TransPrice Times

MLI Special Edition- June 2017

Traversing the Multilateral Wave

The OECD and G20 has slowly and steadily swept the tax world off its feet since it began working on the BEPS Project. This project has created a virtual crossroads of sorts for the tax world. Where one road leads to getting caught eroding the tax base of a country, and the other a chance for countries to traverse the Multi-Lateral Instrument (MLI) wave and BEPS-proof their businesses. Until now MNEs have preferred standing at the helm of a ship, while traversing waves of business models that exploit gaps and mismatches in tax laws.

One might presume that the OECD BEPS Project has come to a full circle with the first implementation package containing the multilateral instrument signed by 68 countries on June 7, 2017. However, this is only the beginning of the tax peace process of MNCs BEPS-proofing their tax structures. The execution of this complex instrument which is divided into VII parts and 39 articles, will result in a facelift to the existing tax treaties of the countries who have signed the MLI, and will prove to be a challenge going ahead.

The MLI in itself is not a protocol amending a treaty. It looks to be applied along with the existing treaties and modify such application. The MLI text is a combination of OECD BEPS Action points forming part of the BEPS Project. These are Action Plan 2 (Hybrid Mismatches), Action Plan 6 (Treaty Benefits), Action Plan 7 (Artificial avoidance of PE) and Action Plan 14 (Dispute Resolution Mechanism). Of this, Action 6 and Action 14 are minimum standards i.e. contracting parties of MLI must compulsorily adopt this in their Covered Tax Agreements (CTA).

While the signing process on June 7, is indeed historical, it essentially ratifies the MLI in accordance with the signing countries' domestic laws. Hence, each country jurisdiction was required to submit their reservations & additions (notifications) at the time of signing itself. This involved one collective negotiation so MLI has to undertake only 1 ratification to be put in force.

Soon, OECD is about to release an online matching tool after all the MLI positions of various countries are recorded and analysed. This tool will be subject to review over the time and provide timing of the modifications made by MLI.

Applications of MLI

- **Article 3 - Transparent entities** – requires any income through a fiscally transparent entity/ arrangement between 2 jurisdictions to be considered as income in the hands of resident to the extent income is treated by the first jurisdiction, as income in hands of resident jurisdiction. **India has made a reservation on this change, and hence this will not apply.**

- **'Dual resident entities'** – where residency shall be determined on the basis of an agreement with Competent Authority following tie breaker rules based on place of effective management and place of incorporation of the entity. India has accepted this change and this will be modified in treaties with Netherlands, Australia, UK, Ireland and Japan. Tie breaker rule is adopted when an entity becomes a resident in both contracting jurisdictions. If the Competing Authority does not agree to a tie breaker, then the treaty benefits shall not apply and lead to entity being doubly taxed.

- **Principle Purpose Test (PPT)** – A treaty benefit will not be granted if a party to MLI's principal purpose or one of the purpose is to obtain a tax benefit. India has accepted this modification to its CTA. India has adopted PPT with simplified LOB (Limitation of Benefits) to restrict the treaty benefits (discussed above) to 'qualified persons' defined in the MLI.

- **Exclusions from definition of PE** – MLI provides specific activity exemption as per Article 5 of OECD Model Convention. India has chosen to apply this exemption only when parties undertake activities that are preparatory or auxiliary in nature.

- **Scope of dependent agency PE –** An enterprise can have a dependent agent PE if the agent person principally acts on enterprise's behalf and routinely concludes contracts (in the name of enterprise) without material modification by the enterprise. India has accepted this in its CTA.

- **Mutual Agreement Procedure** – India has opted for implementing a bilateral notification or consultation process with competent authority for cases where such authority does not consider resident taxpayer's dispute to be justified. Convention provides taxpayer a timeline of 3 years from first notification of tax dispute for presenting the dispute in front of competent authority.

MLI steps to amend an existing treaty summarised

Step 1	Whether both countries are signatories to MLI
Step 2	Signatories have complied with domestic law to bring MLI in force
Step 3	Countries notify treaties as CTA

The MLI can be implemented bilaterally in force, only after an end-to-end step-by-step process is followed.

The **first** step in implementing the MLI is to get the Convention in force. MLI will enter into force after 3 months beginning after five jurisdictions have deposited the instrument of ratification, acceptance or approval of the MLI. Therefore, a country's position of MLI can be subject to change before the final deposit of the instrument. The deposit of the instrument indicates the definitive position of each jurisdiction on the MLI applied. Further, the MLI can be in force only when the MLI is in force for both countries to the tax agreement.

Secondly, the MLI once in force should be read along with the bilateral tax agreement (for avoidance of double taxes on income taxed) as per MLI and verify if it is a CTA that will be instrumental in implementing the CTA ahead.

Thirdly, each country shall specify which MLI provisions shall apply to it and for the reservations made on certain provisions, those provisions shall not apply to CTA. Moreover, 2 countries can adopt an optional provision of MLI that will amend the CTA between the both, provided both have applied the optional provision.

Fourthly, MLI requires parties of Convention to notify existing provisions that are to be modified by MLI provisions. Here, the existing provision shall be replaced by the new MLI provision, when 2 contracting parties of MLI have notified the same existing provision. However, at any point of time if either 1 of the parties has not notified or a different notification has been made, the MLI provision does not apply. This situation is referred to as notification mismatch.

If the new MLI provision *'applies to or modifies'* an existing provision;

Existing provision notified by both parties, then MLI changes application of existing provision without replacing it.
In case of notification mismatch, MLI provision does not apply.

Similarly, an MLI provision can be added if it applies *'in the absence of'* an existing provision, the absence of which was notified by both (2) parties.

If the MLI provision applies *'in place of or in the absence of'* an existing provision;

notified by both parties, the existing provision are replaced by MLI provision
not notified by either party, MLI provision supersedes to extent of new provision added
In case of notification mismatch, MLI provision supersedes existing provision to extent of incompatibility

Fifthly, MLI will have effect once MLI provisions are verified to be in effect at different effective date. Basically, contracting countries have to notify OECD of the completion of their internal procedure, after which MLI provision will have effect. With respect to taxes withheld at source, MLI provisions will have effect on 1st day of next calendar year considering the latest date on which MLI enters in force for both countries. With respect to all other taxes levied by one country, MLI provisions have effect for on expiration of 6 months considering the latest date on which MLI enters in force for both countries.

In India, MLI will be applicable 30 days after the latest date on which MLI enters in force for both countries. India being a signatory to the MLI along with 67 other countries. The Cabinet has forwarded a provisional list of Covered Tax Agreements and reservations, at the time of signing and will be finalised at the time of ratification of the MLI instrument.

Contributed by : Abhijit Deouskar