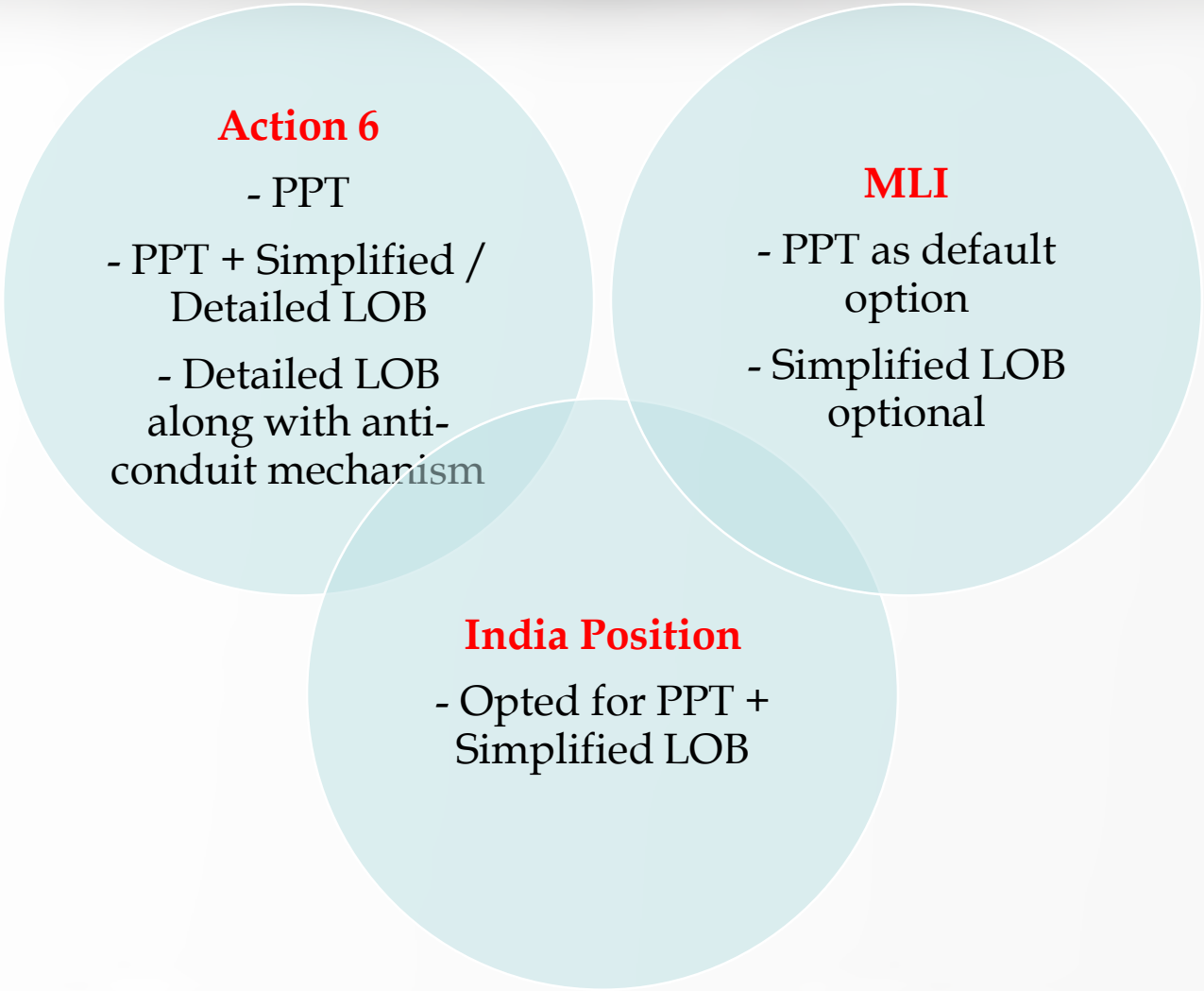
BEPS Action	Part	Article	India Position
Action 7	Part IV: Avoidance of Permanent Establishment Status through: • Commissionaire Arrangements • Specific Activity Exemptions • Splitting up of Contracts Definition of closely related person	• Art 12 • Art 13 • Art 14 Art 15	Optional No reservations made by India Article 13 – India has chosen Option A
Action 14	Part V : Improving Dispute Resolution	Article 16 & 17	India has expressed certain reservations
-	Part VI : Arbitration	Article 18 to 26	India has opted out
-	Part V : Final Provisions	Article 27 to 39	

Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Action 6 – Preventing Treaty Abuse

- Treaty abuse - most important sources of BEPS concerns
- Action Plan provides for - Three pronged approach to deal with Treaty shopping
  - A statement that Treaties intend to avoid tax evasion / avoidance / Treaty shopping;
  - Inclusion of LOB rule in Treaties;
  - Inclusion of general anti-abuse rule (PPT rule) in Treaties
- Rules to address other forms of Treaty abuse:
  - Dividend transfer transactions
  - Companies deriving value primarily from immovable property
  - Dual resident entities
  - Transfer of right / property to PEs in third states
  - Ensuring that Treaties do not prevent application of domestic anti abuse rules

Action 6 – Preventing Treaty Abuse



Principle Purpose Test ('PPT')

- 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.

Simplified LOB

Para 8. Except as otherwise provided in the Simplified Limitation on Benefits Provision, a resident of a Contracting Jurisdiction to a Covered Tax Agreement shall not be entitled to a benefit that would otherwise be accorded by the Covered Tax Agreement, other than a benefit under provisions of the Covered Tax Agreement:

a) which determine the residence of a person other than an individual which is a resident of more than one Contracting Jurisdiction by reason of provisions of the Covered Tax Agreement that define a resident of a Contracting Jurisdiction;

b) which provide that a Contracting Jurisdiction will grant to an enterprise of that Contracting Jurisdiction a corresponding adjustment following an initial adjustment made by the other Contacting Jurisdiction, in accordance with the Covered Tax Agreement, to the amount of tax charged in the first-mentioned Contracting Jurisdiction on the profits of an associated enterprise; or

c) which allow residents of a Contracting Jurisdiction to request that the competent authority of that Contracting Jurisdiction consider cases of taxation not in accordance with the Covered Tax Agreement,

unless such resident is a "**qualified person**", as defined in paragraph 9 at the time that the benefit would be accorded.

Simplified LOB

Para 9. A resident of a Contracting Jurisdiction to a Covered Tax Agreement shall be a qualified person at a time when a benefit would otherwise be accorded by the Covered Tax Agreement if, at that time, the resident is:

a) an individual;

b) that Contracting Jurisdiction, or a political subdivision or local authority thereof, or an agency or instrumentality of any such Contracting Jurisdiction, political subdivision or local authority;

c) a company or other entity, if the principal class of its shares is regularly traded on one or more recognised stock exchanges;

d) a person, other than an individual, that:

   i. is a non-profit organisation of a type that is agreed to by the Contracting Jurisdictions through an exchange of diplomatic notes; or

   ii. is an entity or arrangement established in that Contracting Jurisdiction that is treated as a separate person under the taxation laws of that Contracting Jurisdiction and:

      A. that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that Contracting Jurisdiction or one of its political subdivisions or local authorities; or

      B. that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision A);

Simplified LOB

e) a person other than an individual, if, on at least half the days of a twelve-month period that includes the time when the benefit would otherwise be accorded, persons who are residents of that Contracting Jurisdiction and that are entitled to benefits of the Covered Tax Agreement under subparagraphs a) to d) own, directly or indirectly, at least 50 per cent of the shares of the person.

Para 10.

a) A resident of a Contracting Jurisdiction to a Covered Tax Agreement will be entitled to benefits of the Covered Tax Agreement **with respect to an item of income** derived from the other Contracting Jurisdiction, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned Contracting Jurisdiction, and the income derived from the other Contracting Jurisdiction **emanates from, or is incidental to**, that business. For purposes of the Simplified Limitation on Benefits Provision, the term "active conduct of a business" shall not include the following activities or any combination thereof:

i. operating as a holding company;
ii. providing overall supervision or administration of a group of companies;
iii. providing group financing (including cash pooling); or
iv. making or managing investments, unless these activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such.

Simplified LOB

b) If a resident of a Contracting Jurisdiction to a Covered Tax Agreement derives an item of income from a business activity conducted by that resident in the other Contracting Jurisdiction, or derives an item of income arising in the other Contracting Jurisdiction from a connected person, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned Contracting Jurisdiction to which the item is related is substantial in relation to the same activity or a complementary business activity carried on by the resident or such connected person in the other Contracting Jurisdiction. Whether a business activity is substantial for the purposes of this subparagraph shall be determined based on all the facts and circumstances.

c) For purposes of applying this paragraph, activities conducted by connected persons with respect to a resident of a Contracting Jurisdiction to a Covered Tax Agreement shall be deemed to be conducted by such resident.

Para 11. A resident of a Contracting Jurisdiction to a Covered Tax Agreement that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded by the Covered Tax Agreement **with respect to an item of income** if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least 75 per cent of the beneficial interests of the resident.

Simplified LOB

Para 12. If a resident of a Contracting Jurisdiction to a Covered Tax Agreement is neither a qualified person pursuant to the provisions of paragraph 9, nor entitled to benefits under paragraph 10 or 11, the competent authority of the other Contracting Jurisdiction may, nevertheless, grant the benefits of the Covered Tax Agreement, or benefits with respect to a specific item of income, taking into account the object and purpose of the Covered Tax Agreement, but only if such resident demonstrates to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under the Covered Tax Agreement. Before either granting or denying a request made under this paragraph by a resident of a Contracting Jurisdiction, the competent authority of the other Contracting Jurisdiction to which the request has been made shall consult with the competent authority of the first-mentioned Contracting Jurisdiction.

Para 13. For the purposes of the Simplified Limitation on Benefits Provision:

a) the term "recognised stock exchange" means:
   i. any stock exchange established and regulated as such under the laws of either Contracting Jurisdiction; and
   ii. any other stock exchange agreed upon by the competent authorities of the Contracting Jurisdictions;

Simplified LOB

c) the term "equivalent beneficiary" means any person who would be entitled to benefits with respect to an item of income accorded by a Contracting Jurisdiction to a Covered Tax Agreement under the domestic law of that Contracting Jurisdiction, the Covered Tax Agreement or any other international instrument which are equivalent to, or more favourable than, benefits to be accorded to that item of income under the Covered Tax Agreement; for the purposes of determining whether a person is an equivalent beneficiary with respect to dividends, the person shall be deemed to hold the same capital of the company paying the dividends as such capital the company claiming the benefit with respect to the dividends holds;

d) with respect to entities that are not companies, the term "shares" means interests that are comparable to shares;

e) two persons shall be "connected persons" if one owns, directly or indirectly, at least 50 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares) in each person; in any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

Simplified LOB to apply in place of or in the absence of

Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status

Artificial Avoidance of PE Status

MLI includes provisions for addressing the following PE avoidance structures:

a) Commissionaire Structure for avoidance of dependent agency PE (Article 12)

b) Virtual Conclusion of Contracts for avoidance of dependent agency PE (Article 12)

c) Fragmentation for avoidance of fixed place PE (Article 13)

d) Splitting up of Contracts for avoidance of construction PE (Article 14)

Proposed Changes to Art 5(4) of OECD MC

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity ~~of a preparatory or auxiliary character;~~

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs *a)* to *e)*, ~~provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character,~~

provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

Proposed Changes to Art 5(5) of OECD MC

5. Notwithstanding the provisions of paragraphs 1 and 2 ***but subject to the provisions of paragraph 6***, where a person ~~other than an agent of an independent status to whom paragraph 6 applies~~ is acting ***in a Contracting State*** on behalf of an enterprise and ~~has, and habitually exercises, in a Contracting State, an authority to conclude contracts~~***, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are***

a) in the name of the enterprise***, or***

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

Proposed Changes to Art 5(6) of OECD MC

6. ~~An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.~~

a) Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

b) For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise.

Article 13 0f MLI - Artificial Avoidance of PE Status through the Specific Activity Exemptions

Option A

Para 2. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", the term "permanent establishment" shall be deemed not to include:

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 subparagraph a);

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b),

provided that such activity or, in the case of subparagraph c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

India has chosen Option A

Thank you

Contact Information

P. R. BHUTA & Co.
CHARTERED ACCOUNTANTS

Address	2-I, Jeevan Sahakar, 2nd Floor, Sir P. M. Road, Fort, Mumbai – 400001, India.
Telephone	+91 22 22660010/3427; 43471727
Mobile	+91 9930114418;
Fax	+91 22 22662793
E-mail	harshal.bhuta@bhutaco.com
Website	www.bhutaco.com