



CTC MLI Course

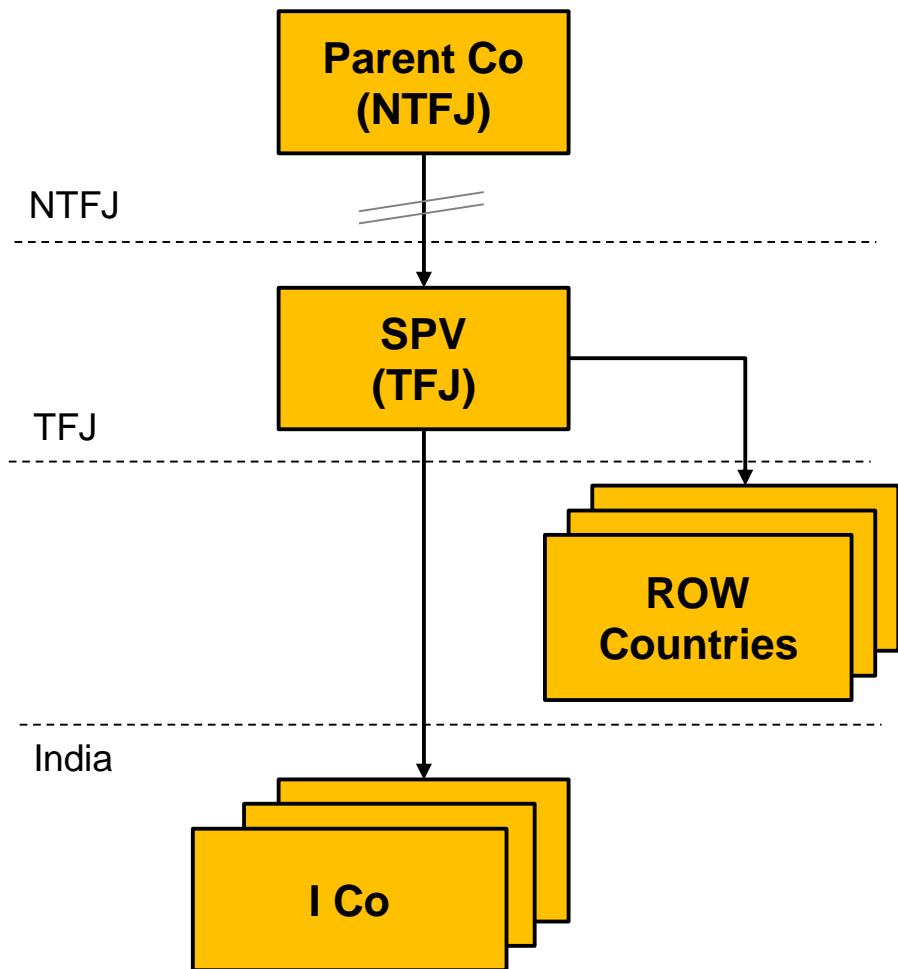
Prevention of Treaty Abuse – Article 6 (Preamble) and Article 7 (PPT), Interplay between GAAR and PPT, Safeguards for deductor

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Inbound investment and PPT impact

Typical structure of inbound investment

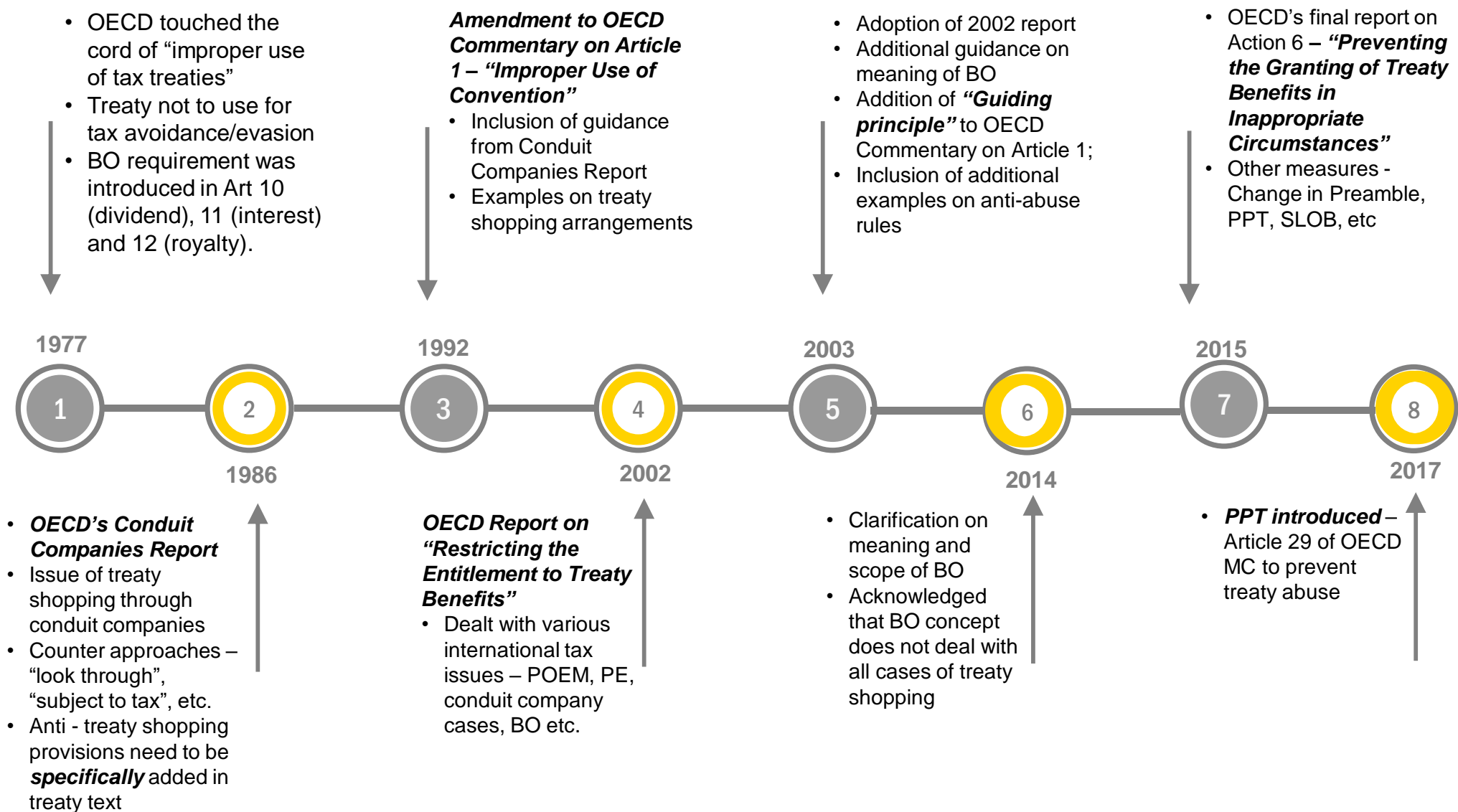


- ▶ Treaty relief (e.g., capital gain tax) to SPV on transfer of I Co shares
- ▶ Treaty shopping not the basis of denial of treaty unless dealt with specifically (Refer ABA, Vodafone SC rulings)
- ▶ Issues for consideration today
 - ▶ How far will MLI impact tax treaty benefit?
 - ▶ How far will GAAR impact tax treaty benefit?
 - ▶ To what extent PPT, LOB or other treaty oriented measures impact treaty entitlement?
 - ▶ Interplay amongst above

Access to treaty benefit



History and evolution of anti-abuse provision in OECD MC



OECD's concerns around treaty shopping

- ▶ Improper use of treaty, especially treaty shopping, was one of key concerns at OECD even prior to BEPS project. In 2003, OECD added following guiding principle to the commentary on Article 1:

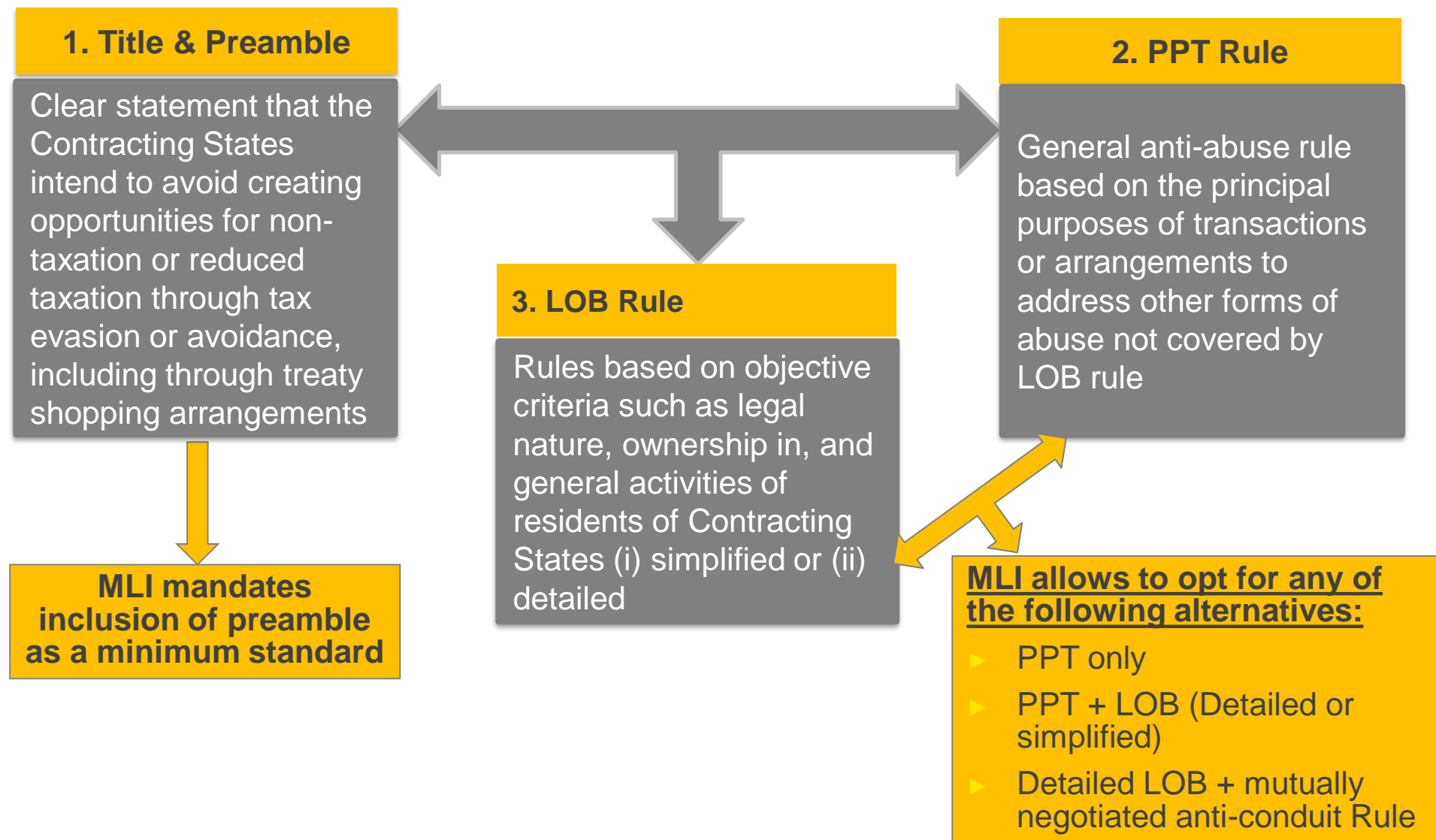
“A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”

- ▶ OECD measure under BEPS Action 6 - *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* deals with a variety of measures to control treaty abuse

*“**Treaty abuse is one of the most important sources of BEPS concerns.** The Commentary on Article 1 of the OECD Model Tax Convention already includes a number of examples of provisions that could be used to address treaty-shopping situations as well as other cases of treaty abuse, which may give rise to double non-taxation. **Tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.**”*

- ▶ Action Plan 6 is one of the minimum standards under OECD BEPS project

Three-pronged approach of BEPS Action 6 for prevention of treaty abuse



Article 6 of MLI – Purpose of CTA (Preamble)

Article 6 of MLI – Purpose of a CTA

► Text of the 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**)”*

- Being a minimum standard, requires insertion in CTA in absence of or in place of present text. Opt out is highly conditional
- Existing treaties may have a preamble, however for CTAs, preamble shall either stand “replaced” or “added” to text of the CTA due to compatibility clause – “in place of” or “in absence of” preamble language [Article 6(2)]

Synthesised text of MLI between India and UAE

Preamble as per existing India-UAE treaty	Preamble as supplemented by MLI
<p><i>The Government of the Republic of India and the Government of the United Arab Emirates desiring to promote mutual economic relations by concluding an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital have agreed as follows:</i></p>	<p><i>The Government of the Republic of India and the Government of the United Arab Emirates desiring to promote mutual economic relations....</i></p> <p><i>The following preamble text described in paragraph 1 of Article 6 of the MLI is included in the preamble of the Agreement:</i></p> <p><i>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 the Agreement for the indirect benefit of residents of third jurisdictions),</i></p>

Significance of “*Preamble*” in tax treaty interpretation

▶ Article 31 of VCLT:

- ▶ *“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”*
- ▶ *“The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, **including its preamble** and annexes:...”*

▶ Guidance from BEPS Action 6:

“73. The clear statement of the intention of the signatories to a tax treaty that appears in the above preamble will be relevant to the interpretation and application of the provisions of that treaty...”

▶ Guidance from Explanatory Statement to MLI:

“23. The inclusion of this statement in the preamble to the Convention is intended to clarify the intent of the Parties to ensure that Covered Tax Agreements be interpreted in line with the preamble language foreseen in Article 6(1).”

Significance of “Preamble” – SC in Azadi Bachao Andolan (263 ITR 706)(SC)

- ▶ SC acknowledged Taxpayer’s arguments to consider Preamble while interpreting treaty

“.....that the preamble of the Indo-Mauritius DTAC recites that it is for the "encouragement of mutual trade and investment" and this aspect of the matter cannot be lost sight of while interpreting the treaty”
- ▶ SC noted an academician’s observation that India has benefited from “Mauritius Conduit”

*“.....Although the Indian economic reforms since 1991 permitted such capital transfers, the amount would have been **much lower without the India-Mauritius tax treaty.**”*
- ▶ SC observed: similar to deficit financing, treaty shopping, though at first blush might appear to be evil , but is tolerated in a developing economy, in the interest of long term development.

*“.....Despite the sound and fury of the respondents over the so called 'abuse' of 'treaty shopping', perhaps, **it may have been intended at the time when Indo-Mauritius DTAC was entered into.** Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations.....”*

- Whether SC conclusion would remain unchanged post MLI?
- Is preamble insertion sufficient to target abuse including of treaty shopping?

Article 6 of MLI – Purpose of a CTA

- ▶ Optional additional text [**not opted** by India]:

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

- ▶ Optional provision is **not** a minimum standard;
- ▶ It will modify a CTA only if **both** the contracting jurisdictions agree to adopt and notify the choice for making the modification
- ▶ Illustrative list of countries which have opted for optional preamble text, include Australia, Belgium, Cyprus, France, Japan, Luxembourg, Netherlands, Singapore, South Africa, Switzerland, UK
- ▶ Impact of India not opting for additional text
 - ▶ Double non-taxation resulting from bona fide commercial activity is not an indicator of improper use of treaty – Example: Profits of Bangladesh PE of I Co
 - ▶ But, double non-taxation from tax avoidant transaction is not in line with object and purpose of treaty – Example: Letter-box company formed to claim treaty benefit

MLI Article and India positions

MLI provisions		Art No.	Minimum standard?	India's positions	MLI positions of all 89 signatories
Article 6 of MLI	Preamble	6(1)	√	√	78 jurisdictions (including India) made no reservation on Article 6. It shall be added to existing preamble.
	Preamble (additional sentence)	6(3)	X	X	57 jurisdictions have chosen to include
Article 7 of MLI	PPT Rule	7(1)	√	√ (but with reservation)	<ul style="list-style-type: none"> 89 jurisdictions to apply PPT From above, 11 jurisdictions (including India) applied with reservation
	PPT as an interim measure	7(1) r.w. 7(17)(a)	√	√	11 jurisdictions (including India) have opted for PPT as an interim measure
	Discretionary relief for PPT	7(4)	X	X	32 jurisdictions have chosen to allow discretionary relief for PPT
	SLOB Provision	7(8) to 7(13)	X	√	17 jurisdictions (including India) have chosen to apply SLOB 2 jurisdictions have opted to permit asymmetrical application of SLOB

Article 7 of MLI - Principal purpose test (PPT)

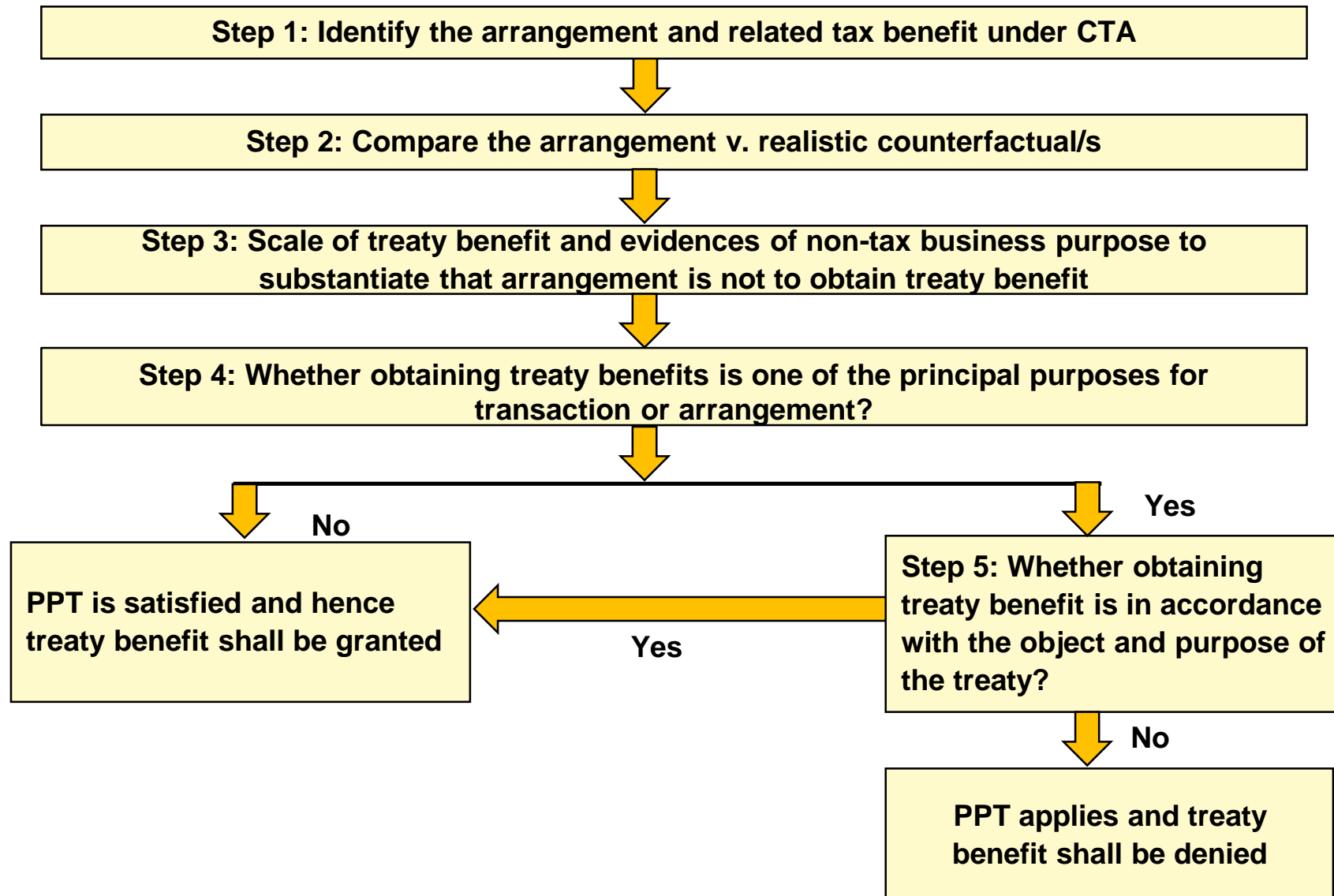
Article 7 of MLI – Prevention of Treaty Abuse

*“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, (‘reasonable purpose test’)*

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.**” (‘object and purpose test’)*

Step process for evaluation of PPT



Relevance of PPT for major investors in India

Country	Existing treaty has PPT or similar clause?	Counterparty posture in MLI?	Emerging position today?
USA	No	USA has not signed the MLI	No impact of MLI on existing treaty. However, existing treaty has Limitation of Benefit Article, which is similar to SLOB of MLI.
Mauritius	No. LOB is limited to capital gains article	India has not been notified as CTA by Mauritius	Until bilateral negotiations take place, no change to the existing treaty.
Singapore	No. LOB is limited to capital gains article	Only PPT adopted	PPT likely to apply. Additionally, in relation to capital gains article, LOB of existing treaty will continue to apply.
UK	Yes	Only PPT adopted	PPT as modified by MLI will form part of CTA in place of existing PPT provision
France	No	Only PPT is adopted	Since India and France both have notified PPT, the PPT will form part of CTA
China	No	Neither India nor China have notified India-China treaty as CTA	No impact of MLI on existing treaty. India-China tax treaty recently amended wherein PPT has been incorporated in Article 27A
Hong Kong	PPT like clause is limited to Articles being Dividend, Interest, Royalties, FTS, Capital gains	India has not been notified as CTA by Hong Kong	No impact of MLI on existing treaty despite India having notified Hong Kong in final notification.

Meaning of arrangement

- ▶ Action 6 final report provides the interpretation of the term ‘arrangement’:

*The terms “arrangement or transaction” should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. These terms also encompass arrangements concerning the **establishment, acquisition or maintenance of a person who derives the income**, including the qualification of that person as a resident of one of the Contracting States,*

For a typical holding structure, the taxpayer needs to explain reasons for having a separate entity and also reasons for establishing the entity in a given jurisdiction. [Need to satisfy separate entity test and location test].

Tax benefit under PPT

- ▶ Non-obstante provision with mandate of denial of treaty benefit
- ▶ Extends to direct as also indirect benefit under CTA
- ▶ “Benefit” covers all limitations on taxation imposed on the COS
 - ▶ Example: tax reduction, exemption, benefit of non-discrimination
- ▶ PPT can also be invoked by COR - In Indian context, UTC claimed under India
Singapore treaty can be subjected to PPT
- ▶ No impact on tax concessions admissible in domestic law (e.g. lower withholding rate admissible u/s 194LC/LD)

Reasonable purpose test

- ▶ Granular approach: Evaluate w.r.t. each arrangement, each stream of income; not qua entity as a whole
- ▶ Applies to an arrangement if its “one of the principal purpose” is treaty benefit
 - ▶ Obtaining treaty benefit need not be sole or dominant purpose
- ▶ Purpose of “arrangement” – an inanimate exercise
 - ▶ Question of fact: Requires objective analysis of all facts and circumstances
- ▶ “Reasonable to conclude”: no conclusive evidence requirement
 - ▶ Having sound judgment, fair, sensible, logical (not unreasonable)
 - ▶ Alternative views need to be examined objectively
 - ▶ All evidences must be weighed
 - ▶ Looking merely at the ‘effect’ not sufficient – tax benefit purpose not to be assumed lightly
 - ▶ Self assertion by taxpayer not sufficient

Is arrangement capable of being explained but for treaty benefit? **OR,**
Is treaty benefit in itself justifying the transaction?

Object and purpose carve out

- ▶ Even if treaty benefit is one of the principal purpose, PPT carve out protects treaty benefit if *'it accords with object and purpose of relevant provisions of CTA'*
- ▶ Onus to “establish” applicability of carve out lies on taxpayer
- ▶ Reasonable purpose test = Question of fact;

Object and purpose carve out = Question of law
- ▶ Evaluate object and purpose of relevant treaty provisions (implicitly, in overall treaty context including modified preamble)
- ▶ Object and purpose of distributive articles based on quantitative criteria v/s other distributive rules v/s general anti-avoidance provision of the treaty

Object and purpose carve out

- ▶ Treaty objects?
 - ▶ Eliminate double taxation: promote (bona fide) exchange of goods and services, and movements of capital and persons
 - ▶ Prevent tax avoidance and evasion; exchange of information
 - ▶ Provide certainty to taxpayers
 - ▶ Strike a bargain between two treaty countries as to division of tax revenues
 - ▶ Eliminate certain formats of discrimination
 - ▶ Foster economic relations, trade and investment
 - ▶ Language of Preamble (as modified by MLI) to aid determination of object and purpose
 - ▶ Eliminate certain forms of discrimination
 - ▶ Foster economic relations, trade and investment

Examples on PPT from OECD Commentary 2017

PPT limitation applies

Ex	Fact Pattern	OECD Conclusion
A, B	<ul style="list-style-type: none"> T Co owns shares of S Co. In absence of T-S treaty, dividend by S Co to T Co is subject to WHT of 25% under domestic law of State S. T Co assigns right to receive dividends declared but not yet paid by S Co, to R Co, an independent financial institution in State R Under R-S treaty, there is no WHT on dividends paid by S Co to R Co. 	In absence of other facts, PPT is applicable because: 'Reasonable purpose test' not satisfied; and 'object and purpose test' also not satisfied.
J	<ul style="list-style-type: none"> R Co has bidden for construction of a power plant for S Co. The project is expected to last 22 months. During contract negotiation, project is divided into two contracts of 11 months each; first contract by R Co and second contract by Sub Co (a recently formed WOS of R Co in State R). Both R Co and Sub Co are jointly and severally liable towards S Co. 	<p>In absence of other facts, PPT applicable because: 'Reasonable purpose test' not satisfied; and 'object and purpose test' also not satisfied.</p> <p>Granting treaty benefit in such situation would render time threshold provided in Article 5 meaningless.</p>

PPT limitation not applicable

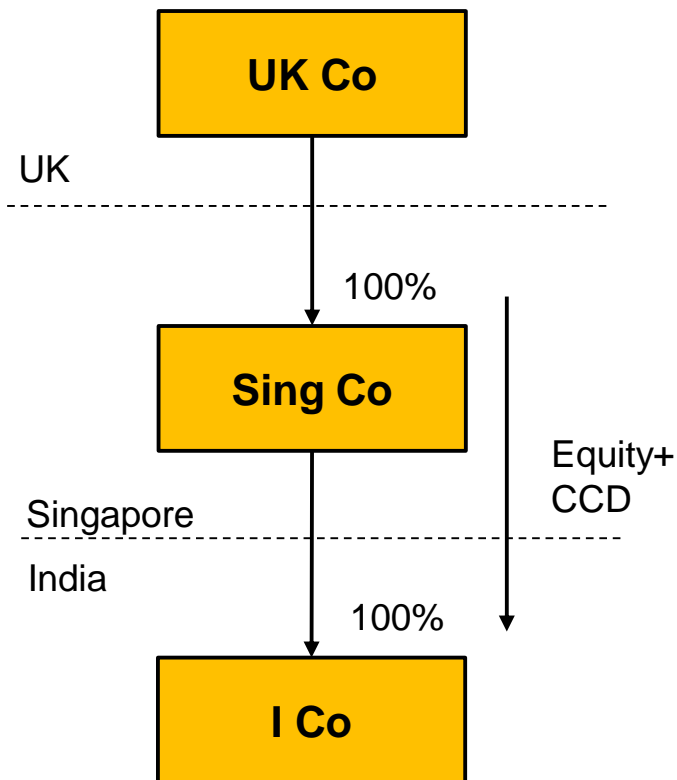
Ex	Fact pattern	OECD Conclusion
C	<ul style="list-style-type: none"> Setting up manufacturing plant in low cost jurisdiction Selection of treaty favourable jurisdiction amongst three equally placed jurisdictions 	<ul style="list-style-type: none"> Principal purpose is expansion of business and lower operation cost Meets treaty object of encouraging cross border investment
E	<ul style="list-style-type: none"> R Co has, for the last 5 years, held 24% shares of S Co. Following the entry-into-force of R-S treaty, R Co decides to increase its ownership to 25% shares of S Co. Decision to increase ownership by 1% is primarily to obtain treaty benefit of Article 10(2)(a) 	<ul style="list-style-type: none"> Though increase in investment is for one of the principal purpose of obtaining treaty benefit, it meets the “object and purpose” of the relevant dividend article of treaty PPT trigger is not warranted
G	<ul style="list-style-type: none"> Establishing intra-group service company in a jurisdiction with skilled labour force, reliable legal system, business friendly environment, political stability, sophisticated banking system and comprehensive treaty network 	<ul style="list-style-type: none"> Not reasonable to deny treaty benefits to R Co which conducts real business, using real assets, assumes real risks, and performs multitude economic functions through its own personnel located in State R.

Key takeaways from PPT examples of OECD Commentary 2017

- ▶ Primary aim of taxpayer should be to support choice of source jurisdiction being driven by commercial considerations relevant to core business; treaty benefit is incidental
 - ▶ Presence in source country supported by real assets, infrastructure and real business activities by deployment of skilled personnel
 - ▶ Various examples list locational advantages driving choice of SPV jurisdiction
 - ▶ At times, examples reflect disadvantages of home jurisdiction which are eliminated in SPV jurisdiction
- ▶ Presence of equivalent beneficiary
- ▶ Benefit under articles dealing with distributive rights with inbuilt conditions to be provided if there is bona fide fulfilment of the prescriptive conditions

Case Study 1 – Inbound investment; PPT/ GAAR impact

Case Study 1 - Inbound investment; PPT/ GAAR impact



- ▶ Sing Co's investments in shares of I Co were made before 1 April 2017
- ▶ Sing Co has invested in CCDs of I Co post 1 April 2017
- ▶ I-S protocol triggers **source taxation**, if gains arise from alienation of shares acquired **on or after 1 April 2017** [Article 13(4A)]
 - ▶ Residence based taxation for shares acquired **on or before 31 March 2017**
- ▶ Treaty benefit continues for gain on transfer of CCDs
- ▶ GAAR not to apply in respect of 'income from transfer' of investment made before 31 March 2017 [Rule 10U(1)(d)]
- ▶ Sing Co transfers certain shares before 31 March 2020 (**Tranche 1**)
- ▶ It is likely that balance shares along with CCDs will be transferred in 2021 (**Tranche 2**)
- ▶ Evaluate GAAR and PPT implications

Summary of tax implications

Assets of Sing Co	Acquisition	Disposal	GAAR applies?	PPT applies ?
I Co Shares (Tranche 1)	Pre April 2017	Pre March 2020	No	No
I Co shares (Tranche 2)	Pre April 2017	In 2021	No	Yes (?)
CCDs of I Co (Tranche 2)	Post April 2017	In 2021	Yes	Yes

Impact of LOB as applicable to capital gains article is to be evaluated separately

Disposal of ICo shares post PPT - Issues

Assets of Sing Co	Acquisition	Disposal	GAAR applies?	PPT applies?
I Co Shares (Tranche 1)	Pre April 2017	Pre March 2020	No	No
<i>I Co shares (Tranche 2)</i>	<i>Pre April 2017</i>	<i>In 2021</i>	<i>No</i>	<i>Yes (?)</i>
CCDs of I Co (Tranche 2)	Post April 2017	In 2021	Yes	Yes

As regard to transfer of I Co shares (Tranche 2):

- ▶ Applicability of PPT when the investments are GAAR grandfathered [Impact of s.90(2A) and interplay of PPT and GAAR]
- ▶ Does PPT apply for investments made prior to MLI developments? Do special considerations apply for treaty grandfathered investments?

PPT and GAAR interplay

Particulars	Domestic GAAR	Article 7 of MLI (PPT)
Applicability	<ul style="list-style-type: none"> Main purpose is tax benefit; and One of the tainted element tests is present 	<ul style="list-style-type: none"> One of the principal purposes is tax benefit Not in accordance with object and purpose of treaty
Consequences	Re-characterization of transaction, re-allocation of income (includes denial of treaty benefit)	Denial of treaty benefit
Onus	Primary onus on tax authority	Primary onus on tax authority and rebuttal assumption for carve out
Methodology	Involves analysis of 'counter factual'	Focus only on actual transaction?
Administrative safeguards	Approving Panel	To be determined by respective states. OECD and UN Model Commentaries suggests this
Grandfathering	Yes	No
De-minimis threshold	Yes	No

Para 22.1 of Article 1 of 2003 OECD Commentary (Para 79 of 2017 OECD Commentary) :

*“To the extent that the application of the (**domestic**) rules results in a re-characterization of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied taking into account these changes.....”*

PPT applicability to GAAR grandfathered investment

▶ S. 90(2)

“Where the Central Government has entered into an agreement with the Government of any country outside India.....under sub-section (1) for granting relief of tax,, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee”

▶ S. 90(2A)

“Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.”

▶ Article 28A of I-S treaty:

“This Agreement shall not prevent a Contracting State from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.”

- ▶ Is GAAR anchored into the treaty?
- ▶ Is PPT scope eclipsed by GAAR including the rules framed thereunder for GAAR?
- ▶ Whether as per Article 28A of I-S treaty, arrangement needs to be evaluated only under GAAR?

PPT and GAAR interplay

- ▶ Qua treaty benefit, PPT fulfilment essential
- ▶ If arrangement/transaction is PPT tainted, treaty benefit is denied:
 - ▶ GAAR invocation may not be necessary for denying treaty benefit
 - ▶ GAAR may still re-characterise the transaction
- ▶ If arrangement passes PPT test, GAAR test most likely gets fulfilled
 - ▶ Main purpose test of GAAR is, if at all, stricter
 - ▶ S.97(1)(c) test likely to be passed as location/residence is likely to be for substantial commercial purposes

Impact of PPT on treaty grandfathered investments

①

Alt 1: PPT will not apply to Article 13(4A) which is introduced for grandfathering past investments

- Grandfathering ensure smooth transition and aligns with domestic GAAR
- Amended I-S treaty was in light of BEPS project and grandfathering was a conscious decision

②

Alt 2: PPT applies to entire treaty including Article 13(4A) notwithstanding that acquisition of investment in I Co was on or before 31 March 2017

- PPT is a “non-obstante” provision and worded widely to cover all benefits
- PPT read with revised preamble will empower tax authority to deny tax benefit in treaty shopping arrangements

③

Alt 3: PPT applies to Article 13(4A). However, availing grandfathering benefit is in accordance with **object and purpose**

- Object and purpose of grandfathering provision is to avoid disruptive transition and provide certainty to the investors
- Providing certainty to taxpayers is one of the object and purpose of the treaty
- Grandfathering is an exception to the normal provision for applicability of treaty and its object may need to be respected.

Disposal of ICo CCD post PPT - Issues

Assets of Sing Co	Acquisition	Disposal	GAAR applies?	PPT applies?
I Co Shares (Tranche 1)	Pre April 2017	Pre March 2020	No	No
I Co shares (Tranche 2)	Pre April 2017	In 2021	No	Yes (?)
CCDs of I Co (Tranche 2)	Post April 2017	In 2021	Yes	Yes

As regard to transfer of CCDs of I Co (Tranche 2):

- ▶ What is the arrangement to which GAAR/ PPT can apply?
- ▶ Can choice of funding be questioned under GAAR/ PPT? i.e. whether CCDs can be recharacterized as shares?
- ▶ Is “one of the principal purpose” test of PPT broader compared to “main purpose” test under GAAR?

Evaluation of 'location test' for PPT and GAAR

- ▶ Arrangement includes establishment, acquisition or maintenance of a person who derives the income (OECD Commentary 2017)
- ▶ Tainted element of GAAR: arrangement that involves location of an asset, transaction, place of residence, without any substantial commercial purpose
- ▶ Illustrative commercials for selection for a location, being TFJ
 - ▶ Availability of skilled, multi-lingual work force and directors with knowledge of regional business practices and applicable regulations;
 - ▶ Membership of a regional grouping, or, of a common currency area
 - ▶ Favourable tax treaty network; especially within the targeted investment area
 - ▶ Favourable regulatory and legal framework
 - ▶ Developed international trade and financial markets
 - ▶ Political stability
 - ▶ Lender and investor familiarity
 - ▶ Difficulties/ limitations of home jurisdiction are ironed out in SPV jurisdiction [Example H of OECD Commentary 2017]

Can choice of funding be questioned under GAAR/PPT?

1

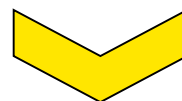
Choice of CCD is commercially driven and its form reflects underlying substance of it being debt till the date of conversion



Unlikely to get recharacterized as equity : skewed debt equity ratio may trigger s.94B

2

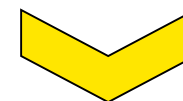
Terms of CCD and facts of the case support that rights, obligations of CCD holders are no different from that of equity shareholders



- Form is different from substance?
- If yes, form can be ignored under PPT
- GAAR too can recharacterize

3

TP analysis support that a debt funding is disproportionate and the behaviour is exceptional / commercially irrational



Is TP analysis to be restricted to TP consequences?

Threshold under GAAR and PPT: Is PPT wider?

- ▶ **“One of the principal purposes” v “main purpose test”: Threshold is practically same (View 1)**
 - ▶ Dictionary meanings of ‘main’ and ‘principal’ suggest that both synonymously refer to something which is ‘chief’ or ‘primary’ or ‘most important’;
 - ▶ GAAR and PPT both require an objective analysis of all facts and circumstances to the arrangement or transaction;
 - ▶ Various examples on PPT in OECD commentary 2017 give an impression that PPT applies only when treaty benefit is “the main” reason for the transaction
 - ▶ 2017 Commentary on PPT (Para 181) - the object and purpose of the PPT is primarily to target treaty shopping arrangements in cases, where obtaining treaty benefit is considered to be a “principal consideration” of entering into a transaction or an arrangement

Threshold under GAAR and PPT: Is PPT wider?

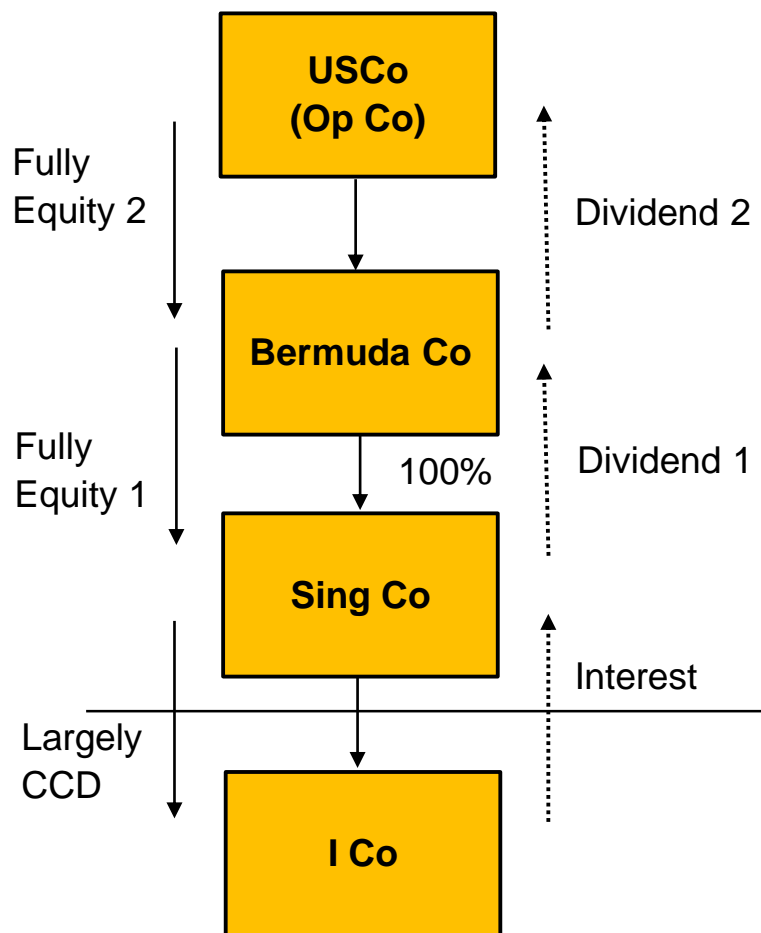
- ▶ **“One of the principal purposes” v “main purpose test”: Threshold is not same, PPT has lower threshold (View 2)**
 - ▶ Shome Committee, to allay concerns of taxpayers, recommended GAAR threshold to be reduced to ‘main purpose’ test from ‘one of the main purposes’ test
 - ▶ A plain reading itself indicates that ‘one of the principal purpose test’ has a lower threshold compared to ‘main purpose test’;
 - ▶ UN Commentary 2011 on Article 1 (para 36) suggests that ‘main purpose test’ may be interpreted restrictively in favour of taxpayers and has potential to render the provision ineffective;
 - ▶ UK HMRC guidance on GAAR states that ‘one of the main purposes test’ is wide enough to cover transactions which are implemented for commercial reasons as also for substantial tax advantage;
 - ▶ UN handbook suggests that ‘one of the main purposes test’ is relatively easily satisfied whereas ‘main purpose test’ is satisfied only when main or sole purpose of the transaction is tax benefit

Threshold under GAAR and PPT: Is PPT wider?

- ▶ **“One of the principal purposes” v “main purpose test” : similarities and differences**
 - ▶ GAAR in India, as also PPT of a treaty do factor the object and purpose of an arrangement
 - ▶ Both the tests require objective of quantitative analysis of all relevant facts and circumstances, but the conclusion needs to be drawn on ‘qualitative’ or ‘overall impression’ basis
 - ▶ PPT may likely have a threshold which is lower compared to ‘main purpose’ test
 - ▶ However, the significance of word ‘main’ as part of the requirement of ‘one of the main purposes’ should not be understated. The tax purpose should be of a threshold which is meaningful and not insignificant/ trivial/ secondary

Case Study 2 – Consequences of PPT

PPT impact – all or none approach?



Withholding on interest	Rate
Domestic law of India	40% + sc
India-Singapore DTAA	15%
India-USA DTAA	15%

- ▶ Sing Co has subscribed to CCDs of Rs. 500 Cr. with a coupon rate of 10% issued by I Co in 2010
- ▶ Sing Co holds valid TRC
- ▶ I Co has paid interest to Sing Co by withholding tax @15% as per I-S treaty
- ▶ Sing Co and Bermuda Co are financed fully by equity
- ▶ Interest received by Sing Co is up-streamed up to US Co by way of Dividend
- ▶ Absent treaty benefit, tax liability in respect of CCD interest is @40% + surcharge as per domestic law
- ▶ India and Singapore MLI related changes become effective from 1 April 2020

Tax Authority contentions for applicability of domestic rate on PPT trigger

- ▶ PPT applicable as Sing Co has been established and maintained for one of the principal purpose to obtain lower WHT rate
- ▶ PPT has absolute effect of denial of treaty benefit on abusive transactions, unless under discretionary relief mechanism
- ▶ PPT works on 'either or not' principle; it does not look beyond I-S Treaty except under discretionary relief mechanism
 - ▶ India has not opted for discretionary relief provision
- ▶ PPT is treaty centric and does not permit look through beyond that
- ▶ The deterrent effect of PPT will be diluted if taxpayer is permitted to have consequential relief which he would have obtained but for such tainted arrangement
- ▶ Since arrangement is PPT tainted, PPT leads to 'cliff effect' and resort to domestic law

Taxpayer's contentions on applicability of concessional rate of I-USA treaty

- ▶ PPT is codification of principles of OECD commentary dealing with improper treaty use, particularly, treaty shopping
- ▶ PPT leads to denial of 'benefit'; vis-à-vis interest, USCo is an equivalent beneficiary
 - ▶ Dictionary meaning of 'benefit' suggests some improvement in condition
 - ▶ By implication suggests denial of "incremental favourable position" obtained due to tainted arrangement
- ▶ PPT limitation restricted only to benefit Identification of benefit by comparison with 'counterfactual'; consequences based on realistic counterfactual
- ▶ A fair "counterfactual" in the case is to relate funding by USA Co
- ▶ Qua interest income, the arrangement is not for the purpose of "treaty benefit"
- ▶ Clear text of PPT requires denial of the benefit from the tainted arrangement and does not contemplate harsher consequences
- ▶ Discretionary relief (which can grant entitlement or different benefit) is an inbuilt good practice not controlled by explicit assertion
- ▶ If treaty consequence for domestic GAAR invocation is based on reattributed/ re-characterised arrangement, PPT as a treaty GAAR, no different

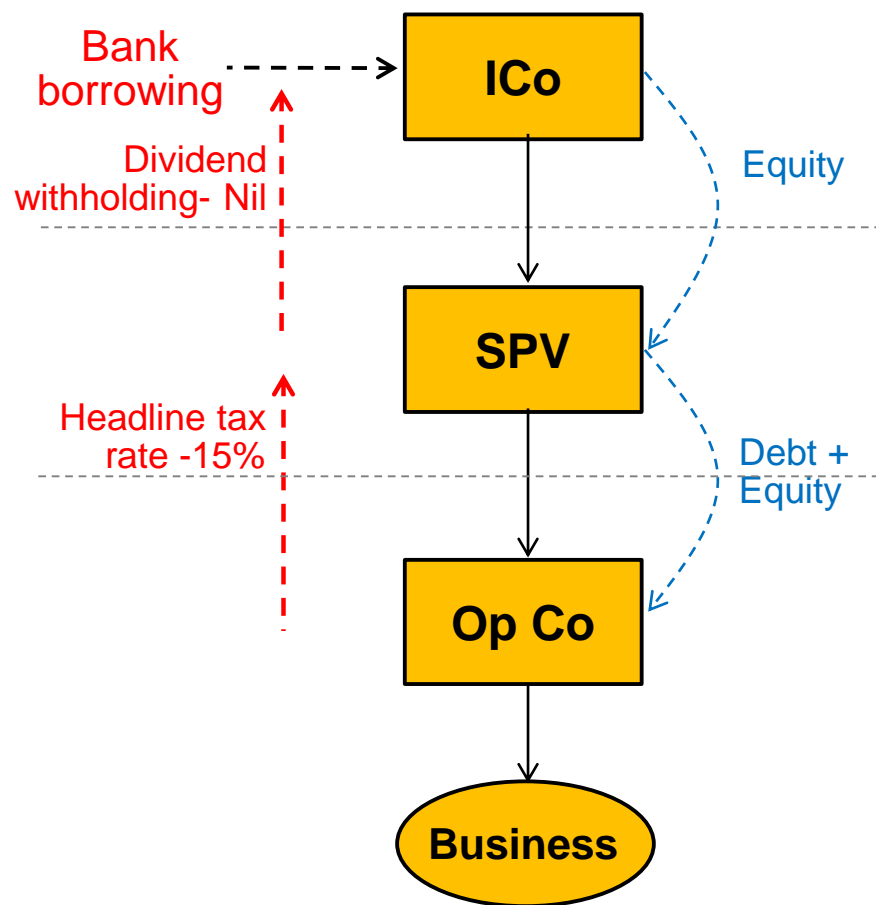
WHT obligation and vicarious liability of the payer

WHT obligation and vicarious liability of the payer

- ▶ Whether impact of PPT is to be considered while determining scope of WHT obligation?
- ▶ Can Buyer be considered as a party to GAAR/PPT prone arrangement?
- ▶ Is there any tax benefit derived by Buyer?
- ▶ Can Buyer be considered as assessee in default or representative assessee of Parent Co or SPV, upon invocation of GAAR/ PPT?
 - ▶ Decision of Indostar Capital [TS-250-HC-2019 (Bom)] in the context of s.197
- ▶ Shome Committee's recommendations:-
 - ▶ "In view of the above, the Committee recommends that, while processing an application under section 195(2) or 197 of the Act pertaining to the withholding of taxes,
 - ▶ (a) the taxpayer should submit a satisfactory undertaking to pay tax along with interest in case it is found that GAAR provisions are applicable in relation to the remittance during the course of assessment proceedings; or
 - ▶ (b) in case the taxpayer is unwilling to submit a satisfactory undertaking as mentioned in (a) above, the Assessing Officer should have the authority with the prior approval of Commissioner, to inform the taxpayer of his likely liability in case GAAR is to be invoked during assessment procedure."

Case Study 3 – Outbound investment and PPT impact

Facts

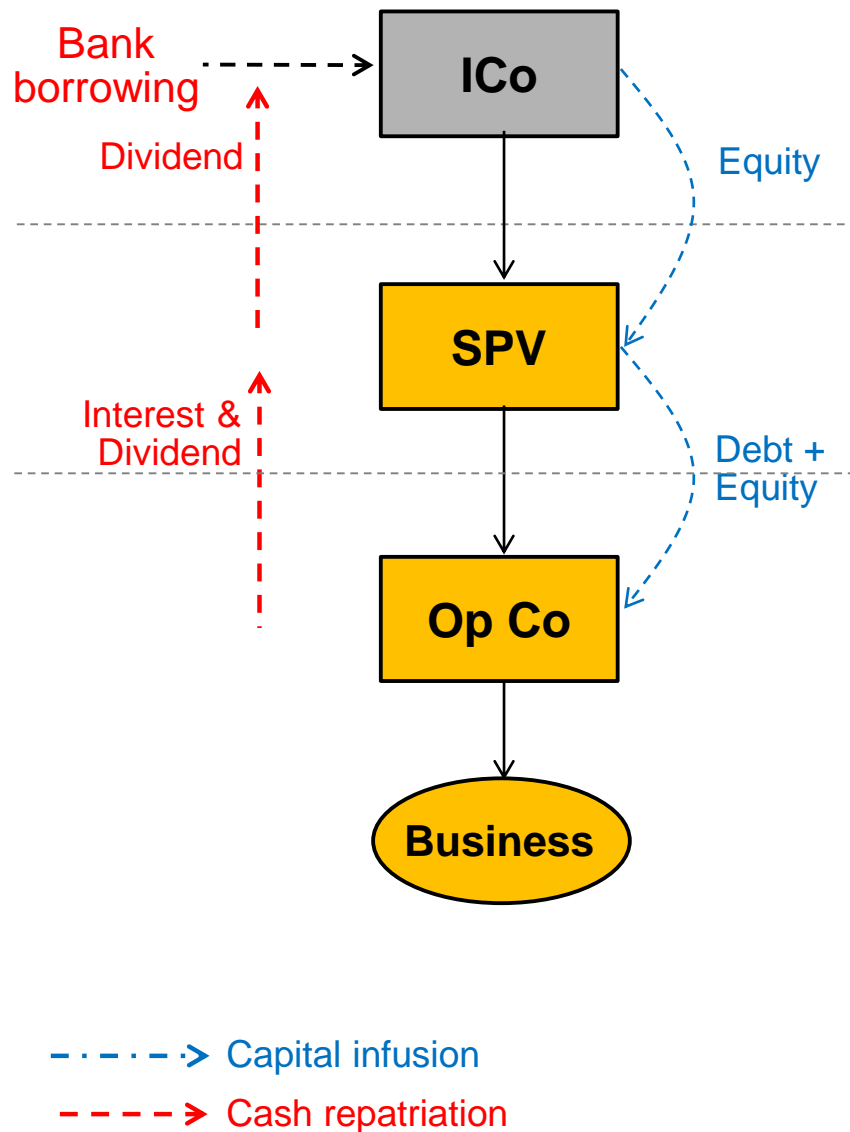


- ▶ I Co to acquire target through borrowing from banks
- ▶ SPV set up in a jurisdiction where UTC benefit granted under the treaty
- ▶ Op Co funded through debt and equity
- ▶ SPV pays taxes @5% in Op Co jurisdiction due to favourable domestic withholding provisions
- ▶ Dividend received by SPV taxed @15% in SPV jurisdiction but relief by way of tax sparing and UTC claimed in SPV jurisdiction
- ▶ I Co taxed u/s 115BBD against which UTC is claimed
- ▶ I Co also claims benefit of roll over exemption when dividend is declared to shareholders

Particulars	Rate
O-S Treaty	15%
Domestic law of Op Co	5% (tax sparing)
Corporate rate of SPV jurisdiction	15% liberal (UTC)
Tax for I Co	S. 115BBD relieved by UTC

- - - - - ➔ Capital infusion
 - - - - - ➔ Cash repatriation

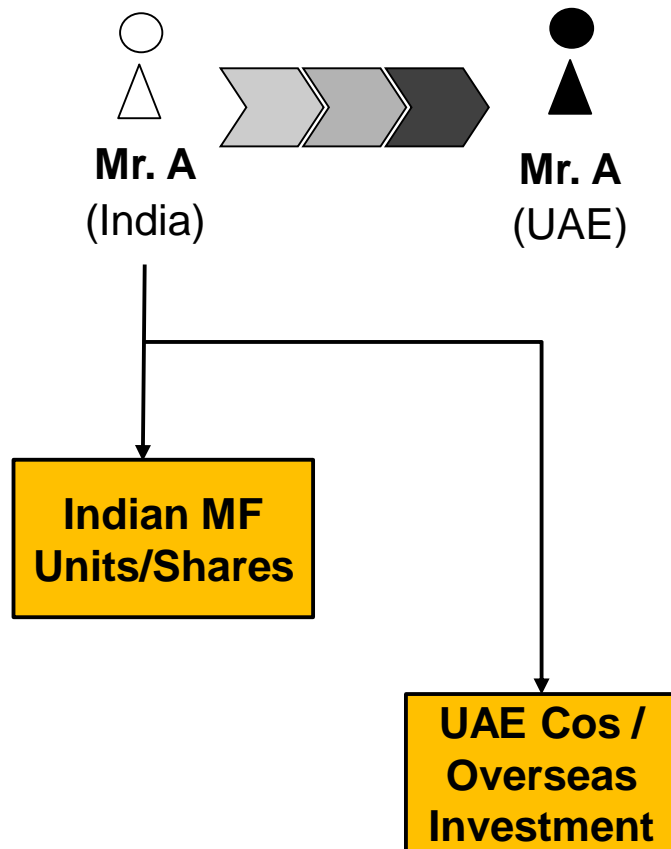
Implications post MLI



- ▶ PPT Clause of MLI requires inquiry into purpose behind establishment, acquisition or maintenance of SPV in treaty favourable jurisdiction
- ▶ I Co may be denied treaty benefit in respect of UTC and SPV may be denied benefit of tax sparing
- ▶ From India perspective, the arrangement justification will require:
 - ▶ Why is SPV formed?
 - ▶ Why is SPV financed by way of equity when borrowed funds are deployed?
- ▶ Beware of existing SAAR in the form of POEM, s. 93, TP provisions or BEPS driven SAAR such as CFC

Case Study 4 – Change of residence

Change of residence



Facts:

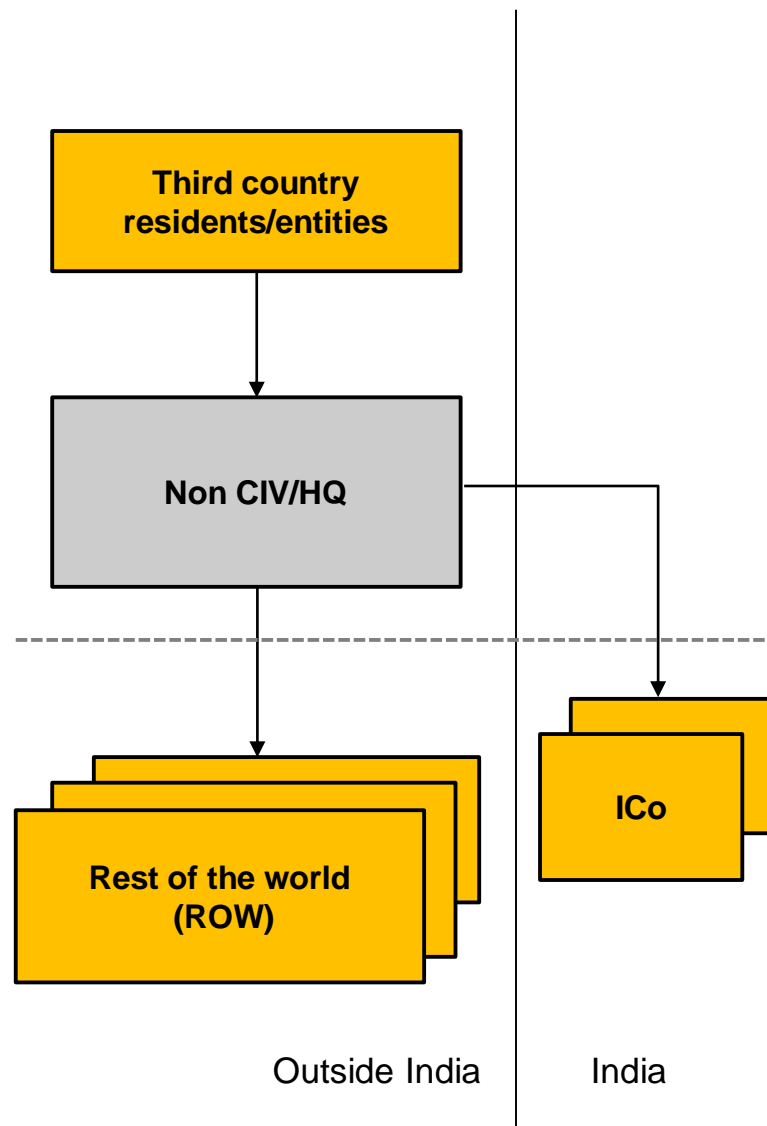
- ▶ Mr. A, an Indian resident, holding investments in India and abroad
- ▶ All investments / acquisitions are pre 1 April 2017
- ▶ Certain assets received by way of inheritance
- ▶ Mr. A and his family migrate to UAE
- ▶ Mr. A proposes to transfer India shares, units and overseas assets over a period of time

Issues:

- ▶ Is Mr. A treaty resident of UAE when the assets are divested for purpose of trigger of PPT?
- ▶ What is the arrangement for GAAR/ PPT?
- ▶ Are assets received by way of inheritance protected by GAAR grandfathering?

Other Issues governing PPT

Effect of multiple treaties benefit



- ▶ HQ holds multiple investment across globe/regions
- ▶ HQ investment in Indian entities is miniscule compared to Rest of the World (ROW)
- ▶ HQ is not able to explain commercial reasons for its presence in HQ jurisdiction
- ▶ HQ to take benefit of treaty network of country of its incorporation
- ▶ HQ's claim: India cannot invoke PPT as tax benefit in India is not "one of the principal purposes" of its existence in HQ jurisdiction
- ▶ OECD's take on impact of benefit arising from multiple treaties

*".....If the facts and circumstances reveal that the arrangement has been entered into for the principal purpose of obtaining the benefits of these (multiple) tax treaties, it should **not** be considered that obtaining a benefit under one specific treaty was not one of the principal purposes for that arrangement."*

Miscellaneous issues

- ▶ Relevance of commentaries; examples prepared as part of BEPS agenda
- ▶ Interplay of PPT with non-discrimination provision
- ▶ Evaluation of PPT/ GAAR where each investment in source jurisdiction is through different SPVs (i.e. halo effect)
- ▶ Is evaluation of PPT to be done at the stage of entering into transaction or at a later stage?
- ▶ Significance of PPT being a mirroring of guiding principle

As we begin towards the end.....

► **Michael Lang - Tax Notes International, Volume 74, Number 7, May 19, 2014**

*“The late German Supreme Court judge Ludwig Schmidt pointed out in section 42 of the German Composition Code (Abgabenordnung) that a good lawyer does not require an anti-abuse rule, since he will apply the teleological interpretation. A weak lawyer, on the other hand, will clutch at the straws that general anti-abuse rules seemingly offer and will hope to avoid the often painstaking and demanding analysis of the object and purpose of the rule by resorting to a rule that allows him to replace the interpretation of the law with his subjective sense of justice. In his closing arguments in Cartesio, former Advocate General Luís Miguel Poiares Maduro described in reference to Gutteridge the abuse of rights principle as **“a drug which at first appears to be innocuous, but may be followed by very disagreeable after effects.”** The OECD should keep its hands off it!”*

Questions?



Thank You!

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