

The Chamber of Tax Consultants

MLI Course - Implementation & Beyond and Impact on Indian Treaties

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Splitting-up of contracts: Anti Abuse Rules under MLI

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Construction PE - Sample clause

OECD

“ARTICLE 5 - PERMANENT ESTABLISHMENT

...3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.”

India – Netherlands Tax treaty

“ARTICLE 5 - PERMANENT ESTABLISHMENT

2. ...(i) an installation or structure used for the exploration of natural resources provided that the activities continue for more than 183 days.

3. A building site or construction, installation or assembly project constitutes a permanent establishment only where such site or project continues for a period of more than six months.”

India – UK Tax treaty

“ARTICLE 5 - PERMANENT ESTABLISHMENT

2. ...

(i) an installation or structure used for the exploration or exploitation of natural resources;

(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

Construction PE – Indian treaties

- Indian tax treaties generally have a lower threshold of 6-9 months
- Types of Projects
 - Installation / construction / assembly; supervisory / consultancy (?)
 - O&G / natural resources exploration, etc.
- Service PE – Not in OECD MC; Indian tax treaties have a 90-120 days threshold

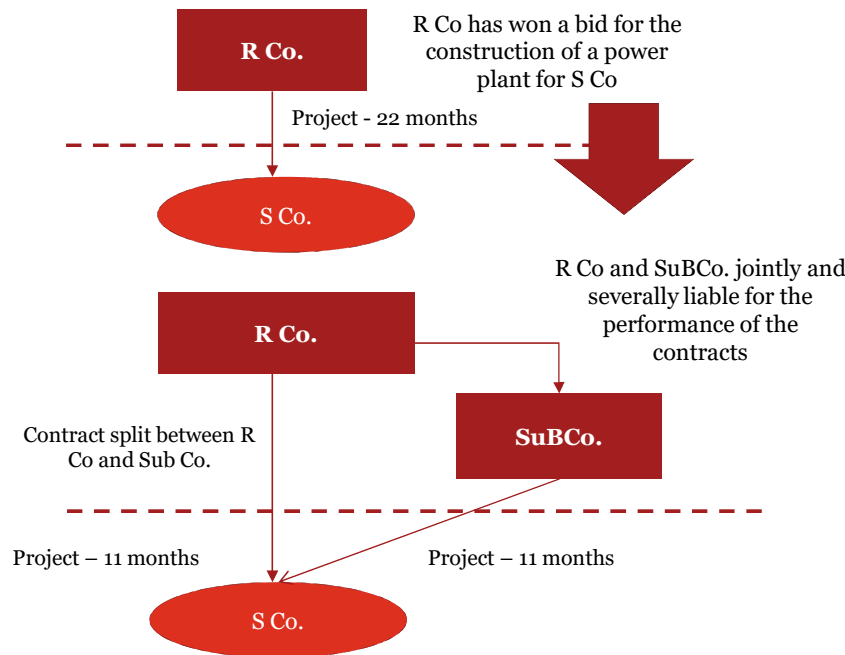
Construction PE – key contours

- Qua each Project
- Connected contracts - Commercial and Geographical coherence rule
- Different locations for a single project
- Project planning & supervision work covered (unless specifically excluded)
- Seasonal / temporary disruptions
- Time spent by sub-contractor

Indian Judicial cases

- Interconnection & Interdependence of contracts (J Ray McDermott Eastern Hemisphere Ltd– 39 SOT 240)
- Independent sub-contractor presence may not be counted sans geographical coherence (Pinstch Bamag, In re – 318 ITR 190)
- Nature of work has to be connected; irrespective of geographical coherence or with same contracting party (Valentine Maritime (Gulf) LLC - 45 SOT 359)
- Subcontractor hired by main contractor to execute the installation work (part of the overall contract) – treated as part of composite contract – Orpak systems Ltd (85 taxmann.com 235)
- Taking care of goods in India at the project site (post transfer of title of goods overseas) cannot be said to be supervisory activity – Hyosung Corporation – 314 ITR 343)
- Specific provision under 5(3) will prevail over general provision under 5(2) – BKI /HAM v.o.f - 347 ITR 570)

Potential abuse



Facts and Question

A threshold period of 12 months is prescribed under the Treaty for constitution of PE

S Co has the expertise to undertake the project and R Co does

Are the activities of R Co and S Co to be aggregated for the purpose of the 12 month rule

Is the contract being split to obtain tax benefit?

Splitting-up of contract - Possible address

- BEPS recommendation
 - Principal purpose test rule (MLI Art 7) – Treaty GAAR
 - Anti-abuse provisions (MLI Art 14 r.w. Art 15) – Treaty SAAR
- Other means
 - Domestic GAAR
 - Judicial GAAR

Key MLI Provision (Article 7)

Prevention of Treaty Abuse

1. 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.

Key Aspects

- Obtaining benefit was “one of” principal purposes
- Results directly or indirectly in the benefit
- Arrangement or transaction including “*establishment, acquisition & maintenance*”
- Exclusion - *object and purpose of the Treaty*
- Over and above LOB test

PPT Rule

Principal Purpose

- Minimum standard
- Objective test
- Case – by – case
- Obtaining benefit
- Not just one of the “purpose” – it will always be
- But “Principal consideration” – key driver of decision
 - Not so when inextricably linked to *commercial criteria*

One of principal purpose v/s Main purpose

Article 14 (MLI) – Splitting-up of contracts

1. For the sole purpose of determining whether the period (or periods) referred to in a provision of a Covered Tax Agreement that stipulates a period (or periods) of time after which specific projects or activities shall constitute a permanent establishment has been exceeded:

a) where an enterprise of a Contracting Jurisdiction carries on activities in the other Contracting Jurisdiction at a place that constitutes a **building site, construction project, installation project or other specific project** identified in the relevant provision of the Covered Tax Agreement, or carries on **supervisory or consultancy activities** in connection with such a place, in the case of a provision of a Covered Tax Agreement that refers to such activities, and these activities are carried on during **one or more periods** of time that, **in the aggregate, exceed 30 days without** exceeding the period or periods referred to in the relevant provision of the Covered Tax Agreement; and

b) where **connected activities** are carried on in that other Contracting Jurisdiction at (or, where the relevant provision of the Covered Tax Agreement applies to supervisory or consultancy activities, in connection with) the same building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement during different periods of time, **each exceeding 30 days, by one or more enterprises closely related** to the first-mentioned enterprise,



these different periods of time shall be added to the aggregate period of time during which the firstmentioned enterprise has carried on activities at that building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement.

Splitting-up of contracts – Key contours

Main Enterprise

- Building / construction/ installation, etc. projects
- Supervisory or consultancy activities – at project site?
 - If excluded by Tax treaty?
- One or more periods of time
- Exceeds 30 days in aggregate – actual physical presence?
 - Activities carried on v/s Project Duration

Closely Related Enterprise

- Connected Activities 
- By Closely related enterprise – Article 15 (MLI) 
- Each period of CRE > 30 days
- No overlap with period of main enterprise

Connected activities - Indicative factors (OECD commentary)

- Whether the contracts covering the different activities were concluded with the same person or related persons
- Whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons
- Whether the activities would have been covered by a single contract absent tax planning considerations
- Whether the nature of the work involved under the different contracts is the same or similar
- Whether the same employees are performing the activities under the different contracts



Commercial & Geographical coherence rule?

Article 15 (MLI) - Closely Related Enterprise

1



.....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.

Key Aspects

- Control
- 50%+ - deemed control
- Not necessarily AEs as per Section 92A (2) (26% shareholding, debt, etc.)

India Treaty Impact (upon MLI being effective)

A. PPT - Minimum standard – will impact all Indian treaties with MLI signatory treaty partners

B. Splitting-up Rule

Sr No.	Article of MLI	India's position	Impact on India's CTA
1	Article 14	Adopted	Can be amended – To the extent treaty partner has not reserved partly or entirely
2	Article 15	Adopted	Applies only if any of the Articles 12, 13 or 14 are applicable

India Treaty Impact – some examples

Splitting up of contracts related provision applicable

India - Netherlands

India - Australia

India - Ireland

India – New Zealand

Splitting up of contracts related provision not applicable

India - France

India - UK

India - Singapore

India - Japan

India - Sweden

Can MLI Article 14 rule be still applied by invoking PPT / Domestic GAAR ?

Interplay of GAAR / SAAR rules – Domestic law & Treaty

- Treaty GAAR (PPT) v.s. Treaty SAAR (Art 14)
 - Both can co-exist (CBDT circular)
 - But cannot overlap
 - If overlap, SAAR will apply
- Domestic GAAR v.s Treaty GAAR
- Any room for Judicial GAAR now?

Service PE v/s Construction PE

- Time threshold linked to actual solar days for which services rendered in Source state
- Time threshold linked to presence at project site (project duration)

Splitting up rules to apply to Service PE as well under PPT / GAAR rule ?

Some practical factors

- Distinct and independent nature of work
- Relevant expertise and experience
- No interdependence in execution
- Commercial risk bearing abilities
- Involvement of third parties
- Arms length justification
- Similar independent contracts with other third parties

Thank you

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