
MLI - Articles 4, 10 and 11 (BEPS Action 6 Report)

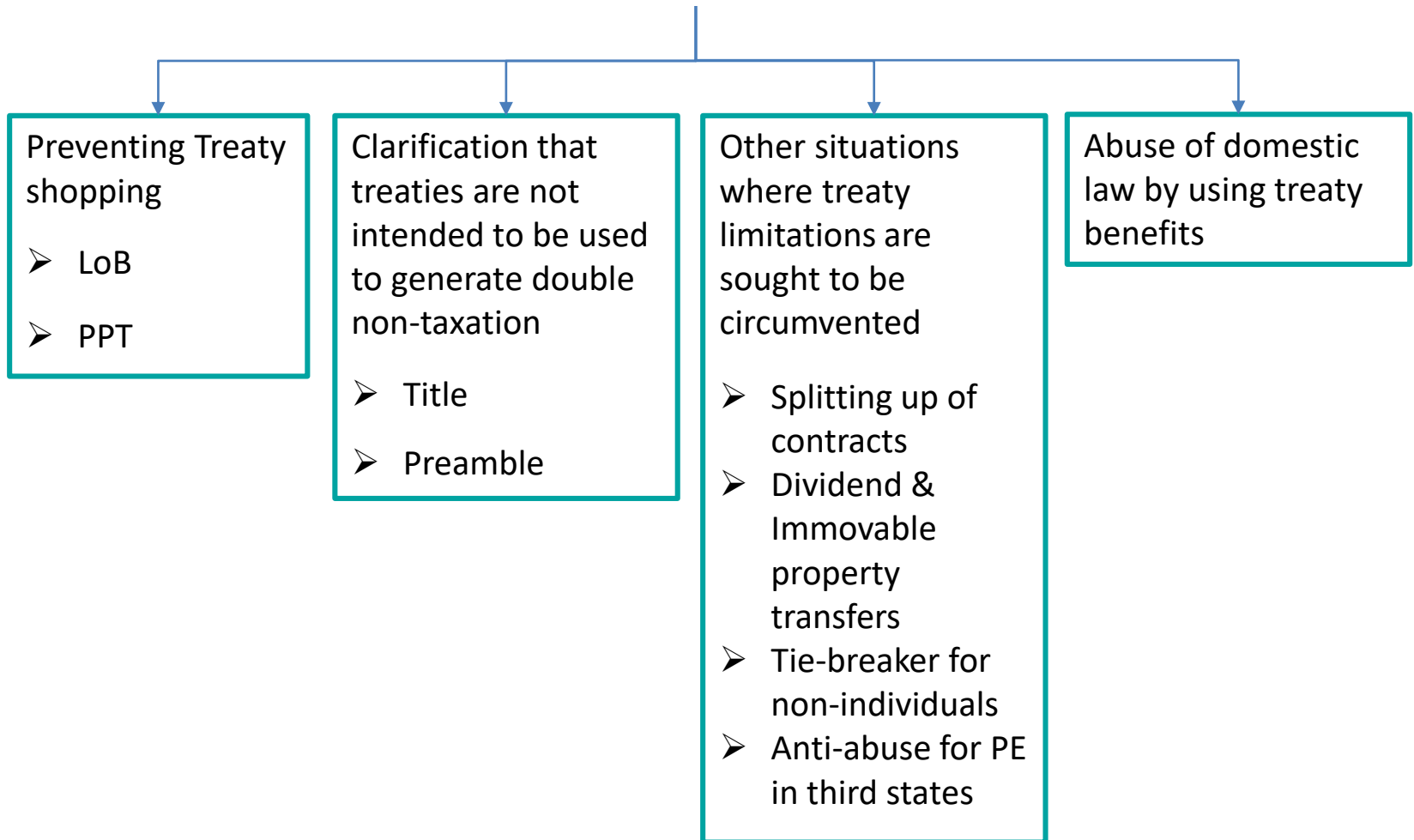
Hariharan Gangadharan
4 October 2019, Mumbai

Background

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BEPS Action 6

Preventing the granting of treaty benefits in inappropriate circumstances



Article 4 – Dual Resident Entities

The Context...

- Treaty benefits available to persons who are *residents* of one or both of the Contracting States
- Residency is determined based on whether the person is, under the laws of a State, liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature
- Since residency is determined in the first instance under domestic law, there is a need for a tie-breaker to establish rules of preference in case of dual-residency
- Tie-breaker for persons other than individuals historically based on 'place of effective management'
- 2008 update to the OECD Model Convention - provided an alternative version of the tie-breaker test based on mutual agreement of Competent Authorities – based on the rationale that though rare, dual-residency arrangements often involved tax avoidance arrangements

...the Context

- India's reservations to the OECD Model Convention and Commentary (2014)
 - India will refer to a MAP for determination of the Country of residence in case of a dual resident person other than an individual if the State in which its effective place of management is situated cannot be determined
 - India does not adhere to the interpretation given in paragraph 24 that the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. It is of the view that the place where the main and substantial activity of the entity is carried on is also to be taken into account when determining the place of effective management.

Most of India's treaties incorporate the POEM test as the tie-breaker test for non-individuals

...the Context...

OECD BEPS Action 6

Existing tie-breaker Rule in Article 4(3) should be replaced by an alternative that involves a case-to case resolution of dual-residency situations

Changes to OECD MC and Commentary

- Update to the OECD MC in November 2017
- Revised Article 4(3) incorporated to MC in November 2017
- Replacement / edits to paragraphs 21 to 24 of the commentary

Article 4 of MLI

- Incorporate revised Article 4(3) of the OECD MC 2017 to earlier tax treaties which would be CTAs

The Text...

Article 4(1)

Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.

...the Text...

Analysis of Article 4(1)

Limb 1 – The Rule

Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement,

Limb 2 – Relevant factors

having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors.

Limb 3 – Consequences

In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.

...the Text

- A look back at the tie-breaker test

“Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.”

KEY DIFFERENCES

- Who applies the tie-breaker?
- Can the tie-breaker test ever fail?
- Consequences of failure?

The Mechanics

Paragraph 2 – Applicability

- Paragraph 1 to apply in **place of or in absence** of provisions of a CTA that provide for rules for determining whether a person other than an individual shall be treated as resident of one of the Contracting Jurisdictions in cases in which that person would otherwise be treated as resident of more than one Contracting Jurisdictions.
- Paragraph 1 shall not apply, however, to the provisions of CTA specifically addressing the residence of companies participating in dual listed-company

Paragraph 3 – Contracting Jurisdictions may reserve the right that :

- Paragraph 4(3)(a) – Entire Article not to apply to CTAs
- Paragraph 4(3)(b) – Entire Article not to apply to CTAs that already address cases of DREs through MAPs
- Paragraph 4(3)(c) – Entire Article not to apply to CTAs that already address cases of DREs by denying tax treaty benefits without requiring the CAs to endeavor to reach mutual agreement
- Paragraph 4(3)(d) – Entire Article not to apply to CTAs that already address cases of DREs through MAPs and also situation where MAP cannot be reached
- Paragraph 4(3)(e) - Last sentence in paragraph 1 to be replaced by - no relief or exemption under CTA if no Mutual Agreement is reached between the CAs
- Paragraph 4(3)(f) - Article not to apply to CTAs with Parties that have made above reservation under Article 4(3)(e)

...the Mechanics

Factors relevant under 4(1)

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- Place of effective management
- Place of incorporation / constitution
- Where meetings of Board / equivalent body are usually held
- Where the CEO and other senior executives usually carry on their activities
- Where senior day-to-day management is carried on
- Where the headquarters are located
- Which country's laws govern the legal status of the person
- Where accounting records are kept
- Impact of decision on the risk of improper use of the Treaty

**From Article
4(1)**

**From the
OECD
Commentary
2017**

...the Mechanics

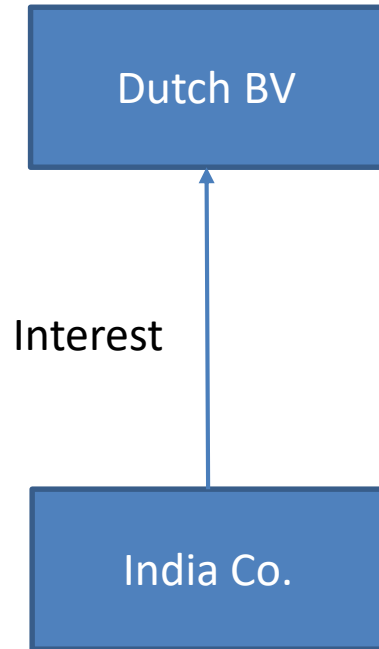
- Resolution of dual-residency situations under Article 4(1) will take place under the MAP mechanism in Article 25 (or its equivalent)
- Request for initiation MAP to resolve dual residency may be made as soon as it is probable that the person will be considered a resident of each Contracting State under para 1 (in any event before 3 years from the first notification of taxation measures denying reliefs/exemptions on account of dual residency)
- Competent Authorities to deal with such requests expeditiously
- Competent Authority decision to clarify the period of time covered by the decision

Impact on India's treaties

Sr.	Countries	Existing Article 4 in tax treaty with India	Options, Reservations and Notification opted by Countries	Impact on India's CTA with the Country
1	Cyprus	Article 4(3) - Where POEM is situated. If by POEM it cannot be determined, then CA to decide.	Reservation under Article 4(3)(a) of the MLI	Article 4 would not apply
2	Singapore	Article 4(3) - Where POEM is situated	Reservation under Article 4(3)(a) of the MLI	
3	Japan	Article 4(2) – Determined by the competent authorities	Article 4(3)(e) - Japan reserved the right to replace the last sentence of Article 4(1) : In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the CTA	India has not opted for 4(3)(f) - Modified Article 4 of MLI will apply with last sentence replacement
4 - 6	Netherlands UK Russia	Article 4(3) - Where POEM is situated	Opt in without any reservations	Article 4(1) will apply without any modification of last sentence

Case Study 1

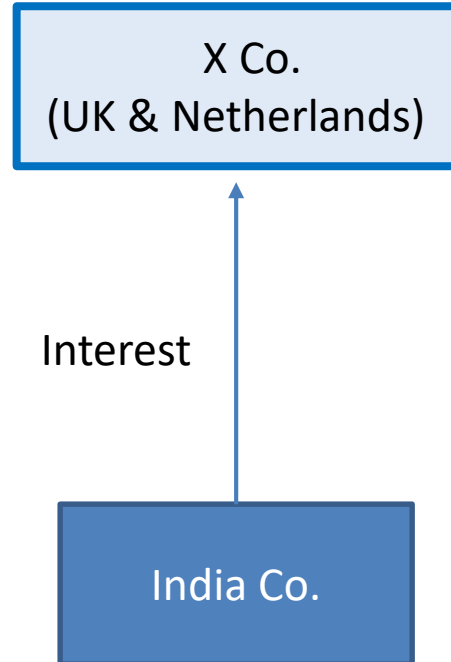
Issues for consideration



- Will 10% rate under the India-Netherlands treaty apply?
 - a) Will a TRC issued by Netherlands suffice for applying the treaty rate?
 - b) What should India Co. do at the time of withholding?
 - c) Will treaty rate benefit be available only at the time of assessment?
- What if the Dutch entity is a partnership?

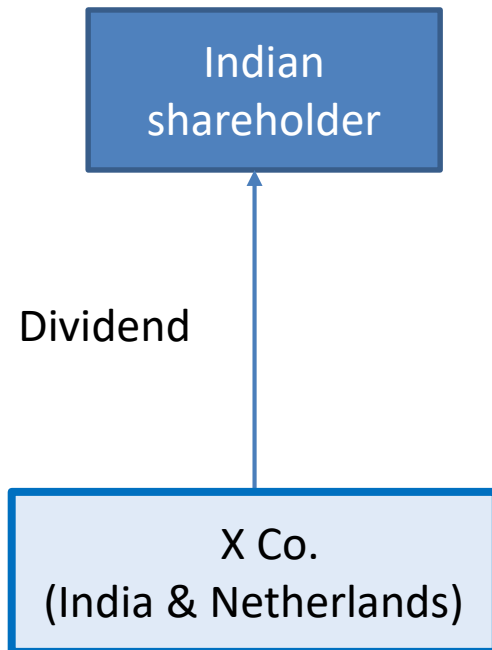
Case Study 2

Issues for consideration



- Will Article 4(1) apply to determine if India Co. should apply the 10% rate under the India-Netherlands treaty or the 15% rate under the India-UK treaty?
- If not, what rate can India apply?

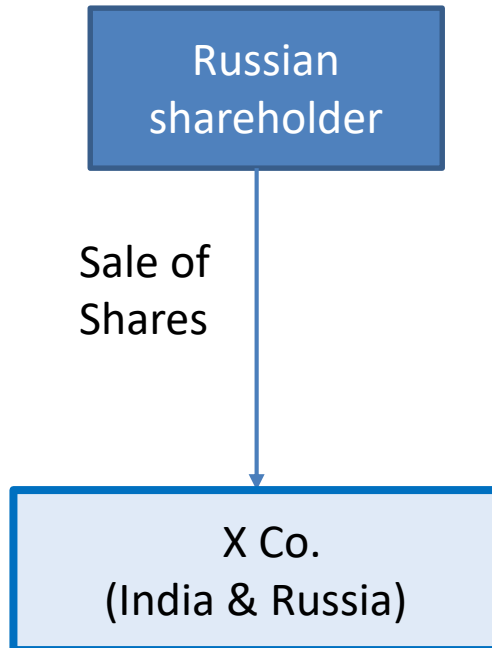
Case Study 3



- X Co. is dual-resident of India (under POEM) and UK (based on incorporation)
- Competent Authorities have been unable to determine residency by mutual agreement
- Will Article 11(2) of India UK Treaty apply?

“However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed... 10 per cent of the gross amount of the dividends”

Case Study 4



- X Co. is dual-resident of India (based on incorporation) and Russia (based on control/management)
- A Russian resident shareholder sells shares of X Co. to a Russian buyer
- Competent Authorities have been unable to determine residency of X Co. by mutual agreement
- What is the taxability of gains under the India-Russia treaty

“13(4). Gains from the alienation of shares of a company which is a resident of a Contracting State may be taxed in that State.

5. Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 3 and 4 shall be taxable only in the Contracting State of which the alienator is a resident.”

Article 10 – Anti-abuse rule for PEs in third jurisdictions

The Context...

- Permanent Establishments / Branches do not have a separate existence for treaty purposes - Treaty benefits determined based on the residential status of the Enterprise that carries on business through the PE
- State of Residence expected to alleviate double taxation by exempting income of PE / granting credit of taxes paid in the country of the PE
- Increased concern that State of Source should not be expected to grant treaty benefits in respect of income of a PE in a third state which is exempt or taxed at a concessional rate by the State of Residence
- Addressed through Article 10 of the MLI

The Text...

Article 10 (1)

Where:

a) an enterprise of a Contracting Jurisdiction to a Covered Tax Agreement derives income from the other Contracting Jurisdiction and the first-mentioned Contracting Jurisdiction treats such income as attributable to a permanent establishment of the enterprise situated in a third jurisdiction; and

b) the profits attributable to that permanent establishment are exempt from tax in the first-mentioned Contracting Jurisdiction,

the benefits of the Covered Tax Agreement shall not apply to any item of income on which the tax in the third jurisdiction is less than 60 per cent of the tax that would be imposed in the first-mentioned Contracting Jurisdiction on that item of income if that permanent establishment were situated in the first-mentioned Contracting Jurisdiction.

...the Text...

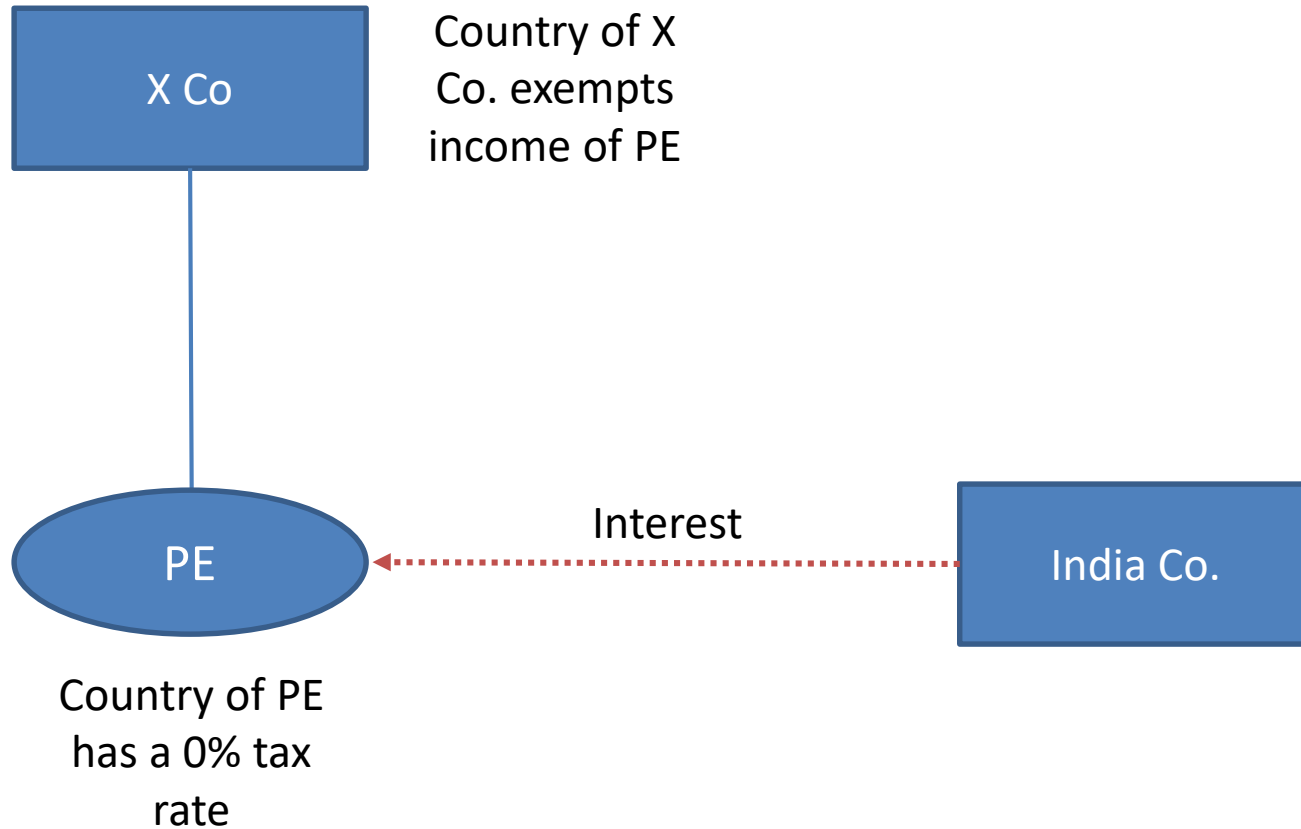
Article 10 (2)

Paragraph 1 shall not apply if the income derived from the other Contracting Jurisdiction described in paragraph 1 is derived in connection with or is incidental to the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively)

Article 10(3)

If benefits under a Covered Tax Agreement are denied pursuant to paragraph 1 with respect to an item of income derived by a resident of a Contracting Jurisdiction, the competent authority of the other Contracting Jurisdiction may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of paragraphs 1 and 2.

...the Text (illustrated)



The Mechanics

- Article 10 is not a minimum standard – Countries can opt out
- Paragraph 1 to 3 shall apply in place of or in absence of provisions in CTA that deny or limit benefits that would otherwise be granted to an enterprise of the contracting jurisdiction which derives income from the other contracting jurisdiction that is attributable to a PE of the enterprise in the third jurisdiction

Impact on India's treaties

Sr	Countries	Existing DTAA	Options, Reservations and Notification by the Country	Impact on India's CTA with the Country
1	Cyprus	No existing provisions	Reserved the right under 5(a) for entirety of Article 10 to not to apply to its CTA	Article 10 would not apply
2	Singapore			
3	UK			
4	Netherlands		Netherlands is silent on the applicability of this Article	India is silent on applicability of this Article. Thus, paragraph 1 to 3 of Article 10 will apply to CTA to the extent of incompatibility since it is "in place of" or "in absence of" criteriaArticle
5	Japan		Japan is silent on the applicability of this Article.	
6	Russia		Russia is silent on the applicability of this Article.	

Other relevant points

- Limited subjectivity in the application of Article 10 - Test largely mechanical
- Requires a comparison between the actual tax in the PE's jurisdiction with the potential tax that would have been leviable in the country of residence (as if the PE been situated there)
- Comparison is to be made with respect to tax on the specific item of income in respect of which treaty benefits are claimed
- Income in connection with or incidental to the active conduct of a business excluded – will be fact specific
- Wide discretion available to the competent authority of the country of source – justification for non-satisfaction of Paras (1) and (2) key

Article 11 – Right to tax own residents

The Context

- Concerns arose that some provisions aimed at taxation of non-residents are interpreted as limiting a Contracting State's right to tax its own residents
- Article 11 is intended to clarify that a treaty does not affect the taxation by a State of its own residents, except in respect of certain specific provisions, which are clearly intended to apply to residents.

The Text..

Paragraph 1 - A CTA shall not affect the taxation by a contracting jurisdiction of its Residents except with respect to the benefits granted under the provisions of the CTA which:

- a) Require a correlative / corresponding adjustments following an initial adjustment made by the other contracting jurisdiction as per CTA on the profits of the PE of the enterprise or the profits of an associated enterprise [Article 7(3) / 9(2) of OECD MC]
- b) May affect how a contracting jurisdiction taxes an individual resident in respect of service rendered to the other contracting jurisdiction or a political subdivision or local authority or other comparable body thereof (Article 19 of OECD MC)
- c) May affect how a contracting jurisdiction taxes an individual resident if that individual is a student, business apprentice, trainee, teacher, professor, lecturer, instructor, research or research scholar who meets the conditions of the CTA (Article 20 of OECD MC with extensions as provided in commentary / CTAs)
- d) Require that contracting jurisdiction provide tax credit / tax exemption to residents with respect to the income that other contracting jurisdiction may tax in accordance with the CTA (including PE) (Article 23A / 23B of OECD MC)
- e) Protects residents of the Contracting Jurisdiction against certain discriminatory taxation practices by that Contracting jurisdiction (Article 24 of OECD MC – E.g. Disallowing deduction for payments to Resident of other Contracting jurisdiction as stipulated, etc.)

...the Text

Paragraph 1 (Cont'd)

A CTA shall not affect the taxation by a contracting jurisdiction of its Residents except with respect to the benefits granted under the provisions of the CTA which:

- f) Allow residents of that contracting jurisdiction to request that the CA of that or either contracting jurisdiction to consider cases of taxation not in accordance with the CTA (Article 25 of OECD MC)
- g) May affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction when that individual is a member of a diplomatic mission, government mission or consular post of the other Contracting Jurisdiction; (Article 19 & 28 of OECD MC)
- h) Provide that pensions or other payments made under the social security legislation of the other Contracting Jurisdiction shall be taxable only in that other Contracting Jurisdiction; (Article 19 & 28 of OECD MC)
- i) Provide that pensions and similar payments, annuities, alimony payments or other maintenance payments arising in the other Contracting Jurisdiction shall be taxable only in that other Contracting Jurisdiction (Article 18 of OECD MC); or
- j) Otherwise expressly limit a Contracting Jurisdiction's right to tax its own residents or provide expressly that the Contracting Jurisdiction in which an item of income arises has the exclusive right to tax that item of income.

Mechanics

Paragraph 2 – Rule for modifying CTA

- Paragraph 1 shall apply in place of or in absence of provisions of CTA stating that the CTA would not affect the taxation by contracting jurisdiction of its Residents

Paragraph 3 - Parties may reserve the right that:

- Sub-paragraph (a) - For the entirety of the Article 11 of MLI not to apply to its CTAs
- Sub-paragraph (b) - For the entirety of the Article not to apply to CTAs that already contain the provisions described in paragraph 2

Paragraph 4 – Notification to the OECD Depository

- Each party not making a reservation under 11(3)(a)/(b) to notify the depository of whether each of its CTA contains a provisions described in paragraph 2 with Article numbers and paragraph numbers
- Where all the Contracting Jurisdictions have made a such a notification with respect to a provisions of a CTA, that provisions shall be replaced by Paragraph 1
- In all other cases, paragraph 1 shall supersede the provisions of the CTA only to the extent that those provisions are incompatible with paragraph 1

Impact on India's treaties

Sr.	Countries	Existing Provision in DTAA	Options, Reservations and Notification opted by the Country	Impact on India's CTA with that Country
1	Cyprus	No existing provision	Reserved the right under Article 11(3)(a) for entirety of Article 11 to not to apply to its CTA	Article 11 would not apply
2	Netherlands			
3	Singapore			
4	Japan			
5	UK		Not reserved the right to applicability of this article. Further, they have provided a list of CTA's where similar provision already exists	India is silent on the applicability of this article and UK has not reserved the applicability of this article, paragraph 1 of Article 11 will get added to India-UK CTA since it is "in place of" or "in absence of" criteria article
6	Russia		Russia is silent on the applicability of this Article.	Since India and Russia both are silent on the applicability of this article, paragraph 1 of Article 11 will apply to CTA to the extent of incompatibility since it is "in place of" or "in absence of" criteria Article

THANK YOU

Hariharan Gangadharan

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