Technical Guide
on
BEPS Action Plans and Multilateral Instrument ("MLI")

Committee on International Taxation
The Institute of Chartered Accountants of India
(*Set up by an Act of Parliament*)
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Foreword to the First Edition

The integration of global national economies market created opportunities for the Multinational Enterprises (MNEs) for Base erosion and Profit shifting (BEPS). BEPS is a global challenge for the domestic tax law of every country and there could be several factors responsible for this. Aggressive tax planning, lack of transparency, gaps and mismatch between the domestic tax law and treaties and lack of co-ordination among the tax authorities are some of them. Internationally, OECD and G-20 joined together to design an inclusive framework in consultation with many tax authorities and international organisations and their BEPS measures identified different issues in its 15 Action plans. It is suggested that domestic tax laws and treaties should be dynamic with the change in global business environment.

The Indian revenue authorities proactively took steps to address BEPS challenges in domestic tax laws in line with the recommendations made by OECD. Introduction of Equalisation levy, significant economic presence, thin capitalisation and country-by-country reporting in past few years are some of the provisions which have been introduced to this effect in Indian Income-tax Act.

Among the 15 BEPS action plans, MLI was also one of the recommendations made by OECD that provides an innovative approach to enable countries to swiftly modify their bilateral tax treaties to implement measures developed in the course of the work on BEPS which is desirable and feasible, that should be convened quickly. Considering the utmost need of effective mechanism and agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income and capital; India has notified Multilateral Convention (MLI) to Implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting.

Considering the importance of the subject, the Committee on International Taxation of ICAI has come out with this publication "*Technical Guide on BEPS Action Plans and Multilateral Instrument (MLI)"* for our ICAI members. I would like to express my gratitude to CA. Nandkishore Chidamber Hegde, Chairman, CA. G. Sekar, Vice-Chairman and all other members of Committee on International Taxation of ICAI for the initiative taken to publish the first edition of the publication.

I am sure that this publication would be of immense use for our members practising in the area of international taxation.

Best Wishes,

Place: New Delhi

Date: 24-09-2020

CA. Atul Kumar Gupta

President, ICAI

Preface to the First Edition

The fairness of tax system always remains challenge for the tax authorities. Considering the issue that profits should be taxed where the economic activities take place and no profit should suffer double taxation, in September 2013, the finance ministers of the G20 nations came out with a comprehensive action plan on BEPS which has three core principles coherence, substance and transparency. The major thrust of the action plan was to address double non taxation challenges which further improves the gap and mismatches in the domestic tax laws and tax treaties. Through the BEPS action plans, OECD recommended some minimum standards, reinforcement of international standards, common practices and best approaches for domestic law that should have been incorporated in every domestic tax system which will facilitate the convergence of the best international tax practices and curbing avoidance by MNE enterprises.

Out of the recommended minimum standards, Action Plan-15 suggested development of multilateral instruments in order to modify bilateral tax treaties. The main purpose was to swiftly modify the existing tax treaties without bilateral negotiation with each and every country. It shall, however, come into effect after ratification of both the signatories and should be read alongside the existing tax treaties. It is one of the innovative measures with no similar precedents in tax law. The BEPS and MLI are now integral part of the international Taxation.

Considering the importance of subject and to develop a clear understanding of the subject amongst our members, the Institute of Chartered Accountants of India (ICAI) through its Committee on International Taxation has brought out this Technical guide. This publication initially discusses each Action plan in detail and thereafter discusses the final Action plan 15 which deals with Multilateral Instrument.

I am grateful to CA. Atul Kumar Gupta, President, ICAI and CA. Nihar Niranjan Jambusaria, Vice-President, ICAI for being a guiding force behind the initiatives of the Committee.

I am extremely thankful to CA. PVSS Prasad, a renowned expert in International Taxation, who took up this project and spared his valuable time for writing this publication. I sincerely acknowledge the efforts put in by him in shaping the publication. His experience and knowledge has added value

and will go a long way in guiding the profession. I am also thankful to CA. Ganesh Rajgopalan for the painstaking efforts taken by him in reviewing this publication which enabled us to bring out this publication in a timely manner.

I am also grateful for the unstinted support provided by Vice-Chairman CA. G. Sekar and other members (including co-opted members) and special invitees of the Committee on International Taxation; CA. Tarun Jamnadas Ghia, CA. Chandrashekhar Vasant Chitale, CA. Dayaniwas Sharma, CA. Rajendra Kumar P, CA. Sushil Kumar Goyal, CA. Anuj Goyal, CA. Kemisha Soni, CA. Satish Kumar Gupta, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, CA. Charanjot Singh Nanda, Shri Manoj Pandey, Shri Chandra Wadhwa, Dr. Ravi Gupta, CA. T.P. Ostwal, CA. Sachin Sastakar, CA. Ujwal Nagnath Landge, CA. B.M.Agrawal, CA. Nidhi Goyal, CA. Kirti Chawla and CA. Amar Deep Singhal.

Last, but not the least, I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary, Committee on International Taxation and CA. Vikas Kumar, Assistant Secretary for co-ordinating the project and for rendering secretarial assistance.

I am hopeful that this new publication will be of immense use to the members.

Place: New Delhi
Date: 24-09-2020

CA. Nandkishore Chidamber Hegde
Chairman,
Committee on International Taxation, ICAI

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Introduction

Economic meltdown in 2008 prompted various Governments to check whether legitimate taxes are being collected in line with the revenue generated by multinational enterprises in respective jurisdictions. Shockingly, it was realized that large corporations are managing to pay around 1-2 percent as taxes against their revenue. This discovery of fact alerted every Government to look into the existing tax rules and their efficacy. It was found that the international tax rules that are in existence are 100 year old and based on brick and mortar business models. Rapid advancement of technology has radically changed business models more so in internet revolution. The then existing rules are not effective to address the latest business models and related tax issues. The Finance Ministers of the G20 nations were of the categorical view that a systematic and coordinated approach is to be adopted to address such tax issues and thus have endorsed critical reforms to the international tax system for curbing avoidance by multiple enterprises. In view of the same OECD initiated a marathon agenda plan to revamp such international tax rules which was readily supported by G20 nations including countries like India and China. The said project of OECD to address the tax leakages by bringing out new rules of taxation was actively supported by G20 nations including India, which project got named as OECD/ G20 BEPS initiative. After conducting various discussions and brain storming sessions with stake holders, OECD finally issued 15 Action plan reports on 5th October, 2015. The said Action plans are as under

Action Plan 1 –	Challenges of Digital Economy
Action Plan 2 –	Neutralizing the Effects of Hybrid Mismatch Arrangements
Action Plan 3 –	Designing Effective Controlled Foreign Company Rules
Action Plan 4 –	Limiting Base Erosion Involving Interest Deductions And Other Financial Payments
Action Plan 5 –	Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

Action Plan 6 –	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
Action Plan 7 –	Preventing the Artificial Avoidance of Permanent Establishment Status
Action Plan 8-10 –	Aligning Transfer Pricing Outcomes with Value Creation
Action Plan 11 –	Measuring and Monitoring BEPS
Action Plan 12 –	Mandatory Disclosure Rules
Action Plan 13 –	Transfer Pricing Documentation and Country – by – Country Reporting
Action Plan 14 –	Making Dispute Resolution Mechanisms More Effective
Action Plan 15 –	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

In this technical guide it is targeted to discuss each Action plan in detail and then discuss the final Action plan 15 which deals with multilateral instrument to incorporate all proposed changes in a swift manner. In the Action Plan 15 – Multilateral Instrument, certain articles have been classified as minimum standards for the member countries to compulsorily choose and opt in. Minimum standard thereby means the rules/principles which are mandatorily to be included as modification in the Covered Tax Agreements (treaties). In other words, the member countries shall not reserve/opt out of the prescribed mandatory minimum standards which are Action Plan 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) and Action Plan 14 (Making Dispute Resolution Mechanisms More Effective).

Chapter 1
Action Pan 1: Addressing the Tax Challenges of Digital Economy

1.1 In the era of rapid advancement of Information and Communication Technology (ICT), Multi National Enterprises (MNEs) make use of gaps in the interaction of different tax systems to artificially reduce taxable income or shift profits to low-tax jurisdictions in which little or no economic activities performed. In order to address this huge concern, OECD along with G20 members established the Task Force on the Digital Economy (TFDE), a subsidiary body on the Committee of Fiscal Affairs to develop a report, identifying the issues arising in digital economy in detailed options to address them. TFDE issued an interim report in September, 2014 and continued its work in 2015. The conclusions regarding the digital economy, the BEPS issues and the broader tax challenges it raises, and the recommended next steps are contained in the final report on Action 1 "Addressing the tax challenges of digital economy".

1.2 The digital economy is the result of a transformative process brought by Information and Communication Technology (ICT), which has made technologies cheaper, more powerful and widely standardized, improving business process and bolstering innovation across all sectors of the economy. It was observed, the digital economy is increasingly becoming the economy itself and it would be difficult to ring-fence the digital economy from the rest of the economy for tax purposes. Key features presented by the digital economy and its business models are mobility, reliance on data, network effects, the spread of multi sided business models, a tendency towards monopoly and volatility. Typical business models could be varieties of e-commerce, app stores, online advertising, cloud computing, participative networked platforms, high speed trading and online payment services.

1.3 Action 1 report summarized broader tax challenges raised in a digital economy as under

- The challenges of digital economy broadly relate to nexus, data and characterization for direct tax purposes, which often overlap with each other.

- The digital economy also creates challenges for Value Added Tax (VAT) collection, particularly where goods, services and intangibles are acquired by private consumers from suppliers abroad.
- The TFDE discussed and analyzed a number of potential options to address these challenges and concluded that
  - The option to modify the exceptions to PE status in order to ensure that only activities that are in fact preparatory or auxiliary in nature to be treated as exceptions as per Action 7 of the BEPS project and in turn to modify the bilateral tax treaties under Action 15 through Multilateral Instrument.
  - The collection of VAT/GST on cross border transactions, particularly B2C is to be governed by principles of the international VAT/GST guidelines.
  - Action 1 report did not recommend the options analyzed by the TFDE for the taxation of digital economy namely
    (i) a new nexus in the form of a significant economic presence
    (ii) a withholding tax on certain types of digital transactions
    (iii) an equalization levy, at this stage
  - Countries could, however, introduce any of the above mentioned three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations as per their bilateral tax treaties. Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments.

1.4 Next steps

Action 1 report is not concluded with the agenda of the BEPS project to continue its work in consultation with broad range of stake holders and to arrive at a report reflecting the outcome of the continued work in relation to the digital economy which should be produced by 2020. Subsequent developments in respect of taxation of digitalized economy have been dealt with in chapter 12 of this Technical Guide.

Chapter 2
Action Plan 2: Neutralising the Effects of Hybrid Mismatch Arrangements

2.1 Hybrid mismatch arrangements exploit differences in tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long term deferral.

2.1.1 This Action plan targets to propose domestic rules and modification to the OECD model tax convention to neutralize the tax effects of hybrid mismatch arrangements. Recommendations have been brought in two parts

Part I contains recommendations for changes in domestic law and
Part II sets out recommendations for changes in tax conventions.

The proposed changes in domestic and treaty law target to put an end to multiple deductions for a single expense, deductions without corresponding taxation or the generation of multiple tax credits for one amount of foreign tax paid. The objective of these changes is to neutralize unintended benefits arising out of hybrid mismatches but the same should in no way impact cross border trade and investment.

2.1.2 Part I recommends to have a primary rule and a secondary rule in domestic tax law of both the treaty partner jurisdictions. It is proposed to address mismatches in tax outcomes where they arise in respect of payments made under a hybrid financial instrument or payments made to or by a hybrid entity. It also recommends rules to address indirect mismatches that are imported into a third jurisdiction. In the whole process it must be ensured that there is no double taxation. Primary rule provides to deny the taxpayers deduction for a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction. Primary rule is generally applied by the country dealing with the payment transaction and claiming it as a deduction by a payer. If by any chance if the primary rule is not applied then the counterparty jurisdiction can generally apply a defensive rule to provide that the deductible payment are to be included as income or denying the duplicate deduction depending on the nature of the mismatch. It obviously calls for coordination between both the jurisdictions to implement this rule.

2.1.3 Part II addresses the changes to be brought in the text of the OECD model convention to ensure that hybrid instruments and entities, as well as dual resident entities, are not used to obtain unduly the benefits of tax treaties and that tax treaties do not prevent the application of the changes to the domestic law recommended in part I. The issue of dual resident entities claiming hybrid mismatch benefits is addressed by proposing to resolve dual residency on a case by case basis rather than on the basis of the current rule based on place of effective management of entities.

Part II also deals with application of tax treaties to hybrid entities, i.e. entities that are not treated as tax payers by either or both states that have entered into a tax treaty, such as partnerships in many countries. It is proposed to provide treaty benefits in appropriate cases to the persons who are getting taxed as against the transparent entity. It is proposed to ensure that there is no conflict between the proposed amendments in treaty law as against the proposed changes in the domestic law in respect of these hybrid mismatches. It is also observed in the Action plan report that domestic rules must be properly worded to ensure that there is no conflict with the non-discrimination provisions.

2.2 How these recommendations have been brought into OECD Model Convention and Multilateral Instrument (MLI)

Article 4 dealing with resident has been amended in respect of dual residents of persons other than individuals to provide that such dual residency would be resolved by the competent authorities of the contracting states through mutual agreement procedure and not on the basis of POEM rule as in the past. However, competent authorities would consider criteria such as place of effective management, place of incorporation and any other relevant factors. It was observed that the POEM rule has been abused in the past which resulted in tax leakages. In view of the same it is now proposed to have resolution through mutual agreement by the competent authorities. If the competent authorities fail to agree, the taxpayer shall lose entitlement to the treaty, except as may be agreed by the competent authorities.

Article 3 of MLI deals with transparent entities. A hybrid entity is one that is treated as a taxable entity in one jurisdiction and as a transparent entity in another. Article 3&4 of MLI embodies the recommendation in Action Plan 2 which provides that the income of a transparent entity would be considered as an income of a resident only to the extent that it is treated as taxable

income of a resident. This provision would ensure that double non-taxation is avoided. India has reserved its right in entirety for the application of this article and had indicated that it will not apply this article to any of its bilateral treaties. This is mainly on account of no transparent entity status in India. As per India's position to commentary to Article 1, India is reluctant to extend access of a bilateral treaty to a third country resident which could encourage treaty shopping. The said position reads as under:

> 5. *India* does not agree with the view expressed in paragraph 7 of the Commentary on Article 1 that the term "income derived by or through an entity or arrangement" includes income derived by or through an entity that may not be a resident of either of the Contracting States. India considers that this term includes only such income that is derived by or through entities that are resident of one or both Contracting States.

Article 4 of the MLI deals with dual resident entities and the same was adopted by the OECD MC 2017 vide its article 4, which states that dual residency of non-individuals would be resolved through mutual agreement between competent authorities. In the absence of such agreement the treaty may be denied. Article 5 of MLI, deals with methods for elimination of double taxation. As per recommendations of Action Plan 2, in order to prevent abuses on account of hybrid instruments being treated as debt in one country and as equity in another, which may result in a payment being deducted as a cost under the rules of the payer jurisdiction and are not included as income in other jurisdiction, or two deductions arising in respect of a same payment, three options have been proposed. These are

- **Option A:** To deny exemption but provide a tax credit for such payments.
- **Option B:** To deny exemption for dividends treated as deductible in the payer state but allow tax credit for any tax paid attributable to that income.
- **Option C:** To use the tax credit method(instead of exemption), based on the OECD model provision(for both income and capital)(OECD 2016, Para 61-68)

Action Plan 2 also recommends a secondary "defensive" rule that if the payer jurisdiction does not neutralize the mismatch by denying deductibility, the payee jurisdiction should require such payment to be included in taxable

income. In respect of those countries following the exemption method a treaty change may be needed to implement this defensive role. This is not necessary for countries which include such payments as income and allow only a tax credit, like India. Accordingly, India has opted for Option C of the Article 5 of MLI as India in general has adopted credit method as per article 23B of the OECD model convention.

2.2.1 Branch Mismatches

OECD has issued a separate report on branch mismatches which was not covered in the original Action plan 2 report. These branch mismatches occur where the residence jurisdiction (that is the jurisdiction in which head office is established) and a branch jurisdiction (that is the jurisdiction in which the branch is located) take a different view as to allocation of income and expenditure between the branch and the head office and include situations where the branch jurisdiction does not treat the tax payer as having a taxable presence in that jurisdiction. Branch mismatches are normally exploited by corporations which results in unintended tax benefits by exploiting differences in domestic tax rules of branch and head office jurisdictions. Some of the examples are:

(a) A deductible payment made to a branch may not be into income in either the branch or residence jurisdiction.

(b) A branch may make a deductible payment to head office that is not taken into account in calculating the net income of the head office under the laws of residence jurisdiction.

(c) The same item of expenditure may be treated as deductible under the laws of both the residence and the branch jurisdictions.

(d) The income from a payment may be off set against a deduction under a branch mismatch arrangement.

2.2.2 Branch mismatch arrangements offer multinationals similar opportunities that arise under hybrid mismatches in terms of competition, transparency, efficiency and fairness for reducing their overall tax burden by exploiting differences in the rules governing the allocation of payments between two jurisdictions.

Mismatches will not arise where both jurisdictions apply a common standard in the rules for determining a taxable presence and in the allocation of income or expenditure to different parts of the same enterprise. However, in

real terms, it is often formed that the tax rules of two tax jurisdictions would not match. BEPS action recommendations in this direction to have common standards can be quoted in the following examples.

(a) The action 7 report on *preventing the artificial avoidance of permanent establishment status* includes recommendations for changes to the permanent establishment definition to address techniques used to inappropriately avoid creating a taxable presence in the branch jurisdiction.

(b) The report on actions 8-10 (*aligning transfer pricing outcomes with value creation*) sets out changes to the transfer pricing guidelines designed to ensure that the transfer pricing of MNEs better aligns the taxation of profits with economic activity.

2.2.3 The recommendations set out in the report call for one-off adjustments in order to neutralize tax planning opportunities that arise in those cases where taxpayers exploit the differences in the methodology for calculating the net income of the branch and head office. It is recommended for countries that have adopted hybrid mismatch rules also to adopt an equivalent and parallel set of rules targeting branch mismatches. The adoption of branch and hybrid mismatch rules as a single package would ensure preventing tax payers shifting from hybrid mismatch to branch mismatch arrangements to obtain the same tax advantages. OECD's report on branch mismatches provides recommendations for the specific changes in the domestic law in line with hybrid mismatch rules set out in Action plan 2 report. Annexure A of this report summarizes the recommendation and annexure B sets out a number of examples illustrating the same.

2.2.4 Disregarded branch structure

In a disregarded branch structure the mismatch arises due to the fact that a deductible payment received by a taxpayer is treated, under the laws of the residence jurisdiction, as being made to a foreign branch (and therefore eligible for an exemption from income), while the branch jurisdiction does not recognize the existence of the branch and therefore does not subject the payment to tax. An example of a disregarded branch structure is illustrated in Figure

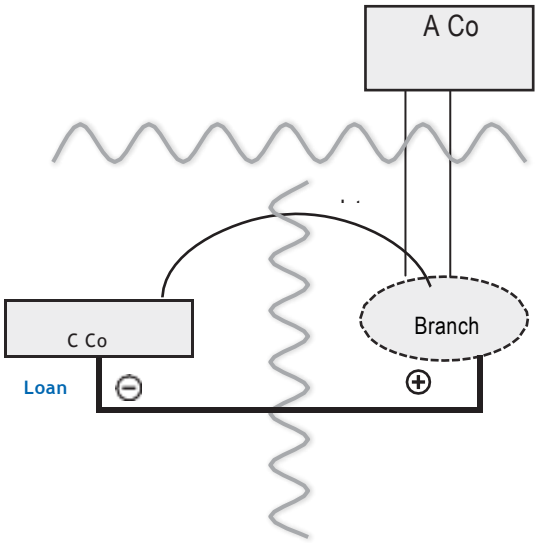

Figure 1: Disregarded branch structure[1]

In this case A Co. lends money to C Co. (a related company) through a branch located in Country B. Country C permits C Co. to claim a deduction for the interest payment. Country A exempts or excludes the interest payment from taxation on the grounds that it is attributable to a foreign branch. The interest income is not, however, taxed in Country B as A Co. does not have a sufficient presence in Country B to be subject to tax in that jurisdiction. The payment of interest therefore gives rise to an intra-group mismatch (a D/NI outcome).

- The D/NI mismatch that results from a disregarded branch structure can arise in a number of ways and could be a product of the domestic rules operating in each jurisdiction or due to a conflict between domestic law and treaty requirements. For example:
- The interest payment could be treated as income of a foreign branch (and therefore tax exempt) under Country A domestic law but may not be included in income under Country B domestic law because the branch does not give rise to taxable presence in Country B for domestic law purposes.
- The branch could be treated as constituting a permanent establishment (PE) under the Country A-B tax treaty so that Country A

[1] *OECD/G20 BEPS project Action Plan 2 'Neutralising the Effects of Branch Mismatch Arrangements'*

is required to exempt the interest payment from tax under a provision equivalent to Article 23A of the OECD Model Tax Convention on Income and Capital: Condensed version 2014 (Model Tax Convention, OECD 2014) (even though the branch does not give rise to a taxable presence under Country B's domestic law).

- The branch may not meet the legal definition of a PE under the Country A-B tax treaty so that the payment of interest received by the branch is excluded from taxation by Country B because a provision equivalent to Article 7 of the Model Tax Convention (OECD, 2014) does not allow Country B to tax residents of Country A in the absence of a PE as defined under that treaty. This may be the outcome provided for under the treaty even though Country A's domestic law allows A Co to treat the payment as exempt from tax in Country A as income of a foreign branch.
- The mechanics and the resulting tax outcomes from the use of a disregarded branch structure are similar to those of a reverse hybrid (discussed in Chapters 4 and 5 of the Action 2 Report (OECD, 2015)) in that both the residence and the branch jurisdiction exempt or exclude the payment from income on the grounds that the payment should be treated as received (and therefore properly subject to tax) in the other jurisdiction.

2.2.5 Diverted branch payment

A diverted branch payment has the same structure and outcomes as a payment to a disregarded branch except that the mismatch arises, not because of a conflict in the characterization of the branch, but rather due to a difference between the laws of the residence and branch jurisdiction as to the attribution of payments to the branch. An example of a diverted branch payment is illustrated in Figure 2. This example is the same as that described in Figure 1, except that both the residence and branch jurisdiction recognize the existence of the branch. The mismatch arises from the fact that the branch treats the deductible interest payment as if it was paid directly to the head office in Country A, while the head office continues to treat the payment as made to the branch. As a consequence, the payment is not subject to tax in either jurisdiction (a D/NI outcome).

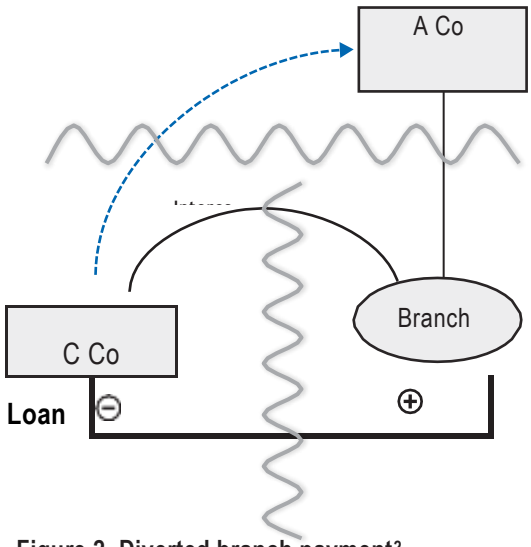

Figure 2. Diverted branch payment[2]

This mismatch in tax treatment could be due to a difference in the rules used by Country A and B for al locating income to the branch (or a difference in the interpretation or application of those rules) or due to specific rules in Country B that exclude or exempt this type of income from taxation at the branch level due to the fact that the payment is treated as made to a non-resident. As with the disregarded branch structures, the mechanism by which the mismatch in tax outcome arises is similar to that of a reverse hybrid in that both the residence and the branch jurisdiction exempt or exclude the payment from taxation on the basis that it should properly be regarded as received in the other jurisdiction.

2.2.6 Deemed branch payments

In the case of diverted or disregarded branch payments the mismatch arises in respect of a deductible payment that is not included in income in either the branch or residence jurisdiction. It is also possible, however, to generate internal mismatches between the branch and residence jurisdictions where the rules in those jurisdictions for allocating net income between the branch and head office permit the taxpayer to recognize a deemed payment between two parts of the same tax payer and there is no corresponding adjustment to the net income in the payee jurisdiction that takes into account the effect of this payment.

[2]*OECD/G20 BEPS project Action Plan 2 'Neutralising the Effects of Branch Mismatch Arrangements'*

A structure illustrating a deemed branch payment is set out in Figure 3. In this example A Co supplies services to an unrelated company (C Co) through a branch located in Country B. The services supplied by the branch exploit underlying intangibles owned by A Co. Country B attributes the ownership of those intangibles to the head office and treats the branch as making a corresponding arm's length payment to compensate A Co for the use of those intangibles. This deemed payment is deductible under Country B law but is not recognized under Country A law (because Country A attributes the ownership of the intangibles to the branch). Meanwhile, the services income received by the branch is exempt from taxation under Country A law due to an exemption or exclusion for branch income in Country A.

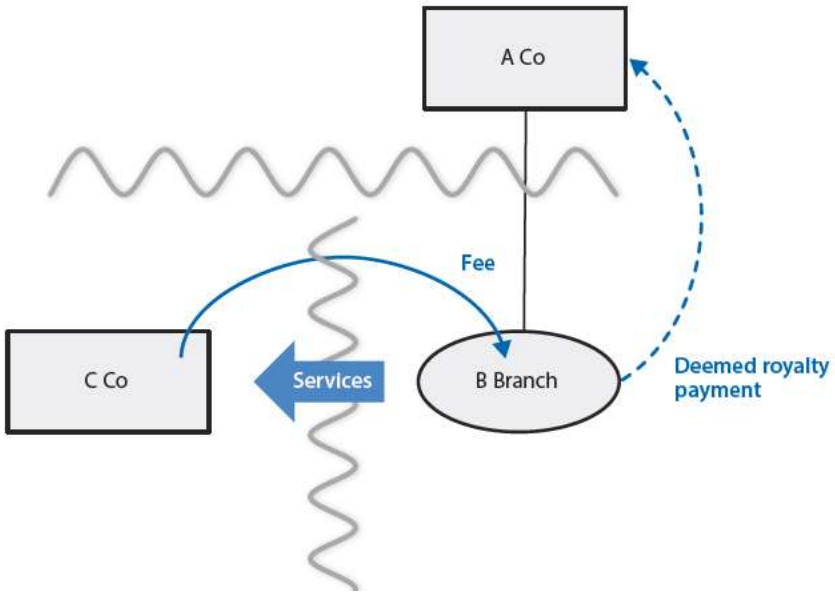

Figure 3: Deemed branch payment[3]

The deemed payment will give rise to an intra-group mismatch (a D/NI outcome) to the extent the deduction is set off against branch income which is exempt from tax in Country A (non-dual inclusion income). Deemed branch payments can only arise in those cases where the rules for allocating net income to the branch or head office allow for the recognition of notional payments between various parts of the same taxpayer. while the structure

[3]*OECD/G20 BEPS project Action Plan 2 'Neutralising the Effects of Branch Mismatch Arrangements'*

illustrated above involves a deemed royalty payment, the application of tax or accounting principles as well as income allocation principles in the branch jurisdiction can also give rise to other deemed payments (such as interest) with similar tax consequences.

The mismatches that arise in respect of deemed branch payments are similar to those that arise in respect of disregarded hybrid payments described in Chapter 3 of the Action 2 Report (OECD, 2015). In that case a hybrid payer (a person that is treated as a separate entity under the laws of the payer jurisdiction but as transparent or disregarded by the payee) makes a deductible payment that is disregarded under the laws of the payee jurisdiction due to the transparent tax treatment of the payer. The deduction resulting from that payment is then set off against income that is not subject to tax in the payee jurisdiction (that is against non-dual inclusion income).

The mechanics of, and outcomes resulting from, deemed branch and disregarded hybrid payments are substantially the same. The branch is entitled to a deduction for an item that is treated as expenditure under the laws of the payer/branch jurisdiction but that is disregarded in the payee/residence jurisdiction because the payee does not treat the payer as a separate enterprise for tax purposes. The deduction that is attributable to the mismatch is then set off against non-dual inclusion income, giving rise to a mismatch in tax outcomes.

2.2.7 DD branch payments

Double Deduction (DD) outcomes arise where the same item of expenditure is treated as deductible under the laws of more than one jurisdiction. These types of mismatches give rise to tax policy concerns where the laws of both jurisdictions permit the deduction to be offset against income that is not taxable under the laws of the other jurisdiction (that is against non-dual inclusion income).

DD branch payments can arise where the residence jurisdiction provides the head office an exemption for branch income while permitting it to deduct the expenditures attributable to the branch. Mismatches can arise where the rules for allocating income and expenditure in the branch jurisdiction also allow the taxpayer to claim a deduction for the same expenditure under the laws of the branch jurisdiction. In these cases the general exemption for branch profits provided by the residence jurisdiction means that the deduction in the branch will be set off against income that is not subject to tax in the residence jurisdiction (that is against non-dual inclusion income).

DD branch payments can also arise in the context of taxable branches (that is where the residence jurisdiction brings all the income and expenditure of the branch into account for tax purposes). Taxable branches can be used to generate DD branch outcomes where the branch is permitted to join a tax group or there is some other mechanism in place in the branch jurisdiction that allows expenditure or loss to be set off against income derived by another person that is not taxable under the laws of the residence jurisdiction.

In the example illustrated in Figure 4, A Co has established both a branch operation and a subsidiary in Country B. Country B law permits the subsidiary (B Co) and the Country B Branch to form a group for tax purposes, which allows the expenditure incurred by the Country B Branch to be offset against the income of the subsidiary.

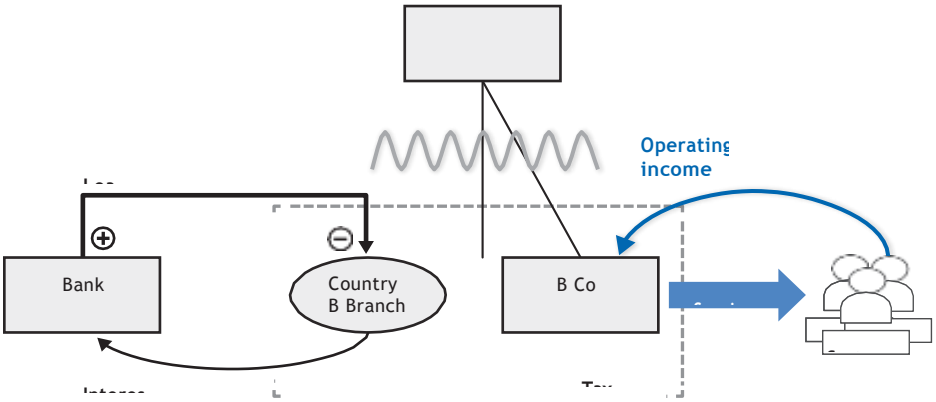

Figure 4. DD branch payment[4]

If Country B Branch is treated as taxable under the laws of Country A, then the interest expense incurred by the branch will give rise to separate deductions under the laws of Country A and Country B. Because Country B Branch and B Co are members of the same tax group this interest expenditure can also be offset, under Country B law, against the operating income derived by the subsidiary (that is against non-dual inclusion income). This structure therefore permits the same interest expense to be set off simultaneously against different items of income in the residence and branch jurisdiction.

[4]*OECD/G20 BEPS project Action Plan 2 'Neutralising the Effects of Branch Mismatch Arrangements'*

The issues raised by these structures are discussed in Chapter 6 of the Action 2 Report (OECD, 2015) which sets out general hybrid mismatch rules neutralizing the effect of DD outcomes, while the recommendations set out in Chapter 6 are drafted broadly enough to cover DD outcomes arising in respect of branch structures. The Action 2 Report (OECD, 2015) does not specifically consider the application of the deductible hybrid payments rule to DD branch payments such as those identified above.

2.2.8 Imported branch mismatches

An imported branch mismatch can arise where a person with a deduction under a branch mismatch arrangement offsets that deduction against a taxable payment received from a third party. An example of an imported branch mismatch is illustrated in Figure 5.

This example is similar to that illustrated in Figure 3 except that A Co and C Co are part of the same group and it is assumed that there is no rule in either Country A or B addressing the mismatch in tax outcomes arising from a deemed royalty payment. As a consequence, a deduction under a branch mismatch arrangement is set off against the (deductible) service fee paid by C Co resulting in an indirect D/NI outcome.

The structure is similar to the imported mismatch structures described in Recommendation 8 of the Action 2 Report (OECD, 2015) in that it relies on the taxpayer engineering a mismatch (in this case a branch mismatch) under the laws of two jurisdictions and importing the effect of that mismatch into a third jurisdiction through a plain-vanilla instrument with an otherwise orthodox tax treatment.

Imported branch mismatch structures raise similar tax policy issues to those identified in the Action 2 Report (OECD, 2015) in that the most appropriate and effective way to neutralize the mismatch is for either or both Country A and B to implement branch mismatch rules neutralizing the mismatch. However, in order to maintain the integrity of the other recommendations (in the event Country A or B do not have branch mismatch rules), an imported mismatch rule is needed to deny the deduction for any payment that is directly or indirectly set off against any type of branch mismatch payment.

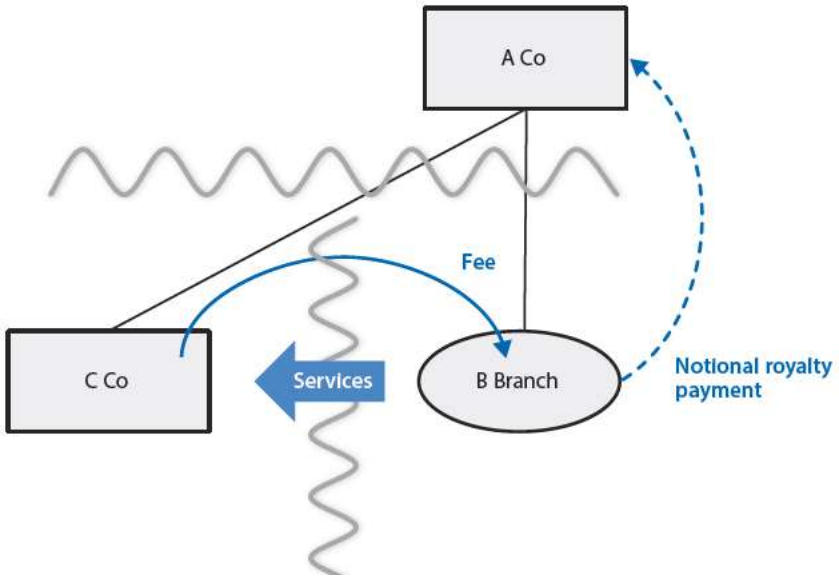

Figure 5. Imported branch mismatches[5]

[5]*OECD/G20 BEPS project Action Plan 2 'Neutralising the Effects of Branch Mismatch Arrangements'*

Chapter 3
Action Plan 3: Designing Effective Controlled Foreign Company Rules

3.1 What is a Controlled Foreign Company (CFC)

Corporations are inclined to construct foreign holding companies in low tax jurisdictions to accumulate dividend, royalty, interest income etc.(passive income) being received from step-down subsidiaries and do not bring them into their resident tax jurisdiction for avoiding taxation. In order to curb this harmful tax practice advanced tax jurisdictions like USA legislated CFC rules as early as 1962, followed by jurisdictions like Canada, Japan, France, UK, New Zealand, Australia etc.

CFC rules operate on the principle of taxation on accrual basis of the passive income earned in the low tax jurisdictions by holding companies irrespective of whether such income is distributed as dividend or not to the parent company.

3.1.1 CFC rules respond to the risk of base erosion wherein the tax payers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC. CFC rules were originally enacted in the year 1962 and currently around 30 countries participating in the inclusive framework of OECD / G20 BEPS project have CFC rules. Many other countries also have expressed their interest in implementing the same. However, the existing CFC rules do not keep pace with the changes in the international business environment and do not tackle BEPS effectively. In view of the same OECD's Action plan 3 report is meant to address the challenges faced by existing CFC rules. The report has brought in recommendations in the form of building blocks. These recommendations are not minimum standards, but they are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent tax payers from shifting income into foreign subsidiaries. The building blocks set out by the report for the design of effective CFC rules are as under:

- **Definition of a CFC** – CFC rules generally apply to foreign companies that are controlled by shareholders in the parent jurisdiction. The

report sets out recommendations on how to determine when shareholders have sufficient influence over a foreign company for that company to be a CFC. It also provides recommendations on how non-corporate entities and their income should be brought within CFC rules.

- **CFC exemptions and threshold requirements** – Existing CFC rules often only apply after the application of provisions such as tax rate exemptions, anti-avoidance requirements, and *de minimis* thresholds. The report recommends that CFC rules only apply to controlled foreign companies that are subject to effective tax rates that are meaningfully lower than those applied in the parent jurisdiction.
- **Definition of income** – Although some countries' existing CFC rules treat all the income of a CFC as "CFC income" that is attributed to shareholders in the parent jurisdiction, many CFC rules only apply to certain types of income. The report recommends that CFC rules include a definition of CFC income, and it sets out a non-exhaustive list of approaches or combination of approaches that CFC rules could use for such a definition.
- **Computation of income** – The report recommends that CFC rules use the rules of the parent jurisdiction to compute the CFC income to be attributed to shareholders. It also recommends that CFC losses should only be offset against the profits of the same CFC or other CFCs in the same jurisdiction.
- **Attribution of income** – The report recommends that, when possible, the attribution threshold should be tied to the control threshold and that the amount of income to be attributed should be calculated by reference to the proportionate ownership or influence.
- **Prevention and elimination of double taxation** – One of the fundamental policy issues to consider when designing effective CFC rules is how to ensure that these rules do not lead to double taxation. The report therefore emphasizes the importance of both preventing and eliminating double taxation, and it recommends, for example, that jurisdictions with CFC rules allow a credit for foreign taxes actually paid, including any tax assessed on intermediate parent companies under a CFC regime. It also recommends that countries consider relief from double taxation on dividends on, and gains arising from the

disposal of, CFC shares where the income of the CFC has previously been subject to taxation under a CFC regime.

3.2 The recommendations of this Action plan report to implement CFC rules that combat BEPS, are flexible in a manner to enable each country concerned adopt in line with their respective policy objectives of the overall tax system and the international legal obligations.

3.3 India does not have CFC rules as on date and accordingly no action is taken in India's domestic level. It is pertinent to note developments happening around the world where CFC rules are being amended in line with recommendation of Action plan 3. Such developments have happened in Argentina, Austria, Belgium, Bulgaria, Finland, Japan, Russia, South Africa, Sweden and USA.

Chapter 4
Action Plan 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

4.1 Multinational groups (MNEs) resort to more of debt funding into their group entities in order to benefit interest payments as deductible expense thereby reducing overall tax burden. Even in cases where equity is to be infused, MNE's prefer debt funding to obtain the tax leverage. There could be instances where the debt equity ratio might be 2:8 or even 1:9.This is one of the important areas of BEPS concerns. In order to address this bothering issue Action plan 4 final report dealt with this matter at length. It was found from various studies that MNEs can easily multiply the level of debt at the level of individual group entities via intra group financing, financial instruments can also be used to make payments which are economically equivalent to interest but have a different legal form, therefore escaping restrictions on deductibility of interest. BEPS risk in this area may arise in three basic scenarios.

- Groups placing higher levels of third party debt in high tax countries.
- Groups using intra group loans to generate interest deductions in excess of the group's actual third party interest expense.
- Groups using third party or intra group financing to fund the generation of tax exempt income.

4.1.1 Action plan 4 after considering all the stake holder's inputs recommended an approach that is based on a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortization (EBITDA). This is like a minimum level rule that should apply to entities in MNE groups. In order to apply fixed ratio rule in a more flexible and practical manner recognizing that not all countries are in same position a corridor of possible ratios of between 10 to 30 percent is recommended. The report also includes factors which countries should take into account in setting their fixed ratio within this corridor. While doing so it is pertinent to have a broad idea that a fixed ratio rule does not take into

account the fact that groups in different sectors may be leveraged differently and, even without a sector bias, some groups are simply more highly leveraged. Therefore, if a fixed ratio rule is introduced in isolation, groups which have a net third party interest / EBITDA ratio above the benchmark fixed ratio would be unable to deduct all of their net third party interest expense. To reduce the impact on more highly leveraged groups, it is recommended that countries consider combining a fixed ratio rule along with a group ratio rule. This would enable an entity in a highly leveraged group to deduct net interest expense in excess of the amount permitted under the fixed ratio rule, considering the overall worldwide group's financial ratio.

4.1.2 The factors which a country should take into account in setting a benchmark fixed ratio are explained as under:

a) A country may apply a higher benchmark fixed ratio if it operates a fixed ratio rule in isolation, rather than operating it in combination with a group ratio rule.

b) A country may apply a higher benchmark fixed ratio if it does not permit the carry forward of unused interest capacity or carry back of disallowed interest expense.

c) A country may apply a higher benchmark fixed ratio if it applies other targeted rules that specifically address the base erosion and profit shifting risks to be dealt with under Action 4.

d) A country may apply a higher benchmark fixed ratio if it has high interest rates compared with those of other countries.

e) A country may apply a higher benchmark fixed ratio, where for constitutional or other legal reasons (e.g. EU law requirements) it has to apply the same treatment to different types of entities which are viewed as legally comparable, even if these entities pose different levels of risk.

f) A country may apply different fixed ratios depending upon the size of an entity's group.

4.1.3 The recommended approach of combining fixed ratio rule with group ratio gives more flexibility for a particular entity in a particular jurisdiction for claiming interest expense beyond the fixed ratio rule but up to a maximum of group ratio rule. This approach ensures that an entity's net interest deductions are linked to a taxable income generated by an entity through its

economic activities. This rule in no way restricts the multinational groups in raising funds through third party debts centrally in one country and for on lending to group entities in other countries. The recommended approach allows countries to supplement the fixed ratio rule and group ratio rule with other provisions that reduce the impact of the rules on entities or situations which pose less BEPS risk such as

- A *de minimis* threshold which carves out entities which have a low level of net interest expense. Where a group has more than one entity in a country, it is recommended that the threshold be applied to the total net interest expense of the local group.
- An exclusion rule in respect of interest paid to third party lenders on loans used to fund public benefit projects, subject to conditions.
- The carry forward of disallowed interest expense and / or unused interest capacity (where an entity's actual net interest deductions are below the maximum permitted) for use in future years. The carry forward of disallowed interest expense will help entities that incur losses in initial years on account of long-term investments and significant debt servicing and which are expected to generate taxable income in the later years. This would also *allow entities with losses to claim interest deductions when they return to profit.*

4.1.4 The above recommended approach given in the final report of Action plan 4 in October 2015 is extracted as part I in final updated report in 2016 by OECD/G20 inclusive framework. The updated report also recommends that recommended approach be supplemented by domestic tax rules that would counter any abuse or artificial circumvention of the rules and should also tackle specific issues arising such as where entity without net interest expense shelters or exempts interest income. Part II of the updated report contains further guidance on elements of the design and operation of a group ratio rule based on the net interest/ EBITDA ratio of a worldwide group, which focuses on the calculation of net third party interest expense, the calculation of group EBITDA and approaches to address the impact of entities with negative EBITDA on the operation of the rule. It is to be noted that the content of the original final report of October 2015 which is extracted as Part I of updated report is not altered or modified in any way. The updated report only provides additional guidance in implementing this rule. Part III of the updated report is the outcome of further work in respect of banking and insurance sectors and application of this rule.

4.1.5 Intra group interest payments or payments economically equivalent to interest are also impacted by the transfer pricing rules. Action plan 8-10 contained in the OECD report with objective of *aligning transfer pricing outcomes with value creation* limit the amount of interest payable to group companies lacking appropriate substance to no more than a risk free return on the funding provided. It also requires group synergies to be taken into account while evaluating intra group financial payments.

4.1.6 It is pertinent to note that interest disallowances as per this report and also as per Action plan 8-10, the essence of which is brought into OECD TP guidelines 2017 should not result in double disallowances and double blow to the tax payer. It is justified to ensure that only disallowance of interest expense happens once only and not twice under two parallel rules.

4.2 How these recommendations have been brought into OECD Model Convention and Multilateral Instrument (MLI)

Recommendations of this Action plan are meant to be implemented by domestic tax law systems through specific rules hence the same is not addressed by MLI or through any revisions in OECD model convention 2017. Each country as per their tax policy adopted these recommendations of Action plan 4 in their respective domestic tax law. India is one of the front runners in bringing this rule in the form of section 94B in the Income Tax Act 1961 through amendments brought in by Finance Act, 2017 which became effective from 01-04-2018.

4.2.1 Provisions of section 94B of the Income Tax Act,1961 – Limitation on interest deduction in certain cases

94B (1) *Notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower, the interest shall not be deductible in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2) :*

Provided *that where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or*

explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.

(2) For the purposes of sub-section (1), the excess interest shall mean an amount of total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortization of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

(3) Nothing contained in sub-section (1) shall apply to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance.

(4) Where for any assessment year, the interest expenditure is not wholly deducted against income under the head "Profits and gains of business or profession", so much of the interest expenditure as has not been so deducted, shall be carried forward to the following assessment year or assessment years, and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with sub-section (2):

***Provided** that no interest expenditure shall be carried forward under this sub-section for more than eight assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.*

(5) For the purposes of this section, the expressions—

(i) "associated enterprise" shall have the meaning assigned to it in sub-section (1) and sub-section (2) of section 92A;

(ii) "debt" means any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession";

(iii) "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.]

4.2.2 Section 94B(1)- Disallowance of excess interest

The objective of this provision is to disallow excess interest which is incurred in the course of earning income under the head profits and gains from business or profession in respect of any debt received from a non-resident being an associated enterprise (AE) of the assessee being an Indian company or a permanent establishment (PE) of a foreign company in India. A de minimis exemption of INR one crore has also been provided in this sub section. In other words, this section is not applicable if the interest or other expenditure of similar nature does not exceed INR one crore in the previous year relevant to the assessment year under consideration.

4.2.3 It is also provided that the borrowing from the AE could be direct or indirect for the purpose of this provision. In other words, an amount borrowed from a third party would come under application of these provisions provided the associated enterprise offers implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender. In such a scenario such debt shall be deemed to have been issued by an associated enterprise.

4.2.4 It is relevant to understand what is to be considered as interest or an amount of similar nature in the context of these provisions. Interest includes

(a) The Honorable Supreme court held that usance interest on delayed supply of goods and material is to be treated as interest [*CIT VS Vijay ship breaking corporation*] and [*Others VS CIT 2008 175 taxmann 77*]

(b) The definition of the word "Debt" means any loan, financial instrument, finance lease, financial derivative or any arrangement. Accordingly, any amount paid as interest, discount or other finance charges in respect of such arrangements are to be treated as amount of similar nature equivalent to interest that are deductible in computing the income under the head profits and gains from business or profession.

(c) Action plan 4 report considers payments in nature of guarantee fee, arrangement fee, finance cost element of finance lease, profit participating loans as equivalent to interest.

4.2.5 Items which may not be treated as interest are as under

- Brokerage or manager's remuneration in securing finance [CBDT instruction F.No.164/18/77-IT (AI) dated 13-7-1978]

- Agreed amount payable by hirer in periodical installments [Instruction No. 1425 dated 16-11-1981 reproduced in N.K. Leasing and Construction (P) Ltd. vs. DCIT (2001) 79 ITD 658 (Hyd)]
- Interest on share application money as share application money is not debt until company decides to refund it [CIT vs. Lucas TVS (249 ITR 302) (SC)]
- Upfront appraisal fee or front-end fee [DIT vs. Commonwealth Development (2012) 24 taxmann.com 154 (Bom)]
- Bill discounting charges [CIT vs. Cargill Global Trading Pvt Ltd. (2011) 335 ITR 0094 (DEL); SLP dismissed by SC in CIT vs. Cargill Global Trading Pvt Ltd. [2012] 21 taxmann.com 496 (SC)]
- Corporate guarantee [Johnson Matthey Public Ltd. vs. DCIT (2017) 88 taxmann.com 127 (Delhi- Trib.)]

4.2.6 As per the wording of sec 94B (1) it is only an Indian company or a PE of a foreign company in India are covered by these provisions. It is therefore clear that the following type of entities are not covered by the provisions

- Limited liability partnership
- Trust/LLP established as Alternative Investment Fund(AIF)
- Foreign company having a place of effective management in India

In a case where amounts are borrowed from a third party against which explicit or implicit guarantee is given by the AE, the same would also get covered by the provisions of sec 94B.It is therefore relevant to understand what is an explicit guarantee and what is an implicit guarantee. Explicit guarantee is understood as a guarantee provided through proper documentation and which is fully demonstrated by the AE. We need to understand three terms that is explicit, implicit and guarantee.

As per the Indian Contract Act it is essential that there must be a principal debtor so as to have a suretyship, it therefore means there should be a person who borrowed a debt from another person which is being guaranteed by a third person. The principal obligation guarantee may be contractual, non-contractual viz. such as those resulting from bailment, tort or unsatisfied judgments[6]. It is therefore to be noted that principal debtor relationship is an essential ingredient of a guarantee.

[6]*Authors Pollock & Mulla in their treaties on Indian Contract Act and Specified Relief Act, Thirteenth Edition, page 1760*

4.2.7 OECD transfer pricing guidelines 2017 gives guidance on this regard in Para 7.13

> *Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group service would usually exist where the higher credit rating were due to a guarantee by another group member, or where the enterprise benefitted from deliberate concerted action involving global marketing and public relations campaigns. In this respect, passive association should be distinguished from active promotion of the MNE group's attributes that positively enhances the profit-making potential of particular members of the group. Each case must be determined according to its own facts and circumstances.*
>
> An implicit guarantee would not create binding contractual obligation on the associated enterprise which is deemed to have provided the same to its AE located in India. It is therefore very difficult to judge the concept of implicit guarantee and its impact on the tax payer belonging to the group being located in India. Even simple letter of comfort given by parent located outside India to its group entity/subsidiary in India would amount to implicit guarantee provided to the bankers of Indian entity. As there is no contractual obligation in the case of an implicit guarantee from the deemed provider of comfort to the lender say a parent company it is a far-fetched proposition to bring it into the ambit of provisions of sec 94B. It may result in a situation where every borrowing made by a company in India from a banker would be treated as having got implicit guarantee from its parent abroad. So in this back drop it is desirable to have specific guidelines from CBDT as to what implicit guarantee would mean and what type of situations would be covered.
>
> The concept of implicit guarantee has been endorsed by a Canadian Court in the case of General Electric Capital Canada Inc. case2010) 2 C.T.C 2187. However, in India, Indian Contract Act provides enforceability only to explicit guarantee and not to implicit one.

4.2.8 In case lender being an Indian bank and the guarantee is given by AE located abroad: In this scenario it is to be examined whether provisions of Sec 94 B would apply at all, as the whole premise on which provisions of interest limitation arise is based on the assumption of interest payer and interest payee being located in two different tax jurisdictions. That is how Action plan 4 visualizes base erosion and profit shifting happening on account of hybrid mismatch or on account of varying tax rules that may provide double non taxation. Hence in a case where interest payer and payee both are located in India it would not result in any base erosion in India and there by provisions of sec 94B should not have any application. It is therefore obvious that lender entity should be a non-resident and the AE providing explicit/implicit guarantee could be a resident or non-resident, for provisions of sec 94B to have application.

4.2.9 Computation of Excess Interest

Section 94B (2) provides how excess interest is calculated and the same is as under

The lower amount of the two figures shall be considered for deduction in the previous year

- 30% of the earnings before interest, tax depreciation and amortization (EBITDA) of the borrower in the previous year.
- Interest paid / payable to AEs for that previous year

In other words, 30% of the EBITDA of the tax payer being a borrower shall be the maximum allowable interest paid/payable to the AE as a deduction in the said previous year. Any interest paid in excess of such benchmark would be disallowed. If the actual interest paid/payable to the AE is lower than such benchmark, then the actual amount paid/ payable would be allowed in the hands of borrower.

4.2.10 There is no definition of the term EBITDA in the Act. In other words, we are not sure whether EBITDA should be an accounting based one or a tax based one. There are two views and first view supports tax EBITDA and the other one supports accounting EBITDA. If we consider the view that tax EBITDA is to be taken into account for the purpose of sec 94B the same is justified in considering only profits computed under the head profits and gains from business or profession and not to include other items of income such as dividends, capital gains etc. This view is also supported by the Action plan 4 report.

As per the second view the EBITDA is a concept more aligned with accounting principles and not tax. Sec 94B(2) refers to "Taxes" as one of the components of EBITDA. So this itself supports the argument that EBITDA is an accounting based concept and not otherwise. Accounting EBITDA would include within its scope not only income tax but also deferred tax. Tax is calculated on the net taxable income and it can vary if there are adjustments or additions by the assessing officer. Accordingly, the second view of considering accounting EBITDA seems to be more appropriate. In other words, tax would be calculated on such earnings which are liable for tax after considering interest, depreciation and amortization. Therefore, it sounds logical to consider second view and uphold accounting based EBITDA.

4.2.11 We need to examine the wording "Expenditure by way of interest or of similar nature" used in section 94B(1). whereas section 94B(2) which deals with excess interest uses the wording" Total interest paid or payable". There arises a question whether interest paid to both AEs and third parties is to be considered for the purpose of calculating excess interest for disallowance. There could be an argument that "interest or of similar nature" is applicable only in the context of *minimis* threshold of Rupees one crore and once the said threshold is crossed it is only "interest" that is to be considered and therefore any amount of similar nature need not be considered for the purpose of computing excess interest. However, such argument may not hold water and for the purpose of section 94B (2) also, item of payments of similar nature to that of interest shall be considered for calculating excess interest. This is on the basis of context, object and purpose of bringing these provisions into the statute.

4.2.12 The next issue that arises for consideration is whether interest paid to third parties shall also be considered for calculating excess interest based on the wording used in section 94B(2) or only such interest that is paid to non-resident AE on the basis of wording used in section 94B(1). Here one needs to note that Action plan 4 deals with entire interest paid by the tax payer in respect of debts raised from AEs as well as third parties. Whereas the provisions of section 94B clearly demonstrate the intention of considering only the interest paid to non-resident AEs and not otherwise. Therefore, it is legally tenable to hold a view that interest paid to non-resident AEs alone is to be considered for calculating excess interest.

4.2.13 There arises another issue for consideration whether we need to consider interest paid both to resident AEs as well as non-resident AEs for

the purpose of computing excess interest. The wording of the section 94B(1) clearly refer to non-resident AE and therefore there is no room to consider resident AEs in this context. It is also pertinent to understand what would be the consequences if EBITDA is negative. In such a scenario applying provisions of section 94B(2) for arriving at the amount of excess interest we need to consider the lower of the amounts of 30% of EBITDA or the actual amount paid to non-resident AE. It is obvious that 30% of negative EBITDA would be a lower figure and hence no interest paid to non-resident AE would be allowed at all.

4.2.14 Carry forward of excess Interest

Section 94B(4) provides for carry forward of excess interest that could not be deducted on account of non-availability of profits, can be carried forward for a maximum period of 8 years starting from the assessment year subsequent to the year in which excess interest was first computed. Such excess interest shall be carried forward to the subsequent year and can be set-off against income from Profits and Gains from Business or Profession ("PGBP") subject to the maximum interest allowable as per section 94B(2). In other words excess interest carried forward would be clubbed along with the interest pertaining of the subsequent year and such overall amount would be subjected to restriction imposed under section 94B(2).

An illustration given below would explain this provision clearly as under:

Particulars	Scenario 1		Scenario 2		Scenario 3	
EBITDA	200		200		200	
Total interest expenditure (A)						
- In relation to AE (A1)	30		Nil		100	
- In relation to other than AE (A2)	70	100	100	100	Nil	100
Maximum interest deduction allowable (30% of EBITDA)(B)	60		60		60	
Interest disallowed & carried forward, (C) lower of:						
Total Interest – 30% of EBITDA (A-B); or	40		40		40	
Interest in relation to AE (A1)	30	30	Nil	Nil	100	40
Interest allowed in computation of income* (A-C)	70		100		60	

4.2.15 An issue arises whether excess interest carried forward should first be deducted against the profits in the order of priority against the current year's interest payments. In the absence of any specific order of priority prescribed in the provisions the tax payer would be eligible to first claim the deduction of

brought forward excess interest and then claim the current year's interest if there exist some cushion in the overall limit. This will facilitate taxpayer in exhausting brought forward excess interest in priority as there is a time restriction of 8-year period for carry forward of excess interest.

4.2.16 There can be a discussion whether the same business is required to be continued by the tax payer for claim of brought forward excess interest in subsequent years. Unlike in the case of business losses prior to the amendment by the Finance Act 1999 there is no specific wording in 94B to insist for continuing the same business for claim of brought forward excess interest. Therefore, it is legally tenable to claim brought forward excess interest against any business income earned during the current year by the taxpayer, irrespective of such business of the previous year where excess interest expense was incurred, was continued or not.

In the same manner there is no express wording regarding the shareholding requirement to be continued in the subsequent years when excess interest brought forward is being claimed. In other words, even if there is any change in the shareholding of the company beyond 51% the claim of excess interest in such subsequent years should not be impacted, unlike provisions of sec. 79.

Another interesting issue is whether provisions of section 94B have impact on MAT provisions governing the Book profits u/s 115JB. Hon'ble Supreme Court in the case of ***Apollo Tyres [255 ITR 273]*** held that the books profits computed in accordance with provisions of Companies Act which are audited and placed before the AGM cannot be tinkered by the Assessing Officer, is a sacrosanct ratio to be followed. Accordingly, provisions of sec.94B would not impact computation of book profit under MAT in any way.

4.2.17 Interplay between section 94B and transfer pricing provisions-

- Any interest payments to AEs would constitute international transactions and transfer pricing regulations would apply. It is obligatory on the part of tax payer to prove such interest payments to AEs are at Arm's length. Interest payment to non-resident AE is also governed by the provisions of sec 94B now. Both, the above provisions, TP regulations and interest limitations are to be considered as Specific Anti Avoidance Rules (SAAR). When the same transaction is covered by two SAARs we should ensure that they are applied appropriately and it should not result in a double blow. Section 94B

dealing with interest limitation has to be applied by tax payer himself while computing the income and filing the tax return. When such tax return which contains international transactions is examined by the transfer pricing officer, it would be examined whether interest payments to non-resident AEs are at Arm's length. For example an interest payment of Rs 50 paid to non-resident AEs and tax payer on his own surrenders Rs 10 as an excess interest in his computation as per section 94 B(2),whether TP regulations apply to whole of Rs 50 or in respect of Rs 40 is an issue to be discussed. One popular view is that TPO should consider only Rs 40 for the purpose of benchmarking under TP regulations. Another issue that merits our attention is whether excess interest carried forward under section 94B(4) and claimed for deduction in the subsequent year would be treated as an international transaction of the subsequent year? Whether TPO is legally empowered to examine and benchmark such excess interest as international transaction of subsequent year? Or would TPO be deprived of examining such excess interest brought forward on the simple reason that it is not a transaction of that concerned year.

- Section 94B acts with an object of limiting excess interest claims with a fixed ratio rule, while TP regulations operate to benchmark the interest payments under the Arm's length rule. When both regulations apply to the same transaction, which needs to be applied first, is of importance. Generally, it is not a case where TPO will examine the transaction first and then 94B regulations have to be applied. It is other way round that a taxpayer would normally claim interest payments to AEs are at Arm's length, which will be supported by TP study and accordingly file the tax return. Tax payer will have to apply interest limitation rule under section 94B and offer disallowance of excess interest in the same income tax return itself. So thereby it looks practical to apply section 94B in first place and then TP scrutiny by TPO would happen at a later point of time. However, in the whole process it must be ensured by tax authorities that there are no double adjustments which will result in double jeopardy.

4.2.18 Interplay between General Anti-Avoidance Rules (GAAR) and section 94B

- Section 94B dealing with interest limitation is a SAAR forming part of chapter X whereas GAAR is under chapter XA which deals with

impermissible avoidance arrangements. It is to be debated whether both section 94B and GAAR can be applied to same transaction. In other words, whether SAAR and GAAR can be applied simultaneously against the same transaction. CBDT vide its circular 7/2017 dated 27/01/2017 clarified in this context as under

Question no. 1: Will GAAR be invoked if SAAR applies?

Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.

It is therefore clarified that if SAAR takes care of the situation effectively then GAAR does not apply. So, for GAAR to be applied at the threshold, the transaction must be abusive. If the transaction is not abusive at the threshold, then SAAR would apply and GAAR will not apply. Hence even in the context of section 94B the same principle would apply.

4.3 Conclusion

Interest limitation is an important BEPS agenda dealt with through Action plan 4 final report. This rule is on the basis of Action plan 4, which has been brought into domestic law of various countries like Belgium, Bulgaria, Croatia, Denmark, Estonia, Finland, Greece, Hungary and Norway etc.

Chapter 5
Action Plan 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

5.0 Harmful tax practices by certain jurisdictions to attract investments would greatly harm other established and transparent tax jurisdictions which apply the normal tax rates. OECD more than 20 years back released its first publication titled as *"Harmful tax competition: An Emerging Issue".* Since then work is going on in this direction and the concerns in the said report 20 years back are equally relevant even today. Now the focus is on preferential regimes on account of which artificial profit shifting happens and also about lack of transparency in connection with certain rulings. So, the importance of this work culminated into Action Plan 5 of OECD/ G20 BEPS inclusive framework initiative.

Forum on Harmful Tax Practices (FHTP) observed revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

Two focal points that emerge are, to define the substantial activity requirement to assess preferential regime, more importantly intellectual property (IP) regimes, and improving transparency through the compulsory spontaneous exchange of certain rulings that could give rise to BEPS concerns in absence of such exchanges.

5.1 Substantial Activity and Nexus Approach

Where a tax jurisdiction offers special tax regime in respect of particular activity, it is to be ensured that a tax payer who claims such tax benefit should have really involved himself and engaged in such activities and incurred actual expenditure on such activities. This is known as substantial activity requirement. In respect of intellectual property (IP) regime it is suggested by the final report to follow the "Nexus Approach". As per this

approach a taxpayer would be entitled to benefit from an IP regime only to the extent that the taxpayer itself incurred qualifying research and development (R&D) expenditures that give rise to IP income. The nexus approach uses expenditure as a proxy for activity and decides the eligibility of the taxpayer to avail tax benefit accordingly. In other words, taxpayer who incurs corresponding R&D expenditure would alone be entitled to claim tax benefit of such IP regime.

5.2 Improving Transparency and Review of Preferential Regimes

It has been provided by the final report that a framework of compulsory spontaneous exchange of rulings by tax jurisdictions among themselves is mandatory and critical. This framework covers six categories of rulings which are

(i) rulings related to preferential regimes

(ii) cross border unilateral advance pricing arrangements (APAs) or other unilateral transfer pricing rulings

(iii) rulings giving a downward adjustment to profits

(iv) permanent establishment (PE) rulings

(v) conduit rulings

(vi) any other type of ruling where the FHTP agrees in the future that the absence of exchange would give rise to BEPS concerns

It does not mean that rulings *per se* are preferential and give rise to BEPS, but it does acknowledge that lack of transparency in the operation of preferential regime might result in mismatches of tax treatment and can give rise to instances of double non taxation. A total of 43 preferential regimes have been reviewed out of which 16 are IP regimes. However, the elaborated substantial activity factor has so far been applied to IP regimes and it was found that there exist many inconsistencies with the nexus approach proposed. On account of nexus approach proposed FHTP would review and suggest reassessments for all the preferential regimes.

5.3 India's final position

India agreed for the transparency rules proposed by Action plan 5 and became part of the framework by joining Forum for Harmful Tax Practices ("FHTP") with this India agreed for the spontaneous exchange of information in respect of rulings relating to

(i) Preferential regime

(ii) Unilateral APA's or Unilateral rulings in respect of transpiring Rulings

(iii) Providing for downward adjustment of taxable profits and

(iv) PE rulings

Finance Act, 2016 has brought in section 115BBF to deal with patent box regime offering a preferential tax rate of 10% in respect of IP income. The details of the said provision are as under:

5.4 Section 115BBF

Tax on income from patent.

115BBF. (1) Where the total income of an eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, the income-tax payable shall be the aggregate of—

(a) the amount of income-tax calculated on the income by way of royalty in respect of the patent at the rate of ten per cent; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the income referred to in clause (a).

(2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the eligible assessee under any provision of this Act in computing his income referred to in clause (a) of sub-section (1).

(3) The eligible assessee may exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of this section, in the prescribed manner, on or before the due date specified under sub-section (1) of section 139 for furnishing the return of income for the relevant previous year.

(4) Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with the provisions of this section and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with the provisions of sub-section (1), then, the assessee shall not be eligible to claim the benefit of the provisions of this section for five assessment years

subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with the provisions of sub-section (1).

Explanation.—For the purposes of this section,—

(a) "developed" means at least seventy-five per cent of the expenditure incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970 (39 of 1970) (herein referred to as the Patents Act);

(b) "eligible assessee" means a person resident in India and who is a patentee;

(c) "invention" shall have the meaning assigned to it in clause (j) of sub-section (1) of section 2 of the Patents Act;

(d) "lump sum" includes an advance payment on account of such royalties which is not returnable;

(e) "patent" shall have the meaning assigned to it in clause (m) of sub-section (1) of section 2 of the Patents Act;

(f) "patentee" means the person, being the true and first inventor of the invention, whose name is entered on the patent register as the patentee, in accordance with the Patents Act, and includes every such person, being the true and first inventor of the invention, where more than one person is registered as patentee under that Act in respect of that patent;

(g) "patented article" and "patented process" shall have the meanings respectively assigned to them in clause (o) of sub-section (1) of section 2 of the Patents Act;

(h) "royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the—

(i) transfer of all or any rights (including the granting of a license) in respect of a patent; or

(ii) imparting of any information concerning the working of, or the use of, a patent; or

(iii) use of any patent; or

(iv) rendering of any services in connection with the activities referred to in sub-clauses (i) to (iii);

(i) "true and first inventor" shall have the meaning assigned to it in clause (y) of sub-section (1) of section 2 of the Patents Act.

Provisions of sec 115BBF are in line with nexus approach suggested by Action plan 5 report. The salient features of the section are as under

(a) A special tax regime of 10% tax is proposed on royalty income in respect of patent developed and registered in India.

(b) A person resident in India is an eligible assessee (non-residents are not covered)

(c) This is taxed on gross basis and no deduction is allowable in respect of any expenditure.

(d) Eligible assessee may exercise the option in the prescribed manner to get covered under these provisions on or before the due date for filing the return.

(e) An eligible assessee having opted to get covered under this section for a particular previous year and subsequently opts out in any of the five assessment years would be deprived for any claim of benefit under this section for five assessment years subsequent to the assessment year in which taxation of such royalty income is not in accordance with this section.

(f) It is provided that at least 75% of the R&D expenditure is incurred in India by the eligible assessee in respect of any invention for which a patent is granted under Patents Act, 1970.

(g) The term “Royalty” under this section does not include any consideration which would be chargeable under capital gains or consideration for the sale of products manufactured with the use of patented process or the patented article for commercial use.

(h) “Patentee” means a person being the first and true inventor of the invention whose name is entered in patent register as patentee in accordance with the Patents Act, 1970.

5.5 Issues and Challenges

(a) Nexus approach adopted by this section mandates eligible assessee to incur R&D expenditure. This approach could pose challenges in genuine transactions where an assessee acquires an "in-process" IP and there after incurs expenditure on enhancement and further developments which results in a patent.

(b) As per the current provisions such assessee would be eligible to claim this preferential tax benefit only in respect of proportionate income relating to the development expenditure incurred post acquisition of "in-process" IP.

(c) The similar issue would arise when an assessee outsources R&D to a third party.

(d) It is to be noted that all IP assets may not be registerable under the Patents Act such as computer software etc. It is therefore essential to expand the scope of IP assets such as formulae, processes, Designs, Patterns, Know-how and inventions etc.

(e) Patent registration process may be time consuming and sometimes an eligible assessee might have opportunities to exploit the said IP assets even before formal registration under Patent Act. In such a scenario it is not clear whether the assessee would be eligible to claim preferential tax regime under this section.

(f) It is usual that an assessee engaged in IP focused business may exploit bundle of IP assets on a combined basis while only some of the IP assets may be eligible for patent protection. This throws a challenge in separating and computing income eligible for preferential tax regime.

(g) Conditions imposed for qualifying an IP income rule out any income arising on the sale of products manufactured or services provided using the IP. In other words, income from products and services developed using the IP is not a qualifying income for the purpose of this section for preferential tax regime.

5.6 Patent box regime being brought in the form of section 115 BBF is a welcome proposition. However, the said provisions require fine-tuning in line with international practices to make it more harmonious and acceptable.

5.7 As this action plan suggests appropriate changes in the domestic law preferential tax regimes in many jurisdictions are being amended in line with recommendations given by Action plan 5 report.

Chapter 6
Action Plan 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

6.0 The whole purpose of BEPS agenda is to address treaty abuse and treaty shopping which is the main cause for tax leakages and lower tax collections. Treaty abuse and treaty shopping undermine tax sovereignty by claiming treaty benefits in situations where it was not intended to be availed by such tax payers. In this scenario OECD/ G20 BEPS initiative unanimously resolved that prevention of treaty abuse is a minimum standard. In order to check and neutralize such treaty abuse and treaty shopping the final report gave various options to provide flexibility to different tax jurisdictions.

6.1 Anti-abuse rules suggested by the final report targets to address treaty shopping where in resident of a third state would explore the possibility of availing the benefit of a treaty. The approach suggested by the report is as under

- Both the treaty partners should endeavor and acknowledge that the purpose of a tax treaty is to avoid double taxation in a legitimate manner and is never meant to create opportunities for non-taxation or reduce taxation through tax evasion or avoidance, including treaty shopping arrangements. The said common understanding should be incorporated as preamble to the treaty.
- It is suggested to have Limitation of Benefits rule (LOB) in the tax treaties to ensure and avoid treaty shopping. Some of treaties already have this LOB clause like India-USA tax treaty etc.
- In order to address other forms of treaty abuse with a more general and powerful anti- abuse rule it is suggested in the final report that a Principal Purpose Test (PPT) rule should be included in the OECD model tax convention. Under this rule if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.

6.2 All the members of inclusive framework of OECD/G20 BEPS initiative have agreed to deal with the prevention of treaty abuse as a critical agenda and the same is agreed as a minimum standard, which means every member unconditionally agrees that treaty abuse or treaty shopping is never the intended purpose of a treaty and always that needs to be dealt with sternly. So this objective would be achieved by the member countries by including anti abuse rule in the treaties like:

1. The combined approach of an LOB and PPT rule prescribed above
2. The PPT rule alone, or
3. The LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

6.3 Section A of the report also provides other rules to address other forms of treaty abuse such as

1. Certain dividend transfer transactions that are intended to lower artificially withholding taxes payable on dividends.
2. Transactions that circumvent the application of the treaty rule that allows source taxation of shares of companies that derive their value primarily from immovable property.
3. Situations where an entity is resident of two Contracting States, and
4. Situations where the State of residence exempts the income of permanent establishments situated in third States and where shares, debt-claims, rights or property are transferred to permanent establishments set up in countries that do not tax such income or offer preferential treatment to that income.

6.4 The final report clearly recognizes the importance of domestic anti abuse rules and provides that changes to the OECD model tax convention should not result in inadvertently preventing the application of such domestic anti abuse rules.

6.5 The report also addresses two specific issues in relation to interaction between treaties and domestic anti abuse rules –

The first issue relates to contracting state's rights to tax its own residents.

A new rule will have to codify the principle that treaties do not restrict a state's right to tax its own residents.

The second issue deals with so called "Departure" or "Exit" taxes, under which liability to tax on some types of income that has accrued for the benefit of a resident (Whether an individual or a legal person) is triggered in the event that the resident ceases to be a resident of that state. It is suggested by the report that commentary of the OECD MC will clarify that treaties do not prevent the application of these taxes.

6.6 Section B of the report endorses the importance of including a clear statement in the preamble of every treaty that the joint intention of the parties to a tax treaty is to eliminate double taxation without creating opportunities for tax evasion and avoidance, in particular through treaty shopping arrangements.

6.7 Section C of the report deals with the tax policy considerations that, in general, countries should consider before deciding to enter into tax treaty with another country. Such policy considerations should help countries decide not to enter into tax treaties with certain low or no-tax jurisdictions or modify / ultimately terminate if a treaty is previously concluded with such jurisdictions.

6.8 How recommendations of Action plan 6 were brought into MLI

Prevention of treaty abuse is the core agenda of OECD/ G20 BEPS initiative. This agenda has been unanimously agreed by all the members of the inclusive framework as non-negotiable and a mandatory rule to be agreed and implemented by each member country. Such rule is known as minimum standard in this context. Treaty abuse results in use of treaty shopping schemes by residents of a non-treaty country to obtain treaty benefits that are not intended to be availed by them. This is mainly done by interposing a conduit company in one of the contracting states so as to shift profits out of the treaty states. As mentioned above a Principal Purpose Test (PPT) rule is suggested as the only approach that can satisfy the minimum standard on its own. It is left open as a flexible option to the member countries to adopt this PPT rule in combination with LOB rule. The essence and purpose of this Action plan 6 is brought into MLI in the form of following articles.

6.9 Article 6 of MLI – Purpose of Covered Tax Agreement (CTA)

Article 6 of MLI primarily seeks to insert a statement in the preamble of the tax treaties to effect that the purpose of the treaty is not to create opportunities for double non-taxation or reduced taxation through tax avoidance or evasion including treaty shopping. It is provided in Article 6(4)

of MLI that a party may reserve the right for paragraph 1 (containing preamble language as mentioned above) not to apply to its CTAs that already contain preamble language describing the intent of the contracting jurisdictions to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance or applies more broadly. It is provided by Article 6 that the preamble text in paragraph 1 is to be added in all cover tax agreements other than those covered by paragraph 4 as mentioned above either the text would be replaced by the earlier text or it would be included in addition to the existing preamble text.

India is silent on its position on Article 6. So, there could be a scenario, if a treaty already has such language then that does not require a change. However, in all other treaties the preamble language needs to be changed as it is prescribed minimum standard.

Paragraph 3 provides that a party may also choose to include the preamble text in its CTAs "with a desire to develop an economic relationship or to enhance co-operation in tax matters" where the existing Preamble does not contain that language. Such party / country shall notify the same to the depository of OECD. India has not opted for adding the text relating to developing economic relationship or to enhance co-operation in tax matters to the Preamble of its treaties. However, Preamble in India's treaties where similar wordings already exist is not affected by this opt-out.

6.10 Article 7 of MLI - Prevention of Treaty Abuse

Three options have been provided to bring in the anti-abuse rule of PPT in the following manner

- A combined approach consisting of Limitation Of Benefits (LOB) provision and a Principal Purpose Test (PPT)
- A PPT alone (Default Option)
- An LOB provision supplemented by specific rules targeting conduit financing arrangements.

Paragraph 1 provides that benefits under CTA 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. A carve out has been provided that such

treaty benefits would be allowed if granting such benefits is in accordance with the object and purpose of the relevant provisions of that CTA. As per paragraph 4, competent authority of the contracting jurisdiction where a treaty benefit is sought shall consider, upon request from a person who is denied all or part of the benefits on account of the PPT rule, granting the said benefit to the said person with respect to a specific item of income or capital. If such competent authority decides to reject the request he should consult competent authorities of the other jurisdiction.

6.11 Simplified Limitation Of Benefits (SLOB) Provision

Paragraph 8 defines SLOB in the following manner. A resident of a contracting jurisdiction to a CTA shall not be entitled to the benefits under such CTA other than

(a) Determining residence of a non-individual person on account of dual residency etc.

(b) Administering corresponding transfer pricing adjustments in the second jurisdiction in respect of initial adjustment made in first jurisdiction on the profits of an associated enterprise.

(c) Allowing residents to request competent authorities to resolve cases of taxation not in accordance with CTA.

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

In other words, the treaty benefit, other than a, b and c listed above, shall be denied unless the taxpayer is a qualified person as defined in Paragraph 9.

6.12 Qualified Person

A resident of a contracting jurisdiction to a CTA shall be a qualified person in respect of a benefit under CTA if such resident is

(a) Individual

(b) Contracting jurisdiction, Political sub-division or local authority or an agency of such contracting jurisdiction, political subdivision, local authority etc.

(c) A listed company whose principal class of shares is regularly traded on one or more recognized stock exchanges.

(d) A person other than an individual such as non-profit organization, post-retirement benefit management agency of Government or local authorities etc.

Paragraph 10 provides that a resident of contracting jurisdiction to a CTA will be entitled to benefits of CTA with respect to income derived from other contracting jurisdiction if such resident is engaged in the active conduct of business in first mentioned contracting jurisdiction, and the income derived from other contracting jurisdiction emanates from, or is incidental to said business, irrespective of whether such resident is a qualified person or not. However, the term "active conduct of business" shall not include 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.

Business activity carried on by the resident in the first mentioned contracting jurisdiction must be substantial in relation to the same activity or a complementary activity carried on in the other contracting jurisdiction. Paragraph 11 provides that a non-qualified person shall be entitled to benefit under CTA with respect to an item of income if on at least half of the days of any twelve-month period persons that are equivalent beneficiaries own directly, or indirectly at least 75% of the beneficial interests of the resident. Paragraph 12 provides that competent authorities of both the contracting jurisdictions would be empowered to consider genuine and deserving cases of such residents who are neither qualified persons nor entitled to benefits under paragraph 10 or 11 and grant such benefits under CTA as mutually decided.

Paragraph 13 gives definition of the terms used in this article. Para 15 and 16 provides flexibility to the parties to use detailed LOB or the PPT rule in place of SLOB to meet minimum standard. Paragraph 17 deals with procedure for a contracting jurisdiction to notify its choice of the options available to meet the minimum standard.

India has taken a position to apply PPT along with SLOB across all its notified treaties. However, most of the other treaty partners of India have opted only PPT. Ultimately SLOB may not be included in Indian tax treaties if the other parties do not agree for its inclusion. It is interesting to see the

interplay of GAAR provisions with PPT rule in treaty law that would come up through MLI being effective in the years to come in India. On a prima facie analysis it may be unlikely for GAAR to get triggered if the PPT is met, except in situations where the PPT is avoided on the ground that the benefit was in accordance with the object and purpose of the treaty provision. GAAR may still get triggered in such situations as it does not provide for such carve out. PPT does not provide for procedural safeguards, whereas GAAR has an approving panel, one needs to see how this would operate.

6.13 Article 8 of MLI – Dividend Transfer Transactions

Article 8 seeks to modify transactions of the treaty to provide for minimum share holding period to be prescribed in a CTA for the beneficial owner to get exemption or reduced rate of withholding tax by the source country.

India has reserved the applicability of this provision in the case of Portugal as there already exists, a minimum holding period longer than 365 days mentioned in Article 8.

India has notified the same with a holding period of 365 days in 21 tax treaties such as Bangladesh, Canada, Denmark, Italy, Nepal, Oman, Philippines, and Singapore etc.

Some of the treaty partner countries have opted not to adopt this article. Hence this Article can get adopted into our treaties subject to matching.

6.14 Article 9 of MLI - Capital gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

Article 9 provides taxing rights to a source country where the immovable property is situated, to tax gains on alienation of shares of a company if the shares derive more than 50% of their value directly or indirectly from immovable property situated in the source country.

It provides that the source country will get taxing rights if the value threshold is met any time during the period of 365 days preceding the date of transfer. It also extends these provisions to interests in partnership or trusts.

India *has not made any reservation* and has chosen to adopt this Article. However, the point to note is that the other treaty partners also need to adopt similar position, for this to apply.

6.15 Article 10 of MLI - Anti-Abuse Rule for Permanent Establishments in third Jurisdictions

Article 10 of MLI addresses abuse of tax treaties in triangular situations. This Article tries to avoid such misuse, by providing that if the tax payable on the attributable income in the third State is less than 60% of the tax that would have been payable in the country of residence of the enterprise to which the PE belongs, then the treaty relief would not apply. This is termed as the 60 per cent test.

Exception as per paragraph 2 of Article 10: Where the income is derived in connection with or incidental to an active mode or business carried on through the PE.

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

6.16 Article 11 of MLI - Application of Tax Agreements to restrict a Party's Right to tax its own Residents

Article 11 of MLI seeks to avoid an argument, according to which, the tax treaty impairs rights of a country to tax its own residents. Additionally, Article 11 also ensures that certain benefits granted to tax residents are not impacted.

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

Chapter 7
Action Plan 7: Preventing the Artificial Avoidance of Permanent Establishment Status

7.0 Artificial avoidance of permanent establishment (PE) status through various methods of tax avoidance by the MNEs in source countries did really bother tax authorities.

Most frequent and popular approaches used by MNEs in this regard of avoiding PE status are as under

(a) Commissionaire arrangements.

(b) Agency PE

(c) Specific activity exceptions under article 5(4).

(d) Fragmenting cohesive operating business functions into smaller operations.

(e) Splitting up of contracts

7.1 Action plan 7 is meant to target these abuses and bring out corrective action accordingly. It is to be noted that Action plan 7 is not a minimum standard and therefore mobilizing consensus on this agenda is critical.

7.1.1 Commissionaire arrangements: It may be loosely defined as an arrangement through which a person sells products in a state in its own name but on behalf of a foreign enterprise that is the owner of the products. The foreign enterprise being the owner of the products does not enter into an agreement with the purchaser, whereas the commissionaire who is not the owner of the products would sell the same to the customers. Foreign enterprise would avoid PE in the source state as there is no agreement with the buyer/ customers. Commissionaire would not be liable for any tax on profits made on sale of products as said products are not owned by him. He is liable only for payment of tax against his commission. This arrangement which is popular in Europe in countries like France was widely used as tax avoidance measure by MNEs. Anti-avoidance measures against this approach are proposed through this Action plan which will be discussed in the later paragraphs.

7.1.2 Agency PE: The present rule of agency PE requires conclusion of contracts in the source state by the agent to trigger agency PE. In order to circumvent this threshold, taxpayers engage agents who will do everything except formal signing of the contract which will be carried out in the resident state of the foreign enterprise. This practice was widely noticed among MNEs operating in source jurisdictions and successfully avoiding agency PE there. The present rule also exempts an independent agent from the ambit of agency PE when his independence is established by proving that he is not exclusively working for the non-resident principal. In wide number of cases it was found an independent agent is in substance not independent for the reason that he serves only the tax payer and his related enterprises. In substance such agent is a dependent agent though being classified as independent objectively. These anomalies have been addressed which will be discussed in detail in the later paragraphs.

7.1.3 Specific activity exceptions under article 5(4): A century back when international tax rules have been framed and the concept of PE have been brought in, certain activities had been observed as preparatory and auxiliary in nature under the then brick and mortar business models. However, there has been a dramatic change in the way businesses are conducted today, more so in the digital age of doing business. It is quite possible that activities once treated as preparatory or auxiliary in nature may now correspond to core business activities. Hence it is essential to examine whether a particular activity is in essence an auxiliary or preparatory in the present day context relevant to the said business model. It was found that MNEs were leveraging on the old definition of auxiliary and preparatory activities in the current age business models. In order to curb this anomaly or abuse of law suitable modifications are proposed in article 5(4) which will be discussed in the later part of this chapter.

7.1.4 Fragmenting cohesive operating business functions into small operations: In order to obtain tax advantage MNEs may fragment a cohesive operating business into several small operations in order to claim that each part of activity is merely of preparatory or auxiliary nature. Whereas when once you look at substance of the overall activity in a combined manner it would be evident fragmentation is designed to achieve non-taxation in the source country by claiming each part of activity as preparatory or auxiliary. Anti-fragmentation rules are proposed by this Action plan which is discussed in the later part of this chapter.

7.1.5 Splitting up of contracts- To avoid PE threshold: In order to avoid PE arising out of execution of contracts in a source state MNEs widely adopted the approach of splitting up of contracts among its closely related enterprises. All such cases of splitting up of contracts, when examined in substance do really trigger PE in the source state as entire contract of all parts are carried out by an MNE or its related enterprises. Counter measures are proposed in this Action plan which will be discussed in detail in the later parts of this chapter.

7.1.6 Attribution of profits to PEs - Follow up action and guidance: In the light of changes proposed to the PE definition and appropriate inclusions in MLI, OECD proposed to carry out follow up work on attribution of profit issues related to PE in Action 7. Such additional guidance has been brought out by OECD in March 2018 in the form of a detailed report.

7.2 How these recommendations have been brought into MLI and OECD model convention

MLI which was originally signed on 7th June, 2017 by 67 countries and later brought into effect contained part IV consisting of 4 articles that is from Article 12 to Article 15 dealing with the proposed measures to combat artificial avoidance of PE as explained above.

7.2.1 Article 12 - Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Article 12(1) deals with a situation where a person is acting on behalf of an enterprise 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 in the name of enterprise, for the transfer of ownership of goods owned by the enterprise or for the provision of services by that enterprise, Such enterprise shall be deemed to have a PE in that contracting jurisdiction (source state), except for those activities which are explicitly notified to be not constituting a PE under fixed place PE rule of the covered tax agreement.

Article 12 (2) provides that an agent would not be an independent agent if he acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related. In other words, a person though claiming to be independent might be serving only an enterprise and its related enterprises and not any other enterprises unrelated then he cannot be treated as an agent of independent status.

Article 12(4) gives the option to a party that is (a country) to reserve the right for the entirety of this article not to apply to its covered tax agreements. This means this is an option and not a minimum standard.

Article 12: India has not made any reservation on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

7.2.2 Article 13 - Artificial avoidance of PE status through specific activity exemptions

Two options were provided to the member countries who have signed the MLI in respect of specific activity exemptions. Neither option may also be taken by the member country. The two options are as under.

Option A: This option replaces existing treaty provisions so as not to change the negotiated list of activities but consider within this list/activities that is done from fixed place of business which shall fall within its ambit as preparatory or auxiliary in nature.

India chose option A and Indian tax treaties will be modified from its existing provision with respect to specific activity exemptions. It would be mandatory to prove that these activities are preparatory or auxiliary in character.

Option B: This option on the other hand does not relate to activities from the fixed place of business but provides a carve out. In that sense option B gives more flexibility to treaty partners. This option makes explicit that specific activity exceptions are *per se* exceptions and are not subject to an overall condition of being "preparatory or auxiliary in character".

Article 13(4) provides that specific activity exemptions shall not apply to a fixed place of business used by that enterprise if such enterprise or its closely related enterprise carries on business activities at the same place or any other place in the same contracting jurisdiction and such activity triggers PE for itself or its closely related enterprise and the activities are complementary in nature that are part of a cohesive business operation. Article 13(6) provides a party or member country to reserve the right for the entirety of this article not to apply to its covered tax agreements. It is incumbent on each party to notify the depository of its choice of options.

7.2.3 Article 14 - Splitting up of contracts

In order to arrest the abuse of splitting up of contracts to circumvent PE

threshold article 14 of MLI provides that where an enterprise carries on activities in the other contracting jurisdiction in respect of building site, construction project, installation project etc. and if such activity is carried out for more than 30 days, then as per this article one has to examine whether any construction activities are carried out by the closely related enterprise of the first mentioned enterprise. If it is so different periods of time shall be added to the aggregate period of time during which the first mentioned enterprise has carried on activities in respect of such building site, construction, installation project, etc. In other words, total aggregate periods spent by an enterprise along with such further period spent by its closely related enterprises will be combined to examine whether the threshold for trigger of PE has crossed.

Article 14(3) gives an option to the party/a member country not to apply this article to its covered tax agreements in entirety.

India has remained silent; so neither expressed any reservation nor has identified any provision containing this language of splitting of contracts in its tax treaties. Some of the India's treaty partners have opted not to adopt these provisions in the tax treaties hence this article would be adopted in Indian tax treaties subject to matching.

7.2.4 Article 15 – Definition of a person closely related to an enterprise

A person shall be considered closely related to an enterprise if he possesses directly or indirectly more than 50 percent of interest in the other enterprise or if the other person possesses directly or indirectly more than 50 percent of beneficial interest in the person and the enterprise.

India has not made any reservation in respect of this article. However, if the treaty partners have adopted this definition, this article would be adopted in Indian tax treaties subject to matching.

7.3 Most of the countries have agreed to incorporate the changes in the PE rule through MLI modifying the existing treaty provisions subject to matching options adopted by the respective treaty partners. It is to be noted that Action plan 7 dealing with the artificial avoidance of PE is not a minimum standard and is to be opted by the members of Inclusive Framework.

Chapter 8
Action Plans 8-10: Aligning Transfer Pricing Outcomes with Value Creation

8.1 Introduction

The existing international standards for transfer pricing rules can be misapplied so that they result in outcomes in which the allocation of profits is not aligned with the economic activity that produce the profit. The works under Actions 8-10 of the BEPS agenda has targeted this issue, to ensure that transfer pricing actions are aligned with the value creation. Arm's length principle has been the cornerstone of transfer pricing rules. The arm's length principle has been widely used by tax payers and tax administrations to evaluate transfer prices between associated enterprises and to prevent double taxation. However, with its perceived emphasis on contractual allocations, assets and risks, the existing guidance on the application of the principle has also proven vulnerable to manipulation. This manipulation can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of a MNE group. It is proposed to strengthen and clarify the arm's length principle to address this issue. If the transfer pricing risks remain further even after clarifying and strengthening the guidance, the BEPS Action plan foresaw of the possibility of introducing special measure either within or beyond the arm's length principle.

In order to address the issue and to ensure that the transfer pricing outcomes are aligned with value creation Action plans 8-10 have focused on three key areas. Action plan 8 looked at transfer pricing issues related to intangibles, since profits generated by the valuable intangibles have been misallocated to low/nil tax jurisdictions that resulted in significant base erosion and profit shifting. Action 9 focused on contractual allocation of risks, and the resulting allocation of profits to those risks, which may not correspond with the activities actually carried out. MNE group members who only fund are to be compensated only with appropriate interest and not beyond that. Action10 focused on other high risk areas including the scope for addressing profit allocations resulting from transactions which are not commercially rational for the individual enterprises concerned (re-characterization), the scope for targeting the use of transfer pricing methods

in a way which results in diverting profits from the most economically important activities of the MNE group, and neutralizing the use of certain types of payments between the members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with value creation. The BEPS project proposed to revamp the OECD transfer pricing guidelines with an objective to look at the substance of the transaction and re-characterize the transaction by allocating profits to those members of the group who really carry out the corresponding economic activities. This job has been done and OECD Transfer Pricing Guidelines, 2017 have been released in a revised form incorporating the suggestions made by these reports.

The revised guidance includes two important clarifications relating to risks and intangibles. Risks are defined as the effect of uncertainty on the objectives of the business. The economic principle that higher risks warrant higher profits allowed MNE groups to abuse the same through tax planning strategies based on contractual re-allocation of risks, sometimes without any change in the business operations. In order to address this abuse, this Action report identifies such group members of an MNE who really exercise control and have the financial capacity to assume the risks and thereby reallocate the profits to such group members by re- characterizing the whole transaction.

In respect of intangibles the guidance clarifies that legal ownership alone does not necessarily generate a right to enjoy entire returns that are generated by exploitation of an intangible. All group members performing important functions, controlling economically significant risks and contributing assets, as determined through the accurate delineation, will be entitled to an appropriate return reflecting the value of their contributions. If a capital rich member of the group provides funding and does no significant activities, such member would be eligible only for a risk-free return and nothing more than that. These capital risk members are called "cash boxes" within this report.

The holistic approach to tackling BEPS behavior is supported by the transparency requirements agreed under Action 13 dealing with country by country reporting, master file and local file. This critical information forming part of TP documentation will be exchanged between tax jurisdictions which would enable them to better risk assessment practices by providing information about the global allocation of MNE group's revenues, profits, taxes and economic activity.

It has been proposed concurrently that none of these new approaches/ methodologies should result in double taxation creating hardship to the tax payer. In this direction Action 14, which is mandated to improve the effectiveness of the dispute resolution mechanism, is a minimum standard providing access to the MAP process for all transfer pricing cases. Mandatory arbitration is an extended facility proposed under Action 14 to resolve those disputes pending under MAP process beyond a specified period. Of course, India did not agree to mandatory arbitration. In this whole process of Action 8-10 the development of the new transfer pricing rules has been achieved without the need to develop special measures outside the arm's length principle. However, the work on transaction profit split method and financial transactions would be critical as a follow up action.

8.2 How these changes have been brought into OECD Transfer Pricing Guidelines 2017 (TPG)

8.2.1 Revisions to section D of chapter I of TPG

Actions 9 & 10 mandate the development of:

(i) "Rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation."

(ii) "Rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be re-characterized."

The guidance ensures that :

- Actual business transactions undertaken by associated enterprises are identified, and transfer pricing is not based on contractual arrangements that do not reflect economic reality.
- Contractual allocations of risk are respected only when they are supported by actual decision-making.
- Capital without functionality will generate no more than a risk-free return, assuring that no premium returns will be allocated to cash boxes without relevant substance.

- Tax administrations may disregard transactions when the exceptional circumstances of commercial irrationality apply.

The above guidance is meant to ensure that transfer pricing outcomes align with the value creating activities performed by the members of an MNE group. Suitable revisions proposed and accordingly modified in section D of chapter I to carry out the above-mentioned agenda. The guidance now would ensure that the transfer pricing risks are appropriately assumed by the respective group members who are capable of controlling the risks and have financial capacity to assume the risk. Capital providing members of the group who do not control the corresponding investment risks would be eligible only for no more than a risk-free return. It is of paramount importance to look at the conduct of the parties rather than confining to contractual terms and conditions in respect of assumption of risks, capability to control the risk and financial capacity to assume the risk. The revisions proposed and accordingly modified reinforce the need for tax administrations to be able to disregard transactions between associated enterprises when the exceptional circumstances of commercial irrationality apply. In a case where the transaction may not happen between independent parties, does not mean that it should not be recognized. Instead, the key question is whether the actual transaction possesses the commercial rationality of arrangements that would be agreed between unrelated parties under comparable economic circumstances.

8.2.2 Additions to Chapter II of TPG

Cross border commodity transactions between associated enterprises ("commodity transactions") is identified as an area that creates BEPS risks and accordingly revised guidance is given in chapter II broadly as under. G20 and OECD countries have examined said category of transactions and provided an improved framework for analysis of commodity transactions by

- Clarification of existing guidance on the application of the comparable uncontrolled price (CUP) method to commodity transactions by
  - (i) holding that CUP method for commodity transactions between associated enterprises is an appropriate method;
  - (ii) Quoted prices can be used for CUP method, subject to a number of considerations, as reference to determine the arm's length price for the controlled commodity transaction; and

(iii) Reasonably accurate comparability adjustments should be made, when needed, to ensure that the economically relevant characteristics of the controlled and uncontrolled transactions are sufficiently comparable.

- In respect of determination of the pricing date for commodity transactions, it is provided that tax payers should be prevented from using pricing dates in contracts that enable the adoption of most advantageous quoted price. It allows tax authorities to impute, under certain conditions, the shipment date (or any other date for which evidence is available) as the pricing date for the commodity transaction.

The guidance under Action 9 & Action 13 (CBC Reporting) is also relevant in this context.

8.2.3 Action 10 has a special agenda on a Transactional Profit Split Method ("TPSM") with a mandate to improve and strengthen the guidance on the same, in the context of global value chains. In this direction it was sought to provide guidance as to what would be the appropriate circumstances for application of TPSM, since experiences indicate that this method may not be straight forward for taxpayers to apply, and may not be straightforward for tax administrations to evaluate. Nevertheless, consultation process confirmed that transactional profit splits can offer a useful method which has a potential when properly applied, to align profits with value creation in accordance with the Arm's Length principle and the most appropriate method, particularly in situations where the features of the transactions makes the application of the other transfer pricing methodologies problematic.

Revised guidance in this regard has been provided by OECD in June 2018.

It provides guidance as to when the transactional profit split method may be the most appropriate method. It describes presence of one or more of the following indicators as being relevant:

- Each party makes unique and valuable contributions;
- The business operations are highly integrated such that the contributions of the parties cannot be reliably evaluated in isolation from each other;

- The parties share the assumption of economically significant risks, or separately assume closely related risks.

The guidance makes clear that while a lack of comparables is, by itself, insufficient to warrant the use of the profit split method, if, conversely, reliable comparables are available it is unlikely that the method will be the most appropriate.

The revised text also expands the guidance on how the profit split method should be applied, including determining the relevant profits to be split, and appropriate profit splitting factors.

Salient features of the revised guidance:-

TPSM is a "transactional profit method" which means that it takes into account the profits arising from the relevant controlled transactions. How the profit is split between the associated enterprises is to be compared with what would have been determined by independent enterprises engaged in comparable transactions. It is important to note that TPSM is the only two sided method provided for in the OECD guidelines. The term "two sided" refers to a method that takes into consideration the contributions of both parties to the transaction as against one sided approach being adopted in respect of other methods. The application of TPSM involves two stages:

1. The overall profits arising from the control transactions has to be identified;
2. These profits have to be split between the associated enterprises on an economically valid basis, reflecting the division of profits that would have been agreed on by third parties.

Revised guidance further expands the list of indicators whose presence may point to the TPSM being the most suitable method

1. "Unique and valuable contributions" by each party to the transaction;
2. "Highly integrated" operations related to the transaction; and
3. The "shared assumption of economically significant risks" or the "separate assumption of closely related risks" by each party to the transaction.

The guidance is given in a structured manner with the following chapters/sub chapters

(i) General

(ii) When is a transactional profit split method likely to be the most appropriate method?

(iii) Guidance for application – In general

(iv) Guidance for application – Determining the profits to be split

(v) Splitting the profits

(vi) Annex "Examples to illustrate the guidance on the transactional profit split method".

8.2.4 Revisions to chapter VI of the Transfer Pricing Guidelines

Chapter VI has been revised in the TPG as per Action 8 which requested the development of rules to prevent BEPS by moving intangibles among group members by

(i) adopting a broad and clearly delineated definition of intangibles;

(ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation;

(iii) Developing transfer pricing rules or special measures for transfers of hard-to-value intangibles.

If an associated enterprise contractually assuming a specific risk, does not exercise control over that risk and has no the financial capacity to assume the risk, then the framework contained in the chapter "Guidance on Applying the Arm's Length Principle" determines that the risk will be allocated to another member of the MNE group that does exercise such control and has the financial capacity to assume the risk. In other words, control of risk and the financial capacity to assume the risk are cumulative conditions for such allocation.

The control requirement mentioned here would also look for assessing which member of MNE group in fact controls the performance of outsourced functions in relation to development, enhancement, maintenance, protection and exploitation of the intangible.

The guidance contained in this chapter is as under

- Legal ownership of intangibles by an associated enterprise alone does not determine entitlement to returns from the exploitation of intangibles;

- Associated enterprises performing important value-creating functions related to the development, maintenance, enhancement, protection and exploitation of the intangibles can expect appropriate remuneration;
- An associated enterprise assuming risk in relation to the development, maintenance, enhancement, protection and exploitation of the intangibles must exercise control over the risks and have the financial capacity to assume the risks, in accordance with the guidance on risks in Section D.1.2 of the chapter "Guidance on Applying the Arm's Length Principle", including the very specific and meaningful control requirement;
- Entitlement of any member of the MNE group to profit or loss relating to differences between actual and expected profits will depend on which entity or entities assume(s) the risks that caused these differences and whether the entity or entities are performing the important functions in relation to the development, enhancement, maintenance, protection or exploitation of the intangibles or contributing to the control over the economically significant risks and it is determined that arm's length remuneration of these functions would include a profit sharing element;
- An associated enterprise providing funding and assuming the related financial risks, but not performing any functions relating to the intangible, could generally only expect a risk-adjusted return on its funding;
- If the associated enterprise providing funding does not exercise control over the financial risks associated with the funding, then it is entitled to no more than a risk-free return;
- The guidance on the situations in which valuation techniques can appropriately be used is expanded;
- A rigorous transfer pricing analysis by taxpayers is required to ensure that transfers of hard-to-value intangibles are priced at arm's length.

8.2.5 Revisions to chapter VII of Transfer Pricing Guidelines

Low value - adding intra-group services are common phenomena between group entities which generally include management fee and head office expenses etc. It is provided by the revised chapter VII to introduce an

elective, simplified approach for low value- adding services that are generally provided by one group entity to other group entity or entities. This is one area of BEPS risks. In view of the same low value-adding intra-group services guidance is provided for achieving the necessary balance between appropriately allocating to MNE group members charges for intra-group services in accordance with the arm's length principle and the need to protect the tax base of payer countries. Accordingly, an elective, simplified approach which:

- Specifies a wide category of common intra-group services which command a very limited profit mark-up on costs;
- Applies a consistent allocation key for all recipients for those intra-group services; and
- Provides greater transparency through specific reporting requirements including documentation showing the determination of the specific cost pool.

In section D of chapter VII at Para 7.45 incorporated definition of low value adding intra group services.

- are of a supportive nature
- are not a part of the core business of the MNE group (that is not creating the profit-earning activities or contributing to economically significant activities of the MNE group),
- do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and
- do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider.

Para 7.49 gives illustrative list of low value – adding services as under:

- accounting and auditing, for example gathering and reviewing information for use in financial statements, maintenance of accounting records, preparation of financial statements, preparation or assistance in operational and financial audits, verifying authenticity and reliability of accounting records, and assistance in the preparation of budgets through compilation of data and information gathering;
- processing and management of accounts receivable and accounts payable, for example compilation of customer or client billing information, and credit control checking and processing;

- human resources activities, such as:
  - staffing and recruitment, for example hiring procedures, assistance in evaluation of applicants and selection and appointment of personnel, on-boarding new employees, performance evaluation and assistance in defining careers, assistance in procedures to dismiss personnel, assistance in programmes for redundant personnel;
  - training and employee development, for example evaluation of training needs, creation of internal training and development programmes, creation of management skills and career development programmes;
  - remuneration services, for example, providing advice and determining policies for employee compensation and benefits such as healthcare and life insurance, stock option plans, and pension schemes; verification of attendance and timekeeping, payroll services including processing and tax compliance;
  - developing and monitoring of staff health procedures, safety and environmental standards relating to employment matters;
- monitoring and compilation of data relating to health, safety, environmental and other standards regulating the business;
- information technology services where they are not part of the principal activity of the group, for example installing, maintaining and updating IT systems used in the business; information system support (which may include the information system used in connection with accounting, production, client relations, human resources and payroll, and email systems); training on the use or application of information systems as well as on the associated equipment employed to collect, process and present information; developing IT guidelines, providing telecommunications services, organizing an IT helpdesk, implementing and maintaining of IT security systems; supporting, maintaining and supervising of IT networks (local area network, wide area network, internet);
- internal and external communications and public relations support (but excluding specific advertising or marketing activities as well as development of underlying strategies);

- legal services, for example general legal services performed by in-house legal counsel such as drafting and reviewing contracts, agreements and other legal documents, legal consultation and opinions, representation of the company (judicial litigation, arbitration panels, administrative procedures), legal research and legal as well as administrative work for the registration and protection of intangible property;
- activities with regard to tax obligations, for example information gathering and preparation of tax returns (income tax, sales tax, VAT, property tax, customs and excise), making tax payments, responding to tax administrations' audits, and giving advice on tax matters;
- General services of an administrative or clerical nature.

Para 7.47 gives the list of services which do not qualify for the simplified approach outlined in Section D. It should not be interpreted to mean that the activity generates high returns, the activity would still add low value and the determination of the arm's length charge should be determined according to the guidance set out in paragraphs 7.1 to 7.42 and such activities are as under

- services constituting the core business of the MNE group;
- research and development services (including software development unless falling within the scope of information technology services in 7.49);
- manufacturing and production services;
- purchasing activities relating to raw materials or other materials that are used in the manufacturing or production process;
- sales, marketing and distribution activities;
- financial transactions;
- extraction, exploration, or processing of natural resources;
- insurance and reinsurance;
- Services of corporate senior management (other than management supervision of services that qualify as low value-adding intra-group services under the definition of paragraph 7.45).

8.2.6 Simplified method proposed under the revised chapter is meant to benchmark low value adding intra group services in a simple and easier way. This mechanism provides an assurance to tax payers that tax administrations that have adopted this simplified approach accept the price charged for these services. MNE group members have to provide tax administrations with targeted documentations enabling efficient review of compliance risks. MNE group electing to adopt this simplified method would as far as practicable would apply it on a consistent, group wide basis in all countries in which it operates. Once a simplified method is adopted by the MNE groups and accepted by the tax administrations it is deemed that benefit test is met in respect of low value adding intra group services which are charged at a recommended profit markup of 5% as per Para D.2.4.

An MNE group electing for application of the simplified method shall prepare and maintain documentation as under as per Para D.3

- A description of the categories of low value-adding intra-group services provided; the identity of the beneficiaries; the reasons justifying that each category of services constitute low value adding intra-group services within the definition set out in Section D.1; the rationale for the provision of services within the context of the business of the MNE; a description of the benefits or expected benefits of each category of services; a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received, and confirmation of the mark-up applied;
- Written contracts or agreements for the provision of services and any modifications to those contracts and agreements reflecting the agreement of the various members of the group to be bound by the allocation rules of this section. Such written contracts or

Agreements could take the form of a contemporaneous document identifying the entities involved, the nature of the services, and the terms and conditions under which the services are provided;

- Documentation and calculations showing the determination of the cost pool as described in Section D.2.2, and of the mark-up applied thereon, in particular a detailed listing of all categories and amounts of relevant costs, including costs of any services provided solely to one group member;
- Calculations showing the application of the specified allocation keys.

8.2.7 Cost Contribution Arrangements

Cost contribution arrangements (CCA) are special contractual arrangements among group enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangibles assets or services are expected to create benefits for the individual businesses of each of the participants. Each group enterprise that contributes is expected to be rewarded with the benefits of the end result of the project appropriately. Any manipulation or distortion in this regard would result in profit shifting away from the location where the value is created through the economic activities performed.

Parties performing activities under arrangements with similar economic characteristics should receive similar expected returns, irrespective of whether the contractual arrangement in a particular case is termed a CCA. The guidance ensures that CCAs cannot be used to circumvent the new guidance on the application of the arm's length principle in relation to transactions involving the assumption of risks, or on intangibles. The analysis of CCAs follows the framework set out in that guidance to ensure that:

- The same analytical framework for delineating the actual transaction, including allocating risk, is applicable to CCAs as to other kinds of contractual arrangements.
- The same guidance for valuing and pricing intangibles, including hard-to-value intangibles, is applicable to CCAs as to other kinds of contractual arrangements.
- The analysis of CCAs is based on the actual arrangements undertaken by associated enterprises and not on contractual terms that do not reflect economic reality.
- An associated enterprise can only be a participant to the CCA if there is a reasonable expectation that it will benefit from the objectives of the CCA activity and it exercises control over the specific risks it assumes under the CCA and has the financial capacity to assume those risks.
- Contributions made to a CCA, with specific focus on intangibles, should not be measured at cost where this is unlikely to provide a reliable basis for determining the value of the relative contributions of participants, since this may lead to non-arm's length results.

In summary the guidance ensures that CCAs are appropriately analyzed and produce outcomes that are consistent with how and where value is created.

As per the revised chapter VIII of OECD TPG it is critical to arrive at the expected benefits from the CCA commensurate with the respective contribution from each participant of the group involved in CCA. The actual conduct of the parties into the group is more critical than the contractual terms entered into in the CCA. The value of each participant's contribution must be arrived at in a systematic manner as explained in Para's 8.23 to 8.33. In nutshell the arm's length principle must be applied to all CCAs primarily, looking at the conduct of the parties if such conduct is at variance from the contractual terms. Ultimately the exercise should result in identifying benefits with respect to such participants where appropriate values created in line with the arm's length principle.

Hard to value Intangibles (HTVI).

HTVI are defined as intangibles or rights in intangibles for which, no reliable comparables exist, and projections of future cash flows expected to be derived from the transferred intangible or assumptions used in valuing the intangibles were highly uncertain making it difficult to predict the level of ultimate success of the intangible at the time of transfer.

The guidance contained in OECD TPG relation to hard to value intangibles aims at reaching a common understanding and practice among tax administrations on how to apply adjustments resulting from the application of the HTVI approach. This guidance should improve consistency and reduce the risk of economic double taxation. In particular, the new guidance:

- Presents the principles that should underlie the application of the HTVI approach by tax administrations;
- Provides a number of examples clarifying the application of the HTVI approach in different scenarios; and
- Addresses the interaction between the HTVI approach and the access to the mutual agreement procedure under the applicable tax treaty.

Chapter 9
Action Plan 11 – Measuring and Monitoring BEPS

9.1 Introduction

Action Plan 11 recognizes the criticality of measuring BEPS activity on a regular basis by Governments of the member countries. The findings of OECD BEPS initiative since 2013 highlight the magnitude of the issue, with global corporate income tax (CIT) revenue losses estimated between 4% and 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. Given developing countries greater reliance on CIT revenues, estimates of the impact of developing countries, as a percentage of GDP, are higher than for developed countries.

Important extracts from the Action Plan Executive summary are as under

In addition to significant tax revenue losses, BEPS causes other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Six indicators of BEPS activity highlight BEPS behaviours using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

- ***The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.*** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.
- ***The effective tax rates paid by large MNE entities are estimated to be 4 to 8½ percentage points lower than similar enterprises with domestic-only operations,*** tilting the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilization of available country tax preferences.

- ***Foreign direct investment (FDI) is increasingly concentrated.*** FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.
- ***The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly.*** For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012. Royalties received by entities located in these low-tax countries accounted for 3% of total royalties, providing evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.
- ***Debt from both related and third parties is more concentrated in MNE affiliates in higher statutory tax-rate countries.*** The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.
- The 2015 Action 11 report *Measuring and Monitoring BEPS* highlighted that the lack of quality data on corporate taxation has been a major limitation to measuring the fiscal and economic effects of tax avoidance as well as any efforts to measure the impact of the implementation measures agreed as part of the BEPS Project. Increasing the quality of the data and the analytical tools available, through the ongoing work under Action 11, is crucial in being able to measure the impact of tax avoidance and the effect of the implementation of the BEPS measures in curbing these practices

Chapter 10
Action Plan 12 - Mandatory Disclosure Rules

10.1 Introduction

Action 12 of The Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan, OECD, 2013) recognized the benefits of tools designed to increase the information flow on tax risks to tax administrations and tax policy makers.

The main objective of mandatory disclosure regimes is to increase transparency by providing the tax administration with early information regarding potentially aggressive or abusive tax planning schemes and to identify the promoters and users of those schemes. This action plan is not a minimum standard and is to be dealt with through the domestic law. Hence, the same need not find place in the MLI.

The term "promoter" has been illustratively explained by the Action plan. The common themes or principles, which defines a promoter would appear to be as follows:

- The promoter is any person responsible for or involved in designing, marketing, organising or managing the tax advantage element of any reportable scheme in the course of providing services relating to taxation.
- This definition can include any person who provides any material aid, assistance or advice with respect to designing, marketing, organising or managing the tax aspects of a transaction that causes the transaction to be a reportable transaction.

10.2 Key design features of a mandatory disclosure regime

In order to successfully design an effective mandatory disclosure regime, the following features need to be considered: who is to report, what information to report, when the information has to be reported, and the consequences of non-reporting.

- Impose a disclosure obligation on both the promoter and the taxpayer, or impose the primary obligation to disclose on either the promoter or the taxpayer;

- Include a mixture of specific and generic hallmarks, the existence of each of them triggering a requirement for disclosure.
- Establish a mechanism to track disclosures and link disclosures made by promoters and clients as identifying scheme users is also an essential part of any mandatory disclosure regime.
- link the timeframe for disclosure to the scheme being made available to taxpayers when the obligation to disclose is imposed on the promoter; link it to the implementation of the scheme when the obligation to disclose is imposed on the taxpayer;
- Introduce penalties (including non-monetary penalties) to ensure compliance with mandatory disclosure regimes that are consistent with their general domestic law.

10.3 Coverage of international tax schemes

There are a number of differences between domestic and cross-border schemes that make the latter more difficult to target with mandatory disclosure regimes. International schemes are more likely to be specifically designed for a particular taxpayer or transaction and may involve multiple parties and tax benefits in different jurisdictions, which can make these schemes more difficult to target with domestic hallmarks. In order to overcome these difficulties, the Report recommends that:

- An arrangement or scheme that incorporates such a cross-border outcome would only be required to be disclosed, however, if that arrangement includes a transaction with a domestic taxpayer that has material tax consequences in the reporting country and the domestic taxpayer was aware or ought to have been aware of the cross-border outcome.
- Taxpayers that enter into intra-group transactions with material tax consequences are obliged to make reasonable enquiries as to whether the transaction forms part of an arrangement that includes a cross-border outcome that is specifically identified as reportable under their home jurisdictions' mandatory disclosure regime.

10.4 Enhancing information sharing

Transparency is one of the three pillars of the OECD/G20 BEPS Project and a number of measures developed in the course of the Project will give rise to

additional information being shared with, or between, tax administrations. Tax Information Exchange Agreement is one of the examples of measures developed on sharing of information.

Chapter – 11
Action Plan 13 - Transfer Pricing Documentation and Country-by-Country Reporting

11.0 Action 13 enhances transfer pricing documentation requirements by introducing a three- tiered standardized approach containing local file, master file and country-by-country reporting (CbCR). Action 13 is also a minimum standard in terms of exchange of information which will be explained in the following paragraphs

Action 13 of the *Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan, OECD, 2013) requires the development of "rules regarding transfer pricing documentation costs for business. The rules to be developed will include a requirement that MNEs provide all relevant Governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template".*

Master file (MF): This document is meant to provide tax administrations with high level information regarding MNEs of their global business operations and transfer pricing policies. This would be made available to all relevant tax administrations.

Local file (LF): This document requires detailed transactional transfer pricing documentation as prescribed by domestic law of each country, with respect to related party transactions or otherwise known as international transactions with associated enterprises and how tax payer has substantiated that such transactions are at arm's length, in the form of a transfer pricing study report. This needs to be filed with the local tax administrations as per the domestic law.

Country-by-country reporting (CbCR): Large MNEs are required to file a CbCR that will provide annually and for each tax jurisdiction in which they do business, the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. Finally, it requires MNEs to identify each entity within the group doing

business in a particular tax jurisdiction and to provide an indication of the business activities each entity engages in.

Country-by-country reports should be filed in the jurisdiction of tax residence of the ultimate parent entity and shared between jurisdictions through automatic exchange of information, pursuant to Government- to- Government mechanisms such as the multilateral conventions on mutual administrative assistance in tax matters, bilateral tax treaties or tax information exchange agreements (TIEAs). CbCR requirements are to be implemented for fiscal year beginning on or after 1st January, 2016 applicable to MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million. India has implemented all the above documentation requirements with effect from AY 2017-18 (FY 2016-17) putting the threshold of application of CbCR for a group turnover of Rs.5500 crores or more and the threshold for application of Master file requirement for groups with a group turnover of equal to or more than Rs.500 crores.

11.1 The content to be provided in Master file, Local file and CbCR is prescribed in OECD TPG, 2017 and extracted as Annexure I, II and IV. The same are explained as under.

Annex I to Chapter V
Transfer Pricing Documentation – Master file

The following information should be included in the master file:

Organizational structure

- Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities.

Description of MNE's business(es)

- General written description of the MNE's business including:
  - Important drivers of business profit;
  - A description of the supply chain for the group's five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than 5% of group turnover. The required description could take the form of a chart or a diagram;

- A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;
- A description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;
- A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, that is key functions performed, important risks assumed, and important assets used;
- A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.

MNE's intangibles (as defined in Chapter VI of these Guidelines)

- A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management.
- A list of intangibles or groups of intangibles of the MNE group that are important for transfer pricing purposes and which entities legally own them.
- A list of important agreements among identified associated enterprises related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements.
- A general description of the group's transfer pricing policies related to R&D and intangibles.
- A general description of any important transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved.

MNE's intercompany financial activities

- A general description of how the group is financed, including important financing arrangements with unrelated lenders.

- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organized and the place of effective management of such entities.
- A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.

MNE's financial and tax positions

- The MNE's annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.
- A list and brief description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

Annex II to Chapter V
Transfer Pricing Documentation – Local file

The following information should be included in the local file:

Local entity

- A description of the management structure of the local entity, a local organization chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.
- A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.
- Key competitors.

Controlled transactions

For each material category of controlled transactions in which the entity is involved, provide the following information:

- A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licenses of intangibles, etc.) and the context in which such transactions take place.

- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (that is payments and receipts for products, services, royalties, interest, etc.) broken down by tax jurisdiction of the foreign payer or recipient.
- An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them. Copies of all material intercompany agreements concluded by the local entity.
- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years.1
- An indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method.
- An indication of which associated enterprise is selected as the tested party, if applicable, and an explanation of the reasons for this selection.
- A summary of the important assumptions made in applying the transfer pricing methodology.
- If relevant, an explanation of the reasons for performing a multi-year analysis.
- A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information.
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both.
- A description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method.
- A summary of financial information used in applying the transfer pricing methodology.

- A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above.
- Financial information
- Annual local entity financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied.
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements.
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

Annex III to Chapter V

Transfer Pricing Documentation–Country-by-Country Report

A. Model template for country-by-country Report

Table 1: Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE Group: Fiscal Year concerned: Currency Used:										
Tax Jurisdiction	Revenues			Profit(Loss) Before Income Tax	Income tax paid(in cash basis)	Income tax accrued-current year	Stated Capital	Accumulated Earnings	Number of employees	Tangible assets other than cash and cash equivalents
	Unrelated party	Related Party	Total							

Table 2: List of all the constituent entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:															
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)												
			and development	Holding or Managing Intellectual property	Purchasing or procurement	Research Manufacturing or production	Sales, Marketing or Distribution	Administrative management or support services	Provision of services to unrelated parties	Internal group Finance	Regulated Financial services	Insurance	Holding shares other than equity instruments	Dormant	Other 1
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

1. Please specify the nature of activity of the constituent entity in the "Additional Information" section.

Table 3 Additional Information

Name of the MNE group: Fiscal year concerned:
Please include any further information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the country-by-country Report

B. Template for the Country-by-Country Report – General instructions Purpose

This Annex III to Chapter V of these Guidelines contains a template for reporting a multinational enterprise's (MNE) group allocation of income, taxes and business activities on a tax jurisdiction-by-tax jurisdiction basis. These instructions form an integral part of the model template for the Country-by-Country Report.

Definitions

Reporting MNE

A Reporting MNE is the ultimate parent entity of an MNE group.

Constituent Entity

For purposes of completing Annex III, a Constituent Entity of the MNE group is:

(i) any separate business unit of an MNE group that is included in the Consolidated Financial Statements of the MNE group for financial reporting purposes, or would be so included if equity interests in such business unit of the MNE group were traded on a public securities exchange;

(ii) any such business unit that is excluded from the MNE group's Consolidated Financial Statements solely on size or materiality grounds; and

(iii) any permanent establishment of any separate business unit of the MNE group included in (i) or (ii) above provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.

Treatment of Branches and Permanent Establishments

The permanent establishment data should be reported by reference to the tax jurisdiction in which it is situated and not by reference to the tax jurisdiction of residence of the business unit of which the permanent establishment is a part. Residence tax jurisdiction reporting for the business unit of which the permanent establishment is a part should exclude financial data related to the permanent establishment.

Consolidated Financial Statements

The Consolidated Financial Statements are the financial statements of an MNE group in which the assets, liabilities, income, expenses and cash flows of the ultimate parent entity and the Constituent Entities are presented as those of a single economic entity.

Period covered by the annual template

The template should cover the fiscal year of the Reporting MNE. For Constituent Entities, at the discretion of the Reporting MNE, the template should reflect on a consistent basis either

(i) Information for the fiscal year of the relevant Constituent Entities ending on the same date as the fiscal year of the Reporting MNE, or ending within the 12 month period preceding such date, or

(ii) Information for all the relevant Constituent Entities reported for the fiscal year of the Reporting MNE.

Source of data

The Reporting MNE should consistently use the same sources of data from year to year in completing the template. The Reporting MNE may choose to use data from its consolidation reporting packages, from separate entity statutory financial statements, regulatory financial statements, or internal management accounts. It is not necessary to reconcile the revenue, profit and tax reporting in the template to the consolidated financial statements. If statutory financial statements are used as the basis for reporting, all amounts should be translated to the stated functional currency of the Reporting MNE at the average exchange rate for the year stated in the Additional Information section of the template. Adjustments need not be made, however, for differences in accounting principles applied from tax jurisdiction to tax jurisdiction. The Reporting MNE should provide a brief description of the sources of data used in preparing the template in the Additional Information section of the template. If a change is made in the source of data used from year to year, the Reporting MNE should explain the reasons for the change and its consequences in the Additional Information section of the template.

C. Template for the Country-by-Country Report – Specific instructions Overview of allocation of income, taxes and business activities by tax jurisdiction (Table 1)

Tax Jurisdiction

In the first column of the template, the Reporting MNE should list all of the tax jurisdictions in which Constituent Entities of the MNE group are resident for tax purposes. A tax jurisdiction is defined as a State as well as anon-State jurisdiction which has fiscal autonomy. A separate line should be included for all Constituent Entities in the MNE group deemed by the Reporting MNE not to be resident in any tax jurisdiction for tax purposes. Where a Constituent Entity is resident in more than one tax jurisdiction, the applicable tax treaty tie breaker should be applied to determine the tax jurisdiction of residence. Where no applicable tax treaty exists, the Constituent Entity should be reported in the tax jurisdiction of the Constituent Entity's place of effective management. The place of effective management should be determined in accordance with the provisions of Article 4 of the OECD Model Tax Convention and its accompanying Commentary.

Revenues

In the three columns of the template under the heading Revenues, the

Reporting MNE should report the following information: (i) the sum of revenues of all the Constituent Entities of the MNE group in the relevant tax jurisdiction generated from transactions with associated enterprises; (ii) the sum of revenues of all the Constituent Entities of the MNE group in the relevant tax jurisdiction generated from transactions with independent parties; and (iii) the total of (i) and (ii). Revenues should include revenues from sales of inventory and properties, services, royalties, interest, premiums and any other amounts. Revenues should exclude payments received from other Constituent Entities that are treated as dividends in the payer's tax jurisdiction.

Profit (Loss) before Income Tax

In the fifth column of the template, the Reporting MNE should report the sum of the profit (loss) before income tax for all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The profit (loss) before income tax should include all extraordinary income and expense items.

Income Tax Paid (on Cash Basis)

In the sixth column of the template, the Reporting MNE should report the total amount of income tax actually paid during the relevant fiscal year by all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. Taxes paid should include cash taxes paid by the Constituent Entity to the residence tax jurisdiction and to all other tax jurisdictions. Taxes paid should include withholding taxes paid by other entities (associated enterprises and independent enterprises) with respect to payments to the Constituent Entity. Thus, if company X resident in tax jurisdiction A earns interest in tax jurisdiction B, the tax withheld in tax jurisdiction B should be reported by company X.

Income Tax Accrued (Current Year)

In the seventh column of the template, the Reporting MNE should report the sum of the accrued current tax expense recorded on taxable profits or losses of the year of reporting of all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The current tax expense should reflect only operations in the current year and should not include deferred taxes or provisions for uncertain tax liabilities.

Stated Capital

In the eighth column of the template, the Reporting MNE should report the

sum of the stated capital of all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. With regard to permanent establishments, the stated capital should be reported by the legal entity of which it is a permanent establishment unless there is a defined capital requirement in the permanent establishment tax jurisdiction for regulatory purposes.

Accumulated Earnings

In the ninth column of the template, the Reporting MNE should report the sum of the total accumulated earnings of all Constituent Entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year. With regard to permanent establishments, accumulated earnings should be reported by the legal entity of which it is a permanent establishment.

Number of Employees

In the tenth column of the template, the Reporting MNE should report the total number of employees on a full-time equivalent (FTE) basis of all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The number of employees may be reported as of the year-end, on the basis of average employment levels for the year, or on any other basis consistently applied across tax jurisdictions and from year to year. For this purpose, independent contractors participating in the ordinary operating activities of the Constituent Entity may be reported as employees. Reasonable rounding or approximation of the number of employees is permissible, providing that such rounding or approximation does not materially distort the relative distribution of employees across the various tax jurisdictions. Consistent approaches should be applied from year to year and across entities.

Tangible Assets other than Cash and Cash Equivalents

In the eleventh column of the template, the Reporting MNE should report the sum of the net book values of tangible assets of all Constituent Entities resident for tax purposes in the relevant tax jurisdiction. With regard to permanent establishments, assets should be reported by reference to the tax jurisdiction in which the permanent establishment is situated. Tangible assets for this purpose do not include cash or cash equivalents, intangibles, or financial assets.

List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction (Table 2)

Constituent Entities Resident in the Tax Jurisdiction

The Reporting MNE should list, on a tax jurisdiction-by-tax jurisdiction basis and by legal entity name, all the Constituent Entities of the MNE group which are resident for tax purposes in the relevant tax jurisdiction. As stated above with regard to permanent establishments, however, the permanent establishment should be listed by reference to the tax jurisdiction in which it is situated. The legal entity of which it is a permanent establishment should be noted (e.g. XYZ Corp – Tax Jurisdiction A Permanent Establishment).

Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence

The Reporting MNE should report the name of the tax jurisdiction under whose laws the Constituent Entity of the MNE is organized or incorporated if it is different from the tax jurisdiction of residence.

Main Business Activity (ies)

The Reporting MNE should determine the nature of the main business activity(ies) carried out by the Constituent Entity in the relevant tax jurisdiction, by ticking one or more of the appropriate boxes.

Business Activities
Research and Development
Holding or Managing Intellectual Property
Purchasing or Procurement
Manufacturing or Production
Sales, Marketing or Distribution
Administrative, Management or Support Services
Provision of Services to Unrelated Parties
Internal Group Finance
Regulated Financial Services
Insurance
Holding Shares or Other Equity Instruments

Business Activities
Dormant
Other[7]

11.2 India implemented Master file and CbCR as prescribed TP documentation with effect from AY 2017-18 (FY 2016-17) and the corresponding rules are as under

11.3 How CbCR and Master file could be utilized by tax authorities and the probable areas under scanner

11.3.1 CbCR is a global financial snapshot of MNE group which contains high level jurisdiction wise information about allocation of profits, revenues, employees and assets, taxes paid, stated capital and accumulated earnings. MF provides overview of MNE's global operations along with TP policies. LF contains detailed information about local business and related party transactions, which is more or less the same as TP documentation as prescribed under section 92 D of Income Tax act , 1961 read with rule 10D of Income Tax Rules,1962.

CbCR consists of the following important information jurisdiction wise in respect of

1. Revenues: Related party. Third party
2. PBT
3. Taxes paid(cash) and accrued
4. Stated capital
5. Accumulated earnings
6. Tangible assets
7. Number of employees
8. Main business of each constituent entity

Master file contains the following information as per Rule 10DB

1. Organizational structure

[7]*Please specify the nature of the activity of the Constituent Entity in the "additional Information" section.*

2. Nature of Business
3. Profit drivers of business
4. Supply chain details
5. Geographical markets
6. Description of important service arrangements
7. Functional analysis of principal contributors
8. TP policy for service cost allocation pricing of intra group services
9. Business restructuring
10. Intangibles
    (a) Overall strategy and transfer pricing policy
    (b) List of intangibles and their legal owners
    (c) List of intangible agreements
    (d) List of entities engaged in R&D
    (e) Details of important transfers
11. Inter-company financing
    (a) Financing arrangements including the details of top 10 unrelated lenders
    (b) Entities providing central financing
    (c) Transfer pricing policies
12. Consolidated financial statement
13. Details of existing APAs, other tax rulings

Local file contains the following information

1. Management / Organization structure
2. Business Description
3. Industry Overview
4. Inter- company transaction details
5. Economic analysis

11.3.2 Use of CbCR by tax authorities

CBDT vide instruction no. 2 of 2018 has provided directions on appropriate use of CbCR data by the tax department, which should be used only for risk assessment procedures and cannot be used for making additions during audits. With the data available from CbCR, tax authorities would go deep into ratios comparing jurisdiction wise with respect to revenues, employees, assets etc and to ensure that profits reported in India are commensurate with the activity carried out in India. The tax authorities would examine quantum of activities, nature of these activities, revenue/profit per employee, revenue/profit per unit of assets and effective tax rate for deciding whether there exists any BEPS risk in India. Tax authorities could come up with red flags on the following probable issues.

1. *Information*
    - Revenues per employee
    - PBT per employee
    - Total Revenues/Tangible Assets
    - Income Tax Accrued/PBT (ETR)
    - Related Party Transactions (RPT)/Revenues
2. *Possible Use*
    - Comparison of jurisdictional revenues/PBTs per employee ratios
    - Profits and/ or revenues per unit of tangible assets
    - To identify ETR per jurisdiction for comparison of Maximum Marginal Rate (MMR) foreach jurisdiction
    - To identify proportion of RPT revenues to total revenues
3. *Possible assertion*
    - Low substantial activities in proportion to revenues/profits could lead to a BEPS risk. Similarly, jurisdictions with significant activity but low levels of profits could also be flagged for fur there enquiry. Moreover, peer activity from other jurisdiction is an internal comparable/ reference point
    - To evaluate whether any profits have been parked in low tax jurisdictions

- In case of higher RPT/ Total revenue ratio, higher could be the possibility of BEPS risk (of course, subject to corroboration with other parameters)

There is a possibility that tax authorities would also make comparison of tax payer's data with that of other group's data which they may possess and might draw adverse inferences. However this would amount to legally unacceptable approach of using another competitor's data which was not originally available to tax payer. Tax payer can raise a valid legal claim for asking the tax authorities to provide such data of competitor which is used for comparison. Obviously the confidentiality of data of tax payers would be at risk if a healthy and legal approach is not followed by the tax authorities. However, the tax payers would be strongly advised to maintain robust documentation justifying factual and commercial rationale behind the same.

Following are some of the adverse ratios that could be further scrutinized by the tax authorities:

- High third-party revenue but low PBT and low ETR (vis-à-vis MMR);
- High third-party revenue, high PBT but low ETR (vis-à-vis MMR);
- High related party revenue but low PBT;
- High related party revenue, high PBT but low ETR (vis-à-vis MMR);
- High tax accrued but low tax payments by way of use of Government schemes to defer tax outflow –possible consideration for BEPS risk assessment; and
- Other BEPS risk considerations/ flags:
  - Entity with no tax residence and Indian entity has significant RPT;
  - Entity with dual tax residence and Indian entity has significant RPT;
  - Low/ high profits with mostly mobile activities;
  - Significant RPT with holding company with no substantial activities;
  - Significant RPT with entity having high PBT and low ETR.

11.3.3 Use of information provided through MF by tax authorities

MF provides comprehensive picture of the MNE group in terms of organizational structure, nature of business, overall TP policies in relation to intra group service arrangements, intangibles, Inter-company financing etc. The same could be used along with details given in CbCR for evaluating high level tax risk assessments. It is given here under how tax authorities may utilize the information given through MF in the assessments.

Organization structure, nature of business, profit drivers, supply-chain details, main geographical markets and functional analysis of entities contributing more than 10% of revenue/profits/assets:

In MF the MNE group is under obligation to provide details of the group entities contributing more than 10% of the revenue/profit/assets, nature of activities etc. Tax authorities could evaluate the role of these top contributing entities as well as Indian group companies in the overall scenario to check whether functional profile of Indian tax payer as per its Local File(LF) is in line with group's macro level supply chain and whether profits earned by Indian tax payer are commensurate with its level of activity.

Intra-group service arrangements:

Large MNE groups have their intra-group service centers mainly for undertaking functions like administrative, management, finance, HR, legal, IT, strategic functions etc for the benefit of all members of the group. Many a time payments for intra group services come under dispute with tax authorities and get into long-drawn litigation. With the additional data being available through CbCR and MF tax authorities would come up with more detailed and specific questions in relation to important service arrangements within the group. There is always a question whether the service availed is in the nature of shareholder activity by the parent or is in the nature of a service that would have been availed for a price even from a third party.

Business restructuring/acquisitions, Divestments:

It is mandatory to provide details of important business restructuring/ acquisitions, divestments etc made by the group during the accounting year in the MF to be filed annually. From the Indian tax perspective. It is to be ensured that business restructuring transactions involving Indian tax payer as reported in MF are required to be reported even in form 3CEB as an international transaction.

Intangibles:

Actions 8-10 provide guidance which is incorporated in OECD TPG 2017 that mandates to delineate a transaction of intangible from the stage of development to enhancing, maintaining, protecting and exploiting stage of such intangibles. These are chiefly called DEMPE functions. It is not only the legal owner of the intangible who is entitled for returns on exploitation of the same, but also all the contributing group entities in various phases of DEMPE functions. Each group entity/member would be entitled to appropriate returns commensurate with the value of their respective contributions. It is pertinent to note that Indian MF regulations require Indian tax payers to additionally provide list of entities engaged in development and management of intangibles. This requirement is to find out whether Indian tax payer plays any role in DEMPE functions. Tax authorities could always go deep into the transactions of the intangibles and find out whether Indian group entity is properly compensated commensurate with its level of contribution in the DEMPE functions. Many a time Indian group entities would have been compensated on a cost plus model which would be rejected by tax authorities and profit split method would be applied to arrive at appropriate attribution of profit to the Indian entity on the basis of DEMPE functions.

CBDT has issued a Circular 3[8]in 2013 in respect of "contract R&D service providers" bearing insignificant risks. The criteria provided in such circular is as under

- Foreign principal performs most of the economically significant functions and Indian development centre carries out work assigned to it;
- Foreign principal provides funds, other assets for R&D and remuneration to Indian development centre for work carried out;
- Indian development centre works under direct supervision of foreign principal which actually controls and supervises R&D activity through its strategic decisions;
- Indian development centre does not assume economically significant risks;
- Indian development centre has no ownership right on the outcome of R&D; and

[8]*Circular 3/2013 (dated March 26, 2013)*

- In case foreign principal is located in low/ no tax jurisdiction, it will be presumed that the foreign principal is not controlling the risk, unless the Indian entities rebut this presumption to the satisfaction of Indian tax authorities.

The approach of CBDT through this circular is in line with principles laid down in Action 13. It would be critical for MNE group to revisit their TP policies in respect of intangibles vis-a-vis the group entities in line with principles laid down in Action 13 and revised OECD TPG 2017.

Inter-company financial activities:

MNE groups have centralized financing arrangements for cash management and corporate financial management to optimize cost of capital for advantage of group entities. Intra group financial transaction include intra group loans, cash pooling arrangements, hedging, guarantees, issuance of instruments like CCDs etc. Many a time it is difficult to benchmark peculiar intra group arrangements. There is increasing litigation in respect of benchmarking of interest rates/ guarantee commission. OECD has brought out discussion draft on July 2018 on financial transactions addressing specific issues relating to items like

(i) Groups placing higher levels of third party-debt in high tax countries,

(ii) Groups using intra-group loans to generate interest deductions in excess of the Group's actual third party interest expense, and

(iii) Groups using third party or intra-group financing to fund the generation of tax exempt income. This risk was addressed by recommending an approach based on fixed-ratio rule which limits interest deduction to an amount equivalent to a percentage of entity's earnings before interest, taxes, depreciation and amortization (EBITDA). Pursuant to the same, Indian Government introduced interest limitation provisions vide section 94B under Income Tax Act, 1961(the Act).

As already noticed in Actions 8-10 it is recommend that a simple "risk-free return" would be provided to such group entities that are treated as cash boxes without really carrying out the critical functions except funding the activity. Interest limitation provided by Action 4 was already discussed at length in earlier chapters covering even the provisions that have been brought into Indian income tax law in the form of section 94B.

Way forward:

In view of critical and minute information of the entire MNE group being available to tax authorities across jurisdictions, it would be expected that the tax authorities of each jurisdiction would pull out internal comparables by comparing transactions of one jurisdiction with that of the other. This would pose a big challenge to tax payers in preparing themselves for detailed scrutiny by tax authorities. Hence any MNE group as a whole needs to comply with consistency, transparency and objectivity in readying themselves for any tax scrutiny.

Chapter 12
Action Plan 14: Making Dispute Resolution Mechanisms More Effective

12.1 Action 14 mandates effective dispute resolution mechanism to be adopted by all members of inclusive framework. This is a minimum standard to be adopted as agreed by all the members of the inclusive framework. BEPS Actions have been focused on plugging tax leakages and arresting opportunities for cross border tax avoidance and evasion. In this process taxpayer should never be subjected to double taxation or any hardship in respect of interpretation of the provisions of the treaty law. This aspect is crucially important and the same is brought in the form of Action 14 to ensure the tax payers are not subjected to any unintended double taxation and also to improve dispute resolution mechanisms which is an integral component of the BEPS project.

Article 25 of the OECD model convention deals with mutual agreement procedure, a dispute resolution mechanism, independent from the ordinary legal remedies available under domestic law, through which the competent authorities of the contracting states may resolve the differences or difficulties regarding the interpretation or application of the convention on a mutually agreed basis. Mutual Agreement Procedure (MAP) is of fundamental importance to proper application and interpretation of tax treaties notably to ensure the tax payers entitled to the benefits of the treaty are not subjected to taxation by either of the contracting states which is not in accordance with the terms of the treaty.

Action 14 mandates to strengthen the efficiency and effectiveness of the MAP process. It is proposed to have effective and timely resolution of disputes regarding interpretation or application of the tax treaties through the MAP process. Action 14 which is a minimum standard will:

- Ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner; Ensure the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
- Ensure that taxpayers can access the MAP when eligible.

The minimum standard is complemented by a set of best practices. The monitoring of the implementation of the minimum standard will be carried out pursuant to detailed terms of reference and an assessment methodology that are developed in the context of the OECD/G20 BEPS Project.

In addition to the commitment to implement the minimum standard of effective dispute resolution mechanism the following countries have declared their commitment to provide for mandatory binding MAP arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified timeframe: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. This represents a major step forward as together these countries were involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD.

12.2 How these recommendations have been brought into MLI

12.2.1 Article 16 of MLI is a detailed and revised MAP process delineated. It sets out the basis for MAP, who can access the MAP process, and the timelines and processes it should follow. It is to be noted that existing MAP procedure under the treaty network has not been effective and the resolution process is taking a long time losing its very relevance. This has prompted OECD/G20 BEPS inclusive framework to target this area as a minimum standard and mandate a more fool-proof, speedier and effective dispute resolution process through MAP. Hence, introduction of Article 16 in the MLI is of paramount importance.

Salient features of Article 16 dealing with MAP are as under:

i) Where a person considers that the actions of one or both of the contracting jurisdictions result in taxation not in accordance with the provisions of a CTA, such person is entitled to present the case to a competent authority of either contracting jurisdiction. The case must be presented within 3 years from the first notification of the action resulting in taxation not accordance with the provisions of the CTA.

ii) The competent authority on being satisfied that the objection made by the taxpayer is appropriate initiates to resolve the dispute by mutual agreement with the competent authority of the other contracting jurisdiction, with a goal to avoid taxation which is not in accordance with provisions of CTA. Any agreement so reached by both competent authorities shall be implemented

irrespective of the time limits prescribed under the domestic law of the respective jurisdictions.

iii) The competent authorities shall address and resolve any difficulties or doubts arising as to the interpretation or application of the CTA. They may also address elimination of double taxation in cases not provided for in the CTA.

iv)

- It is provided that a person shall present the case to the competent authority of the contracting jurisdiction of which such person is a resident. In respect of cases relating to non-discrimination based on nationality the case may be presented to competent authority of a contracting jurisdiction of which such person is a national.
- In case a shorter time threshold is provided for referring a case which is less than three years from the first notification of the action, in a particular CTA, the same must be replaced by a three-year threshold as per this article. Incase such CTA does not provide for any time threshold the provision of three-year threshold must be provided as per this article.
- The provisions of paragraph 2 of the Article in respect of resolution by mutual agreement by both competent authorities and enforceability of such agreements reached irrespective of time limits in the domestic law shall apply in the absence of any such provision in a particular CTA.
- The provisions of paragraph 3 of the Article to deal with any disputes relating to interpretation or application of the provisions of the CTA including those cases of elimination of double taxation not provided for in CTA may apply to such CTA in the absence of such provision available in such CTA.

v)

- An option is provided to a party (member country) that may reserve the right in respect of presenting the case to the competent authority of the either contracting jurisdiction. In other words, such party may present the case only to the competent authority of the contracting jurisdiction of which the person is a resident or if the case presented by that person comes under a provision of a CTA relating to non-discrimination based on nationality, to that of the contracting jurisdiction of which such person is a national. In other words, a party may reserve the right for first sentence of para 1 relating to presenting the case to the competent

authority of either contracting jurisdiction, not to apply to the provisions of the CTA on the basis that competent authority shall as an administrative measure implement a bilateral notification process under Article 16(5)(a).

- A party may reserve the right not to apply that the time period of three years (as per second sentence of paragraph 1) for presenting the case under MAP to its CTAs and may be allowed to present the case within a period of at least three years from the first notification of the action. In other words, the case may be presented to the competent authority even after completion of three years on account of such facility being available under domestic regulations of the concerned party.
- A party may reserve the right not to apply the second sentence of paragraph 2 which reads "any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the contracting jurisdictions", to its CTAs on the basis that any agreement reached via the MAP shall be implemented irrespective of time limits of the domestic laws of the contracting jurisdictions;

Or

It intends to meet the minimum standard for improving the dispute resolution by accepting in its bilateral treaty negotiations, a treaty provision providing that

(a) a contracting jurisdiction shall make no adjustment to the profits attributable to a PE of an enterprise after a particular period from the end of the taxable year in which such profits would have been attributed to the PE and

(b) Contracting jurisdiction shall not include in the profits of the enterprise, and tax accordingly, profits that would have accrued to the enterprise but by virtue of associated enterprise relationship have not so accrued, after a particular period that is mutually agreed from the end of the taxable year in which such profits would have accrued to the enterprise.

(Both the above provisions shall not apply in the case of fraud, gross negligence or willful default)

- Some contracting jurisdictions might consider that such an open ended commitment of implementing MAP resolution irrespective of time limits under the domestic law is unreasonable as a matter of practical

administration. This is where flexibility is created and an option is provided to a country not to apply second sentence and still satisfy the minimum standard requirement even by providing time limits for adjustments as per agreement reached through MAP process. This is as per paragraph 39 of Action 14 final report 2015.

vi)

- Each party that has not made any reservation described in Para 5(a) shall notify the depository of whether each of its CTA contains a provision described in Para 4(a)(i), and if so, the article and paragraph number of each provision. Where all contracting jurisdictions have made a notification with respect to a provision of a CTA, that provision shall be replaced by a first sentence of paragraph 1. In other cases, first sentence of paragraph 1 shall supersede the provisions of CTA only to the extent that those provisions are incompatible with that sentence.
- In respect of period that is "shorter than three years" or "at least three years" the guidance is provided in paragraph 6(b) and what is to be notified to depository is detailed in para 6(c)&(d).

In order to expedite an effective dispute resolution Article 17 "Dealing with corresponding adjustments" is also brought into MLI which is explained below.

12.2.2 Article 17- Corresponding Adjustments

Corresponding adjustment is warranted to avoid economic double taxation in transfer pricing assessments. If two associated enterprises are located in two different jurisdictions and international transactions happen between them, profit earned by each entity is based on functions carried out, assets employed and risks assumed with respect to such international transactions.

Many a time there is a dispute in the transfer pricing assessment of one of the associated enterprises which could result in a transfer pricing adjustment. As the profit earned jointly by the associated enterprises is divided on the basis of FAR analysis any upward adjustment to the profits of one of the AEs must be correspondingly reduced in the hands of other AE. This for the simple reason that the overall profits earned by both the AEs from the third party remains the same and the dispute is only with respect to division of such profit between the two AEs on the basis of FAR. Such adjustment is known as corresponding adjustment which is critical to avoid economic double taxation. This is one of the best practices which may be followed by the various jurisdictions. The same

may be implemented either through unilateral measures or by invoking Mutual Agreement Procedures (MAP) appropriately. This forms part of the broader agenda of effective dispute resolution. In the past some DTAAs entered by India were not having the said clause in Article 9 dealing with associated enterprises. It is now mandatory to have such article in the DTAAs which is being introduced through MLI as Article17.Article 17 is targeted to avoid economic double taxation on the basis of the philosophy canvassed by Action Plan 14 that deals with effective dispute resolution, which is a minimum standard.

Para 1 provides that such corresponding adjustments must be carried out in the other contracting jurisdiction where a transfer pricing adjustment happens in the hands of AE in the first contracting jurisdiction. Para 2 mandates the parties to have such provision in the CTAs which is being implemented through comparability clause which provides for application of paragraph 1 in place of or in the absence of existing provisions for corresponding adjustment in a CTA. Para 3 talks about when a party may reserve the right only on the basis of ensuring that such corresponding adjustment happen otherwise. Para 4 provides the obligation to notify the depository by each party of the existing provision for corresponding adjustment in the CTA which would then get replaced by the language contained in paragraph 1 of the Article.

12.2.3 Arbitration

Article 18 – 26 deal with arbitration in part VI of MLI, which provides for mandatory binding arbitration in cases where MAP proceedings could not be concluded by the competent authorities within a period of two years from the date on which both competent authorities have notified the person who presented the case. India did not accept mandatory binding arbitration and assured that MAP cases would be resolved in a speedier manner. Hence these provisions of Article 18-26 are not being discussed at length here.

Chapter 13
Action Plan 15 : Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

13.1 Introduction

Global economic crisis surfaced in 2008, had driven tax jurisdictions in the advanced world to check their coffers as to whether taxes are being collected properly. It was found that huge tax leakages occurred on account of aggressive tax planning by large multinationals on the basis of the then existing international tax rules. This prompted Organization for Economic Cooperation and Development (OECD) to initiate a marathon agenda of rewriting the tax rules with the support of G-20 Nations. This initiative was named after "Base Erosion and Profit Shifting" (BEPS) which commenced in 2013 and got finalized in 2015 October with 15 Action plans. Entire exercise of BEPS agenda is to plug the loop holes resulting in tax leakages and come out with new rules to tax enterprises in the jurisdiction where value is created. BEPS Action plans are tax avoidance measures against multinational enterprises carrying out economic activity spread in various tax jurisdictions. Prevention of tax treaty abuse or treaty shopping and effective tax treaty dispute resolution mechanism are the core agenda which every tax jurisdiction, who is part of this BEPS inclusive framework, have agreed to adopt in their respective treaties as minimum standards. Action plan 1 to Action plan 14 have dealt with tax avoidance measures in the context of tax leakages arising with respect to digital economy, permanent establishments, hybrid mismatches, harmful tax practices and transfer pricing rules the then existing. The object and purpose of OECD\G20 BEPS initiative is to achieve modification of the existing tax treaties which are as many as 2500 in number by incorporating the said tax avoidance measures in a swift manner. In this regard Action plan 15 suggested developing a Multilateral Instrument (MLI) to modify the existing bilateral tax treaties. As a consequence, MLI was developed and signed by as many as 67 countries on 7th June 2017 at Paris where India was one of the signatories. In three more signing events some more countries have signed MLI bringing the tally to 92 countries as on 26th November 2019.

Amending each bilateral tax treaty through regular negotiations would consume considerable time in the range of five to ten years or even more when it was required to amend as many as 2500 tax treaties. Group of international tax experts recommended an effective and swift way of amending bilateral treaties is through MLI in implementing BEPS measures. MLI is not like an amending protocol to a tax treaty which would set out amendments to the text of specified provisions of treaty, instead MLI is applied alongside existing bilateral treaties, modifying their application in order to implement the tax treaty related BEPS measures. Each signatory tax jurisdiction will have to notify its existing tax treaties which it would like to modify as per BEPS measures. Such tax treaties are called "Covered Tax Agreements" (CTA). The term "Modification" was deliberately chosen after an in-depth discussion among the Group of Experts. MLI follows general legal principle that when two rules apply to same subject matter, the latter in time prevails (*Lex posterior derogate legi priori*) which means, in case they are incompatible, subsequent treaties (that is MLI) would prevail over previously concluded treaty between the same parties on the same subject matter (that is CTA). This rule is explicitly set out in Article 30(3) of the Vienna Convention on Law of Treaties (VCLT) 1969 in line with Customary International Law. Each signatory to MLI indicates its position as to what tax treaties it would like to cover, the options it has chosen and the reservations it has made. A particular bilateral tax treaty will get modified only if both the treaty partners make the same options and make the same reservations. In other words, there should be matching in options and reservations between the treaty partners in order to modify bilateral tax treaty. Such modifications will happen on submitting the instrument for ratification by both the treaty partners to OECD as per their respective legal procedures.

India has notified all its 93 comprehensive bilateral tax treaties under the provisional list at the time of signing of the MLI on 7th June 2017. Corresponding options and reservations from the treaty partners in a matching manner would lead to ratification of the proposed modification of the existing tax treaties. This process is completed and India has ratified and submitted the Instrument of ratification to OECD on June 25, 2019.Concept of Multilateralism in the tax treaty network is experimented in a big way for the first time through OECD\G20 BEPS initiative. This is a metamorphic phase in international tax history. As per Article 34 of MLI five countries have to sign and deposit the instruments for ratification to make MLI enter into force on the first day of the month following the expiration of the period of

three calendar months beginning on the date of deposit of the fifth instrument of Ratification, Acceptance or Approval. MLI entered into force from 1st July 2018 on account of Austria, Isle of Man, Jersey, Poland and Slovenia depositing of their respective instruments for Ratification, Acceptance or Approval.

13.2 Structure of MLI

PART I	**SCOPE AND INTERPRETATION OF TERMS** (Articles 1&2)
PART II	**HYBRID MISMATCHES** (Articles 3 to 5)
PART III	**TREATY ABUSE** (Articles 6 to 11)
PART IV	**PERMANENT ESTABLISHMENT** (Articles 12 to 15)
PART V	**IMPROVING DISPUTE RESOLUTION** (Articles 16 & 17)
PART VI	**ARBITRATION** (Articles 18 to 26)
Part VII	**FINAL PROVISIONS** (Articles 27 to 39)

13.3 Gist/Salient Features- Article wise

13.3.1 Article 1 - Scope of the convention

The agenda of MLI is provided in this article which states that it modifies all Covered tax Agreements (CTAs).

13.3.2 Article 2 - Interpretation of terms

I. Four important definitions have been given in Article 2(1) and they are:

(a) Covered Tax Agreement which means an agreement for avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered) and with respect to which each such party has made a notification to the depository listing the agreement as well as any amending or accompanying instruments there to as an agreement which it wishes to be covered by this convention.

(b) The term "party" means a jurisdiction which has signed the convention or a state for which this convention is in force

(c) The term "contracting jurisdiction" means a party to the Covered Tax Agreement

(d) The term "signatory means a state or jurisdiction which has signed this convention but for which the convention is not yet in force.

II. Article 2(2) reads "*As regards the application of this convention at any time by a party, any term not defined herein shall, unless the context otherwise requires, have the meaning that it has at that time under the relevant covered tax agreement".*

Article 2(2) leads us to provisions of CTA for obtaining meaning of any term not defined in MLI. If such meaning is not available in the relevant CTA for the term undefined in MLI probably one needs to look at Article 3(2) of the respective CTA which directs us to the domestic law of the source state where such CTA is being applied. Article 3(2) is popularly known as an interface between the treaty law and domestic law.

Article 3(2) reads as under "*As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."*

It is evident from the text of Article 3(2) the domestic tax laws of source state have to be considered for obtaining the term undefined in the treaty. It is also clear that one needs to look at the tax laws of the source state over non tax laws. Again a preference must be given to direct tax laws (domestic laws) as against indirect tax laws of the state. If direct tax laws offer definition of the same term at different places like procedural and substantive portions then definition under substantive portion must be preferred. If there is no definition available at all under direct tax laws, then one should consult the indirect tax law of the source state. Incase no definition is available under the indirect tax laws then one needs to consult non tax laws of the source state. A classic example in this context is the term "copyright" which is not defined either in the treaty law or under the domestic law both direct and indirect taxes of

India, then one needs to consult The Copyrights Act, 1957 to get the meaning of the term "copyright".

This exercise is all subject to the context under which such CTA was signed. In other words, if the context provides a different meaning the same shall be adopted. One needs to know "what is the context in respect of a particular CTA" when it was signed by both the treaty partners.

Another issue that merits attention is which definition is to be considered for interpretation, whether the definition of the term that is available in the domestic tax laws at the time of signing the tax treaty or the definition of the term available at the time of applying the treaty?

So, if one adopts the definition of the term that is available at the time of signing the treaty, the same approach is known as static approach. So, if one adopts the definition of the term that is available at the time of applying the treaty the same approach is called ambulatory/dynamic approach. It is by and large a settled proposition as per OECD MCC that ambulatory/ dynamic approach is to be adopted.

- Ambulatory approach to interpretation of DTAs is generally the common approach to interpretation in United States. *Kappus Vs Commissioner 337 F 3d 1053 (DC in 2003)*
- This ambulatory method can be directed by a statute. Example: Sec 3 of the Canadian Income Tax Conventions Interpretation Act, 1985 provides that except to the extent the context otherwise requires an undefined term shall have a meaning after amended law.

Interpretation of tax treaties is governed by the principles laid down in the Vienna Convention on the law of treaties (VCLT) 1969. Article 31 of VCLT is the general rule of interpretation.

Article 31(1) reads as under "*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 referred to in Article 31(1) is explained in Article 31(2) which reads as under

"The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes":

Example: Protocols of DTA which often clarify a matter after the DTA was originally signed

(a) *"Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty";*

Example: Exchange of letters between the contracting states after the DTA was originally signed, which after clarifies a provision contained in DTA.

(b) *"Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty".*

Example: Explanatory memorandum issued by the US treasury after conclusion of DTA, which project the US interpretation of the provisions of DTA.

Article 31(3) reads as under "*There shall be taken into account, together with the context:*

(a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable in the relations between the parties".

Article 31(4) reads as under *"A special meaning shall be given to a term if it is established that the parties so intended".*

Article 32 reads as under *"Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31 :*

(a) Leaves the meaning ambiguous or obscure; or

(b) Leads to a result which is manifestly absurd or unreasonable".

In addition to the context explained which is relevant under the CTA there is also a reference to the word "context" in Article 2(2) of MLI. The subsequent term context obviously refers to the context of the MLI. The preamble to MLI observes as under

"*Noting that the OECD/G20 BEPS package included tax treaty-related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution;*

Conscious of the need to ensure swift, co-ordinated and consistent implementation of the treaty-related BEPS measures in a multilateral context;

Noting the need to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements 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 those agreements for the indirect benefit of residents of third jurisdictions);

Recognizing the need for an effective mechanism to implement agreed changes in a synchronized and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement;"

It is very clear that the context of MLI is to arrest double non taxation and also reduced taxation through tax evasion or avoidance.

Prevention of treaty abuse being a minimum standard which is brought in as Article 6 of MLI which highlights the purpose of CTA, is a mandatory requirement for adoption into every bilateral tax treaty. In other words, the context of MLI gets incorporated into every CTA. Accordingly, there could be a question whether the original context of CTA gets modified /replaced by the context of MLI. This would be a critical assumption in terms of interpreting the context of a CTA.

13.3.3 Article 3 – Transparent Entities

MLI provision

As per this provision, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either contracting jurisdiction, shall be considered to be income of a resident of the jurisdiction. However, this shall be only to the extent that the income is treated for purposes of taxation by that contracting jurisdiction as the income of a resident.

India's final position

India has reserved its right in entirety the application of this Article and had indicated that it will not apply this to any of its bilateral treaties.

13.3.4 Article 4 – Dual Resident Entities

MLI provision

As per this provision, the issue of dual residency for non-individuals is to be addressed by mutual agreement between competent authorities. In absence of such agreement the treaty benefit may be denied.

India's final position

India has not made any formal reservation against this Article, however there would be practical issues. The competent authorities would be unable to reach an agreement as the domestic POEM and the guidelines are not totally in line with the OECD commentaries on this subject.

Hence on this issue, there is likely to be a disagreement and treaty benefit denied resulting in double taxation.

This would amount to transferring of more discretion to revenue authorities which may not be desirable in certain situations.

13.3.5 Article 5 – Application of methods for elimination of Double Taxation

MLI provision

This Article provides for three alternative steps to avoid double taxation. Option A and Option B exemption methods with specific reference to deductibility in a contracting state Option C is credit method.

Further, where each jurisdiction to a Covered Tax Agreement chooses a different Option, the Option chosen by each Jurisdiction shall apply with respect to the residents of that jurisdiction. This article to be treated as asymmetric provision in the MLI which provides different options to treaty partners.

India's final position

India in its final position has chosen to apply option C and notified the following CTAs that contain provision as prescribed Article 5(7) (that is Option C)

(a) Bulgaria

(b) Egypt

(c) Greece

(d) Slovak Republic

13.3.6 Article 6 – Purpose of a Covered Tax Agreement

MLI provision

Article 6 of MLI primarily seeks to insert a statement in the preamble of the tax treaties to the effect that the purpose of the treaty is not to create opportunities for double non-taxation or reduced taxation through tax avoidance or evasion including treaty shopping.

India's final position

India is silent on its position on Article 6. So, there could be a scenario, if a treaty already has such a language then that does not require a change. However, in all other treaties the preamble language needs to be changed as it is a prescribed minimum standard.

13.3.7 Article 7 – Prevention of Treaty abuse

MLI provision

Article 7 of the MLI deals with treaty abuse and uses three conditions and expects at least one of the following conditions to be adopted as minimum standard

(i) A principal purpose test (PPT)

(ii) A PPT supplemented with a simplified/ detailed limitation of benefits (SLOB/ LOB)

(iii) Detailed limitation of benefits (LOB)

The PPT test has been prescribed as a default test and parties can choose a supplementary SLOB or a LOB.

India's final position

India has not made any reservations and has taken a position to apply PPT with SLOB across all its notified treaties originally.

Finally, India has accepted to apply PPT as an interim measure and intends where possible to adopt LOB provision, in addition or replacement of PPT, through bilateral negotiations along with simplified LOB.

Indian has not notified for the special relief under Article 7(4) to be administered by Competent Authorities.

13.3.8 Article 8 – Dividend transfer transactions

MLI provision

Article 8 seeks to modify the provision of the treaty to provide for minimum shareholding period and percentage of holding for the beneficial owner to get exemption or reduced rate of withholding tax by the source country.

India's final position

India has chosen to apply to its CTA (except India-Portugal treaty)

13.3.9 Article 9 – Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property

MLI Provision

Article 9 provides taxing rights to a source country where the immovable property situated, to tax gains on alienation of shares of a company if the shares derive more than 50% of their value directly or indirectly from immovable property situated in the source country. It provides that the source country will get taxing rights if the value threshold is met any time during the period of 365 days preceding the date of transfer.

It also extends these provisions to interest in partnership or trusts.

India's final position

India has not made any reservations and has chosen to adopt this Article.

13.3.10 Article 10 - Anti-abuse Rule for Permanent Establishments in third Jurisdictions

MLI provision

Article 10 of MLI addresses abuse of tax treaties in triangular situations.

This Article tries to avoid such misuse, by providing that if the tax payable on the attributable income in the third State is less than Sixty Percent of the tax that would have been payable in the country of residence of the PE, then the treaty relief would not apply. This is termed as the Sixty Percent test.

Exception: Where the income is derived in connection with or incidental to an active trade or business carried on through the PE.

India's final position

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

13.3.11 Article 11 - Application of Tax Agreements to restrict a Party's Right to tax its own Residents

MLI provision

Article 11 of MLI seeks to avoid an argument, according to which, the tax treaty impairs rights of a country to tax its own residents. Additionally, Article 11 also ensures that certain benefits granted to tax residents are not impacted.

India's final position

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

13.3.12 Article 12 – Artificial avoidance of Permanent establishment (PE) status through commissionaire Arrangements and similar strategies

MLI provision

Article 12 of MLI seeks amendment to Article 5 of the tax treaties which defines the term PE on the following aspects:

- Enhanced scope of agency PE to counter the commissionaire or similar arrangements entered into by foreign enterprise in order to avoid PE in the source state;
- Creation of agency PE when the agent habitually plays principle role leading to conclusion of contracts with routine approval of the principal;
- Agent will not be considered to be an independent agent if he acts exclusively or almost exclusively on behalf of a *closely related enterprise*.

India's final position

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

It has been observed that a dependent agent in the source country virtually

does everything in concluding the contracts for the non-resident principal except formal signing of the contracts. These instances are to be identified as abusive tax avoidance approaches, only to avoid PE trigger in the source state. Action 7 was initiated only to address this abuse of deliberately avoiding PE threshold. The present Article 12 is meant to look into substance of the conduct of the dependent agent and to decide whether such agent is habitually playing principal role that is leading to the conclusion of the contracts that are routinely concluded without material modifications by the principal. It is a "substance over form" approach that would decide whether the dependent agent constituting a PE or not in the source country.

It is also quite often observed that an independent agent is not truly independent in nature for the simple reason that such agent serves the enterprise and its closely related enterprises. There again in substance the agent is not to be treated as independent agent as he serves several enterprises of the same group. In such a scenario again the substance approach would treat such agent as a dependent agent who creates a PE for the enterprise in the source country. This Article 12 which is in part IV is an optional standard and not a minimum standard. In other words, each country is entitled to choose for a modification of PE rule in this regard subject to same option being adopted by the treaty partner.

13.3.13 Article 13 - Artificial Avoidance of Permanent Establishment status through the specific Activity Exemptions

MLI provision

Article 13 provides for curbing specific activity based exemptions to avoid PE in the source country through activities which were hitherto considered as preparatory and auxiliary in nature.

Here the Article provides that Parties may have two options;

(i) Option A

This replaces existing treaty provisions so as not to change the negotiated list of activities but consider within this list/activities that is done from the fixed place of business which shall fall within its ambit as preparatory or auxiliary in nature.

(ii) Option B

On the other hand, does not relate to activities from the fixed place of

business but provides a carveout. In that sense option B gives more flexibility to treaty partners.

India's final position:

India *has not made any reservation and* has taken a position *to go by option A* and India tax treaties will be modified from its existing provision with respect to specific activity exemption. It will additionally be necessary to prove that these activities are of a preparatory or auxiliary character.

This being optional standard countries like Canada, China, Hong Kong, Sweden, Cyprus and Switzerland have totally opted out of this rule. Countries such Argentina, Australia, Austria, Germany, India, Indonesia, Italy, Japan, Mexico, Netherlands, New Zealand, South Africa and Spain have opted for option A. Countries such as Belgium, France, Ireland, Luxemburg and Singapore have opted for option B.

Article 13 (4) deals with anti-fragmentation rule where it provides to deny specific activity exemptions when a closely related enterprise carries on business activity in one or more places of the same state and either

(a) one or more such places constitute a PE for one of the related enterprises

(or)

(b) The overall activity resulting from the combination of the activities in such places is not of preparatory or auxiliary in character.

This provision is targeted to neutralize abuse of fragmenting the activities between closely related enterprises and unjustifiably claiming activity exemption in the hands of a tax payer enterprise. India follows this rule along with majority of the countries that have opted for this rule. Few countries like Germany, Luxemburg and Singapore have opted out this rule. A member party may reserve the right for the entirety of this Article not to apply to its Covered Tax Agreements (CTAs).

13.3.14 Article 14 – Splitting up of Contracts

MLI provision

Article 14 of MLI addresses avoidance of PE by splitting the contracts in respect of construction or installation activities between related enterprises to circumvent the threshold of creation of PE.

India's final position

India *has* remained silent. Considering the language "in place of or in the absence of" used in Para 2 of this Article, in the absence of existing anti abuse rule in the Indian treaties, anti-abuse provisions of aggregating the time spent for constitution of a permanent establishment applies to all of India's treaties except where a treaty partner has made a reservation. Some of the India's treaty partners have opted not to adopt these provisions in the tax treaties hence this article would be adopted in Indian tax treaties subject to matching.

It provides to aggregate time spent at a building site or construction or installation project by the enterprise and closely related enterprises at the same site to arrive at the period of time spent by the first mentioned enterprise. Countries like Argentina, Australia, France, India, Indonesia, Ireland, Netherlands and New Zealand have opted for this Article. Many other jurisdictions have opted out of this rule as this is not a minimum standard.

13.3.15 Article 15 – Definition of a Person closely related to an enterprise

MLI provision

Article 15 of MLI gives definition of the term "person closely related". This term is used in Article 12, Article 13 and Article 14 of MLI and the definition of Article 15 would be relevant in this context.

India's final position

India has not made any reservation in respect of this Article. However, if the treaty partners have adopted this definition, this article would be adopted in Indian tax treaties subject to matching.

It provides that a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than fifty percent of the beneficial interest in the other (or) if another person possesses directly or indirectly more than fifty percent of the beneficial interest in the person and the enterprise.

13.3.16 Article 16 – Mutual Agreement Procedure

MLI provision

Some of the salient features of Article 16 are:

- The tax payer can approach competent authority of either of the contracting jurisdiction (under the existing provision of Article 25 of the OECD model convention the tax payer can only approach the competent authority of the country of which he is resident / national)
- The tax payer needs to present his case to the competent authority within three years of the first notification of the action resulting in taxation, not in accordance with the provisions of the tax treaty (Article 25 of the OECD model convention contains similar provision)
- The agreement reached among competent authorities shall be implemented irrespective of the time limits in the domestic laws (Article 25 of the OECD model convention contains similar provision).

India's final position

India has made a reservation against Article 16(1). Therefore, India would not adopt a provision according to which the tax payer can approach competent authority of either of the contracting jurisdiction. However, as this is a minimum standard, India has opted for bilateral notification or consultation process.

India has preferred to continue with its stand that a tax payer can approach competent authority of the country of which he is a resident. The same position is found in the tax treaties India has entered into. MAP is a very important Article as this constitutes minimum standard agreed upon by OECD/G20 Inclusive Framework. OECD is of strong view that BEPS Action plans which are targeted to arrest tax leakages should not lead to unnecessary uncertainty for compliant tax payers and unintended double taxation. Improving dispute resolution mechanisms is therefore an integral component of the work on BEPS issues.

In real experience MAP inventory is growing in every country and the resolution process is getting unduly delayed. The thrust of Action 14 is to create an effective and speedier dispute resolution process. OECD also has set up peer review mechanism to periodically verify whether the countries of the Inclusive Framework are able to make their respective MAP processes

effective and speedier. In the context of India, it is all the more important to make MAP process more effective as India strongly opposed mandatory arbitration which India feels would infringe on its sovereignty. It is therefore widely expected that India would make MAP process more effective and speedier.

13.3.17 Article 17 – Corresponding Adjustments

MLI provision

Article 17 of MLI is based on Article 9(2) of the OECD Model and requires compensatory or corresponding adjustment if there is double taxation arising out of transfer pricing adjustments.

India's final position

India would adopt this provision except where such provision already exists in the tax treaty, as, in some of its treaties have this provision of corresponding adjustment and has notified the same.

However, the CBDT through press release dated November 27, 2017 had changed its position and had held that it is open to corresponding adjustment in a APA or MAP regardless of the position in the DTAAs.

This would facilitate adoption of this article in tax treaties, subject to matching. It would facilitate settlement of TP disputes through MAP and bilateral APA negotiations.

13.3.18 Article 18 – 26 –Mandatory Binding Arbitration

MLI provision

Articles 18 to 26 deal with mandatory arbitration and issues such as appointment of arbitrators, confidentiality of arbitration proceedings, and resolution of a case prior to the conclusion of arbitration, type of arbitration process, etc.

India's final position

As per the provisional notification, India has opted not to adopt mandatory arbitration provisions, as expected.

13.3.19 Ratification of MLI by India

Depending on the position taken under MLI by a country, India's DTAA with it shall get modified in the following prominent ways:-

(a) The minimum standard under BEPS Action 6 to tackle treaty abuse, i.e., insertion of new Preamble and the Principal Purposes Test (PPT) in the DTAAs shall be achieved.

(b) The minimum standard under BEPS Action 14 relating to the mutual agreement procedure shall get implemented.

(c) Artificial avoidance of Permanent Establishment (PE) status through commissionaire arrangements and similar strategies would be prevented. Avoidance of PE formation through specific activity exemptions and splitting up of contracts would also be prevented.

(d) Avenues leading to avoidance of capital gains from alienation of shares/ interests deriving value principally from immovable property would be plugged.

(e) Certain dividend transfer transactions that are intended to lower withholding taxes payable on dividends artificially would be prevented.

On 25th June, 2019, India has deposited the Instrument of Ratification to OECD, Paris along with its final position in terms of Covered Tax Agreements, reservations, options and notifications under the MLI, as a result of which MLI will enter into force for India on 1st October, 2019 and its provisions will have effect on India's DTAAs from FY 2020-21 onwards. Out of 93 CTAs notified by India, 30 countries have already ratified as on date 19th December, 2019[9] and the DTAAs with these countries will be modified by MLI.

13.4 Explanatory Statement to MLI[10]

Legal Framework of MLI

Each signatory to MLI indicates its position as to what tax treaties it would like to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI positions until ratification. Even after ratification, the parties can change their positions or withdraw reservations. MLI is not like an amending protocol to a tax treaty which would set out amendments to the text of specified provisions of treaty. Instead MLI is applied alongside existing bilateral treaties, modifying their application in

[9] *Signatories and Parties to the Multilateral Convention status as of 19 December 2019*
[10] *http://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf*

order to implement the tax treaty related BEPS measures. MLI does not freeze the underlying bilateral tax treaties in time. Group of experts recommended an effective and swift way of amending bilateral treaties through MLI for implementing BEPS measures. MLI modifies any tax treaty in force between parties to the MLI which has been listed by both contracting jurisdictions, which they wish to be covered by MLI as "Covered Tax Agreement" ("CTA").

The term "Modification" was deliberately chosen after an in-depth discussion among the Group of experts. MLI follows general legal principle that when two rules apply to same subject matter, the later in time prevails *(Lex posterior derogate legi priori)*. In case they are incompatible, subsequent treaties (i.e MLI) would prevail over previously concluded treaty between the same parties on the same subject matter (i.e. CTA).This rule is explicitly set out in Article 30(3) of the VCLT 1969 in line with customary international law. The existing provisions of CTA will now be modified through mutually chosen options of the MLI. Such mutual consent can continue to be modified in the future also either by a protocol, another MLI or termination of treaty. Modification is through Compatibility Clauses such as "in place of", "modifies", "in the absence of" or "in place of or in the absence of" an existing provision in the bilateral treaty. The Explanatory Statement was prepared by the participating countries in the adhoc group to provide clarification of the approach taken in the convention and how each provision is intended to affect CTAs. It therefore reflects the agreed understanding of the negotiators with respect to MLI. It includes descriptions of the types of treaty provisions which are intended to be covered and the ways in which they are intended to be modified. Explanatory Statement is intended to clarify the operation of the convention to modify CTAs, it is not intended to address interpretation of the underlying BEPS measures (except the mandatory binding arbitration provisions contained Art.18 through 26 as noted in para.19 and para.20) of the Explanatory Statement. Accordingly, the provisions contained in Articles 3 through 17 should be interpreted in accordance with the ordinary principles of treaty interpretation, which is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the term of the treaty in their context and in light of its object and purpose. In this regard the object and purpose of the convention is to implement the tax related BEPS measures. Minimum standards are prescribed through Action plan 6 dealing with treaty abuse and Action plan 14 dealing with Dispute Resolution Mechanism.

13.5 Minimum Standards and Options

Prevention of treaty abuse and effective dispute resolution have been prescribed as minimum standards in the entire OECD / G20 BEPS inclusive framework agenda. These two minimum standards are agreed upon for mandatory implementation by all the members of the Inclusive Framework. Countries agree that introduction of BEPS measures should not lead to unnecessary uncertainty for compliant tax payers and to unintended double taxation. Improving dispute resolution mechanisms is therefore an integral component of the work on BEPS issues. The two minimum standards have been covered in four Actions that are

- Action 5 on harmful tax practices
- Action 6 on tax treaty abuse
- Action 13 on country-by-country reporting
- Action 14 on mutual agreement procedure

It is interesting to note the progress achieved on the minimum standards as per the progress report given by OECD in May 2019[11] which is as under:

(a) Action 5 (Harmful tax practices): 255 preferential tax regimes have been reviewed to ensure that there is substance associated with the activities they are intended to attract, and more than half have already been amended or abolished, with the others either already in accordance with the standard or still in the process of being reviewed or reformed. Exchanges of information on more than 21,000 tax rulings took place, thereby ensuring greater transparency of the arrangements between tax administrations and tax payers.

(b) Action 6 (Tax treaty Abuse): MLI has been signed by 88 jurisdictions which will impact more than 1,500 bilateral tax treaties once the respective Governments finalize the ratification process. Around 20 member countries have ratified the MLI and have deposited their ratification instruments including final positions with OECD secretariat. All measures relating to prevention of treaty abuse would become effective in the respective tax treaties as modifications.

(c) Action 13 (country-by-country reporting(CbCr)):The first exchange of

[11] *OECD/G20 Inclusive Framework on BEPS Progress Report July 2018 - May 2019*

CbCr reports took place in June 2018 and currently there are more than 2000 relationships in place for the exchange of CbCr reports, under the Convention for Mutual Administrative Assistance in Tax Matters, under bilateral double tax conventions and tax information exchange agreements.

(d) Action 14 (Mutual Agreement Procedure): It is to be noted that around 85 percent of MAP pending cases have been concluded in 2017 by resolving the disputed issues. Almost 60 percent of MAP cases closed were resolved with an agreement fully resolving the taxation not in accordance with the tax treaty. This is a very commendable development in furthering the cause of effective dispute resolution.

13.6 India's Journey towards MLI

India has been an active member of G20 and participated in OECD / G20 IF BEPS initiative from the beginning. All the anti-abuse and anti-avoidance rules as brought in by different BEPS actions have culminated into MLI which is published on 24th November, 2016. First signing ceremony of MLI happened on 7thJune, 2017 where in 67 member countries including India have signed the MLI. On 1st July, 2018 MLI entered into force with five jurisdictions Austria, Isle of Man, Jersey, Poland and Slovenia depositing of their respective instruments for Ratification, Acceptance or Approval. On 13th June, 2019 Indian Government approved ratification of MLI. On 25th June, 2019, India has deposited the Instrument of Ratification to OECD, Paris along with its final position in terms of Covered Tax Agreements, reservations, options and notifications under the MLI, as a result of which MLI will enter into force for India on 1st October, 2019 and its provisions will have effect on India's DTAAs from FY 2020-21 onwards. Out of 93 CTAs notified by India, 23 countries have already ratified and the DTAAs with these countries will be modified by MLI.

13.7 Indian CTAs that were ratified so far

List of the jurisdictions that have notified tax treaties with India as CTAs and have deposited their ratification instruments with OECD secretariat by 27th May, 2020 is as under.

Austria	Malta	Serbia	Denmark	Portugal
Australia	Ireland	Singapore	Latvia	Indonesia
Belgium	Israel	Slovak Republic	Mauritius	Czech Republic
Finland	Japan	Slovenia	Norway	Cyprus
France	Netherlands	Sweden	Ukraine	
Georgia	New Zealand	United Kingdom	Iceland	
Lithuania	Poland	UAE	Saudi Arabia	
Luxemburg	Russia	Canada	Qatar	

13.8 Modifications brought in through MLI – Key Impact Areas on Indian tax treaties

Key prominent modifications in the Indian tax treaties are as under (93 CTAs)

(a) Prevention of tax treaty abuse

- This is a minimum standard covered by BEPS Action 6 to tackle treaty abuse
  - Insertion of new preamble and principal purpose test (PPT) in all CTAs
  - PPT is going to replace any existing anti-abuse provisions in the CTAs.
  - India has also chosen simplified limitation of benefits test (SLOB) which will be applicable only if the respective treaty partners also opt for it.

(b) Expanded scope of permanent establishment

- Dependent Agency PE (DAPE) to trigger if such DAPE habitually plays a principal role leading to the conclusion of contracts.
- Exemption of specific activities only if they are preparatory or auxiliary character (Option A as chosen by India) along with anti-fragmentation rules.
- Anti- splitting up of contracts

(c) Improving Dispute resolution Mechanism

- MAP request to be made by the tax payer to the competent authority of the state of which he is a resident.
- MAP request to be implemented through bilateral negotiation or consultation process.
- India strongly opposed mandatory binding arbitration proposed by Articles 18-26 of MLI.
- India agreed to bring in Article 9(2) in every treaty where it did not exist in the past to provide for corresponding adjustment if there is double taxation arising out of transfer pricing adjustments.

(d) Other Key Modifications

- Change of tie-breaker rule in case of dual residency of non-individuals now to be decided by competent authorities of the contracting states.
- Taxation of capital gains from alienation of shares/ interests deriving value principally from immovable property may also be amended.

(e) Select Indian tax treaties – How MLI is going to operate

- MLI provisions are going to enter into effect for the following Indian tax treaties from 1st April 2020 for both WHT and other taxes
- India-France tax treaty
  - Only PPT to be added since France has not opted for SLOB
  - Broader agency PE rule applicable since France has notified India tax treaty
  - Avoidance of PE status through specific activity exemptions related provision not applicable since France has not chosen same option; anti-fragmentation rule applies.
  - Splitting up of contracts related provision not applicable since France has made a reservation
- India-UK tax treaty
  - Only PPT to apply since UK has not opted for SLOB
  - Broader agency PE rule not applicable since UK has made a reservation

- —— Avoidance of PE status through specific activity exemptions related provision not applicable since UK has not chosen any option but anti-fragmentation rule applies
- —— Splitting up of contracts related provision not applicable since UK has made a reservation

- India-Netherlands tax treaty
  - —— Only PPT to be added since Netherlands has not opted for SLOB
  - —— Broader agency PE rule not applicable since Netherlands has made a reservation
  - —— Avoidance of PE status through specific activity exemptions related provision applicable since Netherlands has chosen same option; antu-fragmentation rule applies
  - —— Splitting up of contracts related provision applicable
- India-Singapore tax treaty
  - —— Only PPT to apply since Singapore has not opted for SLOB
  - —— Broader agency PE rule not applicable since Singapore has made a reservation
  - —— Avoidance of PE status through specific activity exemptions related provision not applicable since Singapore has not chosen same option
  - —— Splitting up of contracts related provision not applicable since Singapore has made a reservation
- India – Australia
  - —— Only PPT to be added since Australia has not opted for SLOB
  - —— Broader agency PE rule not applicable since Australia has made a reservation
  - —— Avoidance of PE status through specific activity exemptions related provision applicable since Australia has chosen same option; anti-fragmentation rule applies.
  - —— Splitting up of contracts related provision applicable

13.9 Interpretation of MLI - Challenges & Issues

13.9.1 MLI vs CTAs

It is a massive achievement on the part of OECD/ G20 IF to make MLI a reality. Multilateralism is being experimented in a significant manner to modify the existing tax treaties in order to bring in anti-abuse and anti-avoidance measures in an effective manner. Explanatory Statement emphasizes that the MLI modifies tax treaties not by directly amending the text of the tax treaty but by being applied together with the relevant CTA.

MLI is not intended to act as an amending protocol to a tax treaty which would set out amendments to the text of the specified provisions to the treaty, but to function as a legally independent international agreement between the same parties as does the CTA[12].

OECD's proposition to interpretation is that both the MLI and CTAs must be interpreted separately on a standalone basis, only being linked by Article 2 (2) of MLI. Article 2(2) of MLI only deals with the role of a CTA in interpreting the MLI, but says nothing regarding the effect of the MLI on the CTA in question. However, a closer examination of the MLI[13] reveals that the clear distinction between the MLI and CTAs becomes more and more unclear the deeper the substantive parts of the MLI are analyzed[14].First of all it is very critically important to address the question whether the MLI changes the text of a CTA both from international law perspective and domestic constitutional law perspective. The flexibility given to the member countries of IF to deal with any amendments to the existing tax treaties in a bilateral process subsequent to signing the MLI is unquestionable. Such flexibility available to member countries may not necessarily result as a consistent approach in line with the agenda of MLI agreed upon. This could create a dichotomy in interpreting a bilateral tax treaty with respect to amendments carried out post MLI ratification. Modification of the existing provisions of the bilateral tax treaty is proposed to be carried out by MLI through compatibility clauses, reservations and notifications such as "in place", "modifies", "in the absence of", or "in place of or in the absence of" an existing provisions in the bilateral

[12]*Daniel W Blum – Article published online 12/2/2018 / Bulletin for international taxation, 2018(Volume 72), No.3*

[13]*Daniel W Blum – Article published online 12/2/2018 / Bulletin for international taxation, 2018(Volume 72), No.3*

[14]*M.Lang, Die Anwendung des Multilateralen Instruments (MLI) "Alongside existing Tax treaties", 12 SWI 27,p. 624 et seq. (2017)*

treaty. In other words, subsequent modifications of CTA under Article 30 should not be in conflict with the obligations set out to the member countries in the MLI.

13.9.2 *Lex posterior, Lexspecialis* or subsequent agreement to CTAs – Article 31(3)(b) of VCLT (1969)

The Explanatory Statement to the MLI emphasizes that principle of *lex posterior* as stipulated in Article 30(3) of the Vienna Convention will apply for the enforceability of MLI and with regard to the relationship between the MLI and CTAs. Legal principle of Lex posterior provides that when two rules apply to the same subject matter, the later in time prevails (*Lex posterior derogatlegi priori*). As per the interpretative principles under customary international law, Lex posterior rule would apply only when there is normative conflict between the MLI and a given CTA. Both the *Lex posterior* rule and the *Lex specialis* rule presuppose a normative conflict between two equally applicable rules. In other words, the principles of *Lex posterior* and *Lex specialis* do not apply as long as there is no normative conflict between the MLI and a given CTA[15].

Two rules can be understood to be normatively conflicting if they have the same legal pedigree, have the same personal and material scope, that is the same subject and object, but accord conflicting legal consequences to their application. Then it is to be examined whether there is any normative conflict between the MLI and CTA.As we understand CTAs main objectives are allocation of taxing rights and avoidance of double taxation whereas MLI is brought in to modify the content of certain provisions of CTA. MLI proceeds on the criteria of the substance over form compared to those rules in the past which were based on the form. Whether this difference in both the instrument that is CTA and MLI, would it result in a normative conflict giving rise to different results regarding the same subject matter. It can always be argued that what is purport that is proposed to be brought in by MLI as a modification for achieving prevention of treaty abuse has always been an objective of the CTAs even in the past (OECD commentary on Article 1). MLI is not changing any allocation of taxing rights. It is only broadening, for example, the PE rule going by the substance approach. Whether these modifications being brought in by MLI compared to the existing text of

[15]*For a general overview, see N. Bravo, The Multilateral Instrument and its relationship with tax treaties, 8 World Tax J. 3 , sec. 3. (2016), Journals IBFD*

provisions of the CTAs, can be considered as a normative conflict so as to apply *Lex posterior* rule as per Article 30 (3) of Vienna Convention.

However, Article 30 of the Vienna Convention (1969) is not only potentially relevant provision in determining the relationship between the MLI and CTAs. From the perspective of CTAs another provision of the Vienna Convention (1969) also appears to be relevant. In this respect, it should be noted that Article 31 (3)(b) of the Vienna Convention reads "There shall be taken into account, together with the context: any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions"[16].

Then, can we consider MLI as subsequent agreement to a CTA that has been concluded between the same parties regarding interpretation or application of its provisions?

The very purpose of MLI is to bring out modification in the CTAs. In this scenario whether MLI *per se* can be treated as a separate international agreement unconnected with CTA?

If MLI is treated as a subsequent agreement under Article 31(3)(b) of the Vienna Convention would it alone be sufficient as an interpretative argument in respect of interpretation of provisions of modified CTA.

In other words, whether the MLI would overshadow all the other interpretative arguments that can be normally considered in the routine interpretation under the public international law? OECD's approach is to keep the MLI and CTAs as separate agreements. If MLI is dominant in its approach so as to change the very context of the CTA by insertion of new preamble through Article 6, one needs to make an effort to reconcile the import of Article 30 which gives bilateral treaty partners the flexibility of amending provisions of CTA at a later point of time. Article 30 of the MLI makes it clear that states are free to amend their bilateral tax treaties in any way that they desire in the future and arguably, setting aside the politically more delicate Minimum Standards, even to entirely reverse the provisions of the MLI without the consent of the other parties to the MLI[17].

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[16] *R.K. Gardiner, Treaty Interpretation 2nd edn., p. 250 et seq. (Oxford U. Press 2015)*
[17] *Daniel W Blum – Article published online 12/2/2018 / Bulletin for international taxation, 2018(Volume 72), No.3*

13.9.3 Article 2(2) of MLI and Article 3(2) of OECD MC – "Terms not defined"

In order to interpret the provisions of MLI it requires application of interpretative methods set out in Vienna Convention 1969. Scholars would critically examine whether the provisions of MLI change the text of an existing CTA or not. In either of the situation it is mandatory that interpretative methods set out in the Vienna Convention 1969 have to be applied.

Article 2(2) of MLI states that "*As regards the application of this Convention at any time by a party, any term not defined herein shall, unless the context otherwise requires, have the meaning that it has at that time under the relevant Covered Tax Agreement".* It provides that if any term is not defined in MLI, and unless the context otherwise requires, it leads us to consult the CTA for such definition of the term. If there is no definition that exists in the CTA then Article 3(2) of the CTA springs into action. Article 3(2) leads us to the definition available under the domestic tax laws of the state applying the treaty over a meaning given to term under other laws of that state. Even in the wording of Article 3(2) we have the words "unless the context otherwise requires". So in this scenario one needs to have clarity which "context" would prevail i.e. is it the context under MLI or is it the context under the CTA when it was bilaterally signed. There could be a practical situation where context of the CTA which was signed many years back would have been different from the context of MLI which was entered into by the respective treaty partners recently. In such a scenario which context would prevail?

In this backdrop it is very relevant to note Professor Michael Lang's view point that, in principle, an autonomous interpretation based on the context of MLI is to be preferred over the immediate recourse to the CTA[18].The very wording embedded in Article 2(2) making a reference to seek the meaning of the term undefined from the relevant CTA, indicates and confirms the bilateral approach that is embedded in the MLI. Probably this would clearly lead an interpreter to consult the concerned CTA. Of course, this is where one needs to examine a situation where the context of the CTA differs from the context of MLI and if it is so which one would prevail? A CTA has always two important objectives and that are

1. Avoidance of double taxation.
2. Prevention of fiscal evasion.

[18]*M.Lang, Die Auslegung des Multilateralen Instruments, 1 SWI 11 (2017)*

OECD G20 BEPS IF focused with a specific agenda on tax avoidance and double non taxation. Hence the context of MLI is very specific with respect to prevention of treaty abuse and avoiding double non taxation. Hence the context of MLI subsumes the context of CTA not in a different manner but in a more effective manner. Therefore, the context of MLI seems to prevail over the context of CTA, what was agreed upon at the time of signing the CTA. This legal position has been reconfirmed by the Explanatory Statement at Para 38 clarifying that context of the CTA gets changed through insertion of preamble modified by Article 6 of MLI. The exact wording is "*For this purpose, the context would include the purpose of the Convention, as described in paragraphs 1 through 14 above, and of the Covered Tax Agreement, as reflected in the preamble as modified by Article 6 (see paragraphs 21 to 23 above, related to the preamble of the Convention, and paragraph 76 below, related to Article 6*)".

Consequently, the OECD has tried to retroactively align the object and purpose of both the MLI and CTA[19].

It is also discussed by the scholars whether domestic law provisions would be relevant in the interpretation governed by Article2 (2) of the MLI, other than in case of Article 3(2) of the OECD Model is consulted in the hierarchy? Various terms such as "transparent entities, shares, stock, voting rights or similar ownership interests of the company paying dividends, immovable property etc" are to be understood in the context of domestic law of the contracting states and not otherwise.

The context of the MLI, therefore can and will, in certain limited circumstances, require the domestic law of the contracting states to be taken into account[20].

13.9.4 BEPS Action Plan Final Reports, Revised OECD Model and commentaries Vs MLI

In the context of BEPS initiative after the release of final reports of Action plans OECD Model convention has been revised in line with the same and version 2017 has been released. Consequently, commentaries on the OECD Model 2017 were also released. Whether revised OECD Model Convention and corresponding commentaries will form part of the "context of the MLI" is

[19]*Daniel W. Blum (supra)*

[20]*In the context of Article 3(2) of the OECD Model, see M.Lang, Art 3 Abs 2 OECD – MA und die Auselegung von Doppelbesteuerungsabkommen, IWB 8, p. 289 et seq (2011).*

a question to be addressed? It is relevant to consult Para 45 of Explanatory Statement which reads as under "*Accordingly, the provisions contained in Articles 3 through 17 should be interpreted in accordance with the ordinary principle of treaty interpretation, which is that 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 light of its object and purpose. In this regard, the object and purpose of the Convention is to implement the tax treaty-related BEPS measures. The commentary that was developed during the course of the BEPS Project and reflected in the Final BEPS Package has particular relevance in this regard".* The text of the MLI was adopted on 24th November, 2016 and the revised OECD Model and commentaries were notified in 2017 in line with BEPS initiative. To the extent that the OECD Commentaries (2017) reflect the final reports of the part of the context of the MLI and, therefore play an important role in its interpretation. In circumstances in which the final reports of the OECD/G20 BEPS initiative reserved a final conclusion to the OECD Model (2017) or, in other words where the OECD Commentaries (2017) go beyond what is said in the Final Reports, this is, however, doubtful[21].

It is therefore possible to take a view that OECD MC (2017) and Commentaries (2017) form part of the MLI.

[21]*Daniel W. Blum (supra)*

Chapter 14
Taxation of Digitalized Economy

14.1 Unilateral Actions by different tax jurisdictions on digital taxation[22]

14.1.1 India's New Nexus and Equalisation Levy

India introduced an equalisation levy of 6% in 2016. With the new levy, any Business to Business (B2B) payment made to a non-resident in respect of online advertising is withheld by the resident taxpayer. The gross value tax is aimed at digital business models, such as Google and Facebook. The equalisation levy does not apply when a non-resident service provider maintains a PE, in which case the income tax rate of 40% applies and expenses may be deducted from the tax base. India may extend its Google tax to include streaming and marketing services like those offered by Facebook, Amazon.com and Netflix Inc.

In addition, India amended the concept of 'business connection' to include a significant economic presence in its Finance Act of 2018. Such a move could impose a 40% tax on any foreign company rendering digital goods and services to India.

The Indian SEP test is divided into two limbs: The first limb is triggered if aggregate of payments arising from transactions are carried out by a non-resident in India, including the download of data or software exceeding a certain threshold in India. The second limb is kicked off if such business activities are conducted in a systematic and continuous way in interaction with a certain number of users. The SEP applies even when there is no local agreement signed, independently of the existence of a fixed placed of business of the non-resident who may or may not provide services to local customers. The Finance Act 2020, has clarified certain aspects relating to Significant Economic Presence. The transaction carried out by a non-resident ***with any person*** in India will be subject to the scope of SEP. Also, the words "through digital means" has been removed, thereby intending that activity through any means may include in the scope of SEP. Vide

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[22]*http://www.europarl.europa.eu/RegData/etudes/STUD/2019/626078/IPOL_STU(2019)626078_EN.pdf*

Explanation 2A of Section 9 (1) (i) of the Act, the provisions of Significant Economic Presence will be applicable from AY 2022-23.

In addition to the existing equalization levy under Section 165 of the Finance Act, 2016, in March 2020, Government of India has introduced additional provisions for charging equalization levy in respect of e-commerce transactions by inserting a new Section 165Athrough Finance Act, 2020. Under the new provisions, an equalization levy of 2% is levied on every e-commerce transaction of an e-commerce operator whose sales, turnover or gross receipts from e-commerce transactions are/is Rs.2 Crore or more during the previous year. Equalization levy is charged broadly in respect of two types of transactions. One, is e-commerce transaction which is in the form of supply of goods or services by or through e-commerce operator where such supply is made to a resident or to a customer who avails such services by using internet protocol address located in India. Two, is e-commerce transaction with a non-resident, where such transaction is in the form of sale of advertisement which targets Indian customers or sale of data which is collected from a person in India. However, no equalization levy is levied where such e-commerce operator has PE in India and such transactions are effectively connected with such PE. Further, where the transaction is covered under the existing provisions, i.e. under Section 165 at the rate of 6%, no separate levy under Section 165A shall be levied.

14.1.2 UK's Diverted Profits Tax

The UK's diverted profits tax was conceived as a response to BEPS activities facilitated by digital businesses, circumventing PE status despite having significant economic presence through intragroup mismatch arrangements to shift profits. The measure is tied to the presence of PE standard, in the absence of which it could not apply.

The Diverted Profit Tax aims at establishing a nexus between the entity producing the income and the place where the income originates. The tax is an upfront tax at 25 % (as opposed to the UK Corporate Income Tax of 19%) and is of a punitive character. The conditions are purposeful avoidance of PE and structures lacking economic substance and mismatch arrangements to shift profits. In case there is a tax mismatch in that the tax paid by a company abroad is less than 80 % of the tax avoided, tax reduction is perceived as one of the main purposes of the arrangement. If these conditions are satisfied, a 25 % tax applies to diverted profits.

In April 2018, the UK proposed a targeted royalty withholding tax applicable to IP royalties paid by a non-UK resident entity to a related party in a low-tax jurisdiction. A withholding tax is a step towards taxing the digital economy by reference to nexus of consumer and user base rather than physical presence. The proposed tax requires no UK presence for the taxpayer beyond a UK customer base. The withholding tax would be waived if the non-resident has a PE or is subject to diverted profits tax. The UK-resident related parties to the non-resident supplier would be made jointly liable for the tax.

14.1.3 Australia's Multinational Anti-Avoidance Law (MAAL)

Australia introduced a similar tax to the UK's DPT: The Multinational Anti-Avoidance Law. The tax, which is also dependent on PE condition, puts the burden of proof on the non-resident. A draft guidance issued on May 2nd2018 further clarified this tax, which will be subject to a low-threshold connection test between the company and its supply of a product or service. The connection test will be satisfied irrespective of whether the supply of a product or service has occurred. Examples to the included activities are: Attracting new customers (through local advertising campaigns), procuring demand for sales, supporting the execution of supply through supplier arrangements (telephone based assistance to customers by local support staff), and relating to the ability to supply the goods or service.

14.1.4 Italy's Web Tax

The Finance Law 2018 in Italy introduced a web tax, which will be applicable from January 2020onwards. The 3% tax is applicable to Internet services distinguished by minimum human intervention and use of technology, provided both by Italian resident and non-resident entities to local business recipients. The new tax will be settled by the buyers of the service. The minimum threshold is 3000 transactions per year. The special turnover tax does not take into account expenses and is not creditable against Italian income tax. The tax is intended to apply to intangible goods, such as online advertising and sponsored links, but not to online retail. The Italian Income Tax Code has also introduced a Significant Economic Presence (SEP) test and amended the definition of PE. The SEP test shall apply where factors, such as revenues and numbers of customers, are located but physical presence is not necessarily needed to indicate a significant presence.

Italy has also passed a new transfer pricing rule that stipulates the use of valuation techniques other than cost-based indicators for determining the arm's length prices of digital transactions.

14.1.5 Austria's Online Advertisement Tax

Austria extended the scope of its national tax to include online advertising. With the new measures, which came into force in 2018, the Government intends to reduce the advertisement tax while broadening the tax base to include online advertising.

14.1.6 France's YouTube and GAFA Tax

In France, a 2% tax levied on the advertising revenue by resident or non-resident platforms broadcasting free or paid videos online, such as YouTube or Netflix, came into effect in the beginning of 2018. The tax complements tax mechanisms for online television platforms or video-on-demand services. Although the tax was found compatible with the EU laws, concerns arise as to its narrow scope and difficulties regarding collection from the platforms located abroad. France also introduced its so- called "GAFA tax"—named after Google, Apple, Facebook and Amazon—to ensure the global internet giants pay a fair share of taxes on their huge business operations in Europe (applies as from 1 January 2019).

14.1.7 Hungary's Advertisement Tax

Hungary's Advertisement Tax Act, introduced in 2014, targeted advertisement turnover of companies, which were subject to progressive tax rates ranging from 0% to 50%. A first amendment was made to the law following the launch of the European Commission investigation in July 2015 to limit targeting sales revenues over a smaller range of 0% and 5.3%. The upper threshold was applied to companies exceeding 100 million Hungarian Forints (HUF) in revenues. On 4 November 2016, the European Commission found that Hungary was in breach of EU state aid rules because its progressive tax rates granted a selective advantage to certain companies. Hungary amended its advertisement tax again in 2017 to comply with the EU rules, raising the upper threshold of the progressive tax rate to 7.5% for taxpayers with sales revenues from advertising over HUF 100 million. The de minimis threshold at which the tax kicks in was retained despite the European Commission's warning that a low turnover could give unfair advantages over competitors.

The tax does not target the digital sector but is considered to be influential in the operation of the digital market.

14.1.8 Israel's New Nexus and Significant Economic Presence Test

In April 2016, Israel published guidelines on changes to income tax and VAT which expand the concept of the PE to include non-resident online businesses, which sell or provide services through Internet to Israeli residents. The proposals focus on instances in which income of foreign company could be attributed to a PE in Israel in the context of digital economy. A virtual PE would be established for companies with a significant presence, even if these activities are of preparatory and auxiliary nature. To countries with which no treaty has been concluded, a significant digital presence test will be applied taking into account the number of contracts concluded with local customers, adjustments to the online services for Israeli users (i.e. the use of Hebrew language and local currency), high web traffic by local users, a close correlation between the consideration paid to the foreign company and the level of Internet usage.

14.1.9 Saudi Arabia and Kuwait's Virtual PE

Saudi Arabia and Kuwait introduced the virtual service PE, which can be triggered even in the absence of physical presence, when a non-resident provides services to local customers. Any services performed for more than 6 months under cross-border agreements between non-resident and local consumers create a virtual PE. In this context, the OECD notes a minority view that physical presence is not required under the Article 12 of the UN Model Convention on fees for technical services adopted in 2017, but concludes this is at risk of taxpayer challenge and its efficiency is not known. Like Saudi Arabia, other countries started re-interpreting the concept of the PE and creating a digital PE. Recent discussions and actions start regarding websites as potential PEs and even consider them as a 'virtual PE'.

The Indian Equalisation levy, which was inspired by the OECD's 2015 Final Report, drew much criticism. The Indian levy is imposed just on transactions effectuated through a digital platform and it is applicable only when a non-resident enterprise has a significant economic presence, covering only cross-border B2B transactions.

However, it differs from the OECD proposal for the reason that it is collected by the service recipient and not by the foreign enterprise or local intermediary. In this sense, it is similar to an income tax. Although India

defends the opposite view, chances are high for the tax to be covered by India's tax treaties. **Such new taxes give rise to legal uncertainty and lead to arbitrary distinctions**, as they combine elements of taxes on profits with elements of consumption taxes and defy clear classification for tax treaty purposes. The uncertainty extends to treaty overrides and tax treaty arbitration.

The **nature of the Indian levy** is also questioned. While it shares common features with both income tax and turnover tax, some believe that it is neither an income tax nor a turnover tax and thus, should come on top of existing direct and indirect taxes. There are also uncertainties about the scope of the levy as to whether or not it covers all transactions concluded remotely or just those effectuated through a digital platform.

The equalisation levy introduced in India was seen by some as **an attempt to engage in 'treaty dodging'** by delinking the taxation of digital transactions from tax treaties with the introduction of a new levy not covered therein. As the levy would be carved out of income taxation, it cannot be credited against tax paid by the foreign company in its residence country. Yet, the manner in which taxes are levied is of no relevance for their inclusion in the scope of application of tax treaties.

14.2 European Parliament's Report on digital taxation[23]

14.2.1 Key findings:

- The digital economy is growing exponentially while the whole economy is going digital. Digitalization transforms entire industries by changing the nature of innovation, product development and producer-consumer interactions.
- Digital businesses have a tendency towards monopolization due to network effects, scale effects, restrictions of use, potential to differentiate and multi-sided platforms. Yet, they are volatile and easily contestable by disruptive newcomers, as barriers of entry and exit are low.
- The Fourth Industrial Revolution marked by 'a range of new technologies that are fusing the physical, digital and biological worlds, impacting all disciplines, economies and industries' fundamentally changed the way of doing business.

[23]*http://www.europarl.europa.eu/RegData/etudes/STUD/2019/626078/IPOL_STU(2019)626078_EN.pdf*

- The intensity, magnitude, speed and transformational power of the digital economy puts pressure on Governments to design and address modern and innovative policies fit for the digital age.
- Lux Leaks, Panama Papers and Paradise Papers as wells the EU investigations on digital tech giants shed light on a wide range of tax evasion schemes used by large businesses triggering a heated public debate on the need for fair taxation.
- The main tax challenges of the digital economy include lack of nexus, reliance on intangibles, data and user-generated content, income characterization, spread of new business models, in which the buyer and seller are in different jurisdictions and the expansion of e-commerce.
- New digital business models are emerging and expanding as a consequence of AI, IoT, adaptive manufacturing and autonomous supply chains.
- The European Commission (EC) divides digital businesses into online retailer model, social media model, subscription model and collaborative platform model while the OECD defines them as multi-sided platforms, resellers, vertically integrated firms and input suppliers.
- Some traditional industries, such as automotive manufacturing, have begun to digitize their processes and services.
- The digital transformation puts into question the existing taxation framework and the role of new technologies as well as high-skill jobs for value creation, with market jurisdictions highlighting the income-generating contribution of data and user interaction. According to the Commission, in some digital business models, including social media, distant sales, platforms and advertising, value is not linked to taxation.
- The OECD discusses three value creation processes: value chain, value shop and value network, the latter of which represents the strongest case for value creation in the market and accounts for online advertising and intermediation services.
- There is no strong consensus within the OECD on whether or not user contribution shall be taken into consideration to determine how value is created for taxation purposes.

- Although user data are in the centre of discussion at present time, the digitalization of the economy underpins that broad spectrums of data could be turned into smart data in the near future.

14.2.2 Conclusion and policy recommendations:

Rapid digitalization of the economy, new business models and the challenges they pose to the international tax system

- Only after some 20 years of their inception, the **ever-increasing prominence of tech companies** is unstoppable. **Business models are rapidly evolving** and new business models are emerging due to Internet of Things (IoT), Artificial Intelligence (AI), collaborative economy and other technological advancements.
- With digitalisation allowing businesses activities to spread across the globe, it is more and more **complex to identify the location of value creation** and to decide on how to allocate profits.
- In addition to globalisation, '**environmental unsustainability, demographic change, inequality and political uncertainty'** may all be relevant to thoroughly address digital transformation
- **Tax competition** and the ensuing race to the bottom also contribute to inequality. According to Oxfam, 62 people own the same wealth as the bottom 3,6 billion people in the world. Over the last thirty years, net profits by the MNEs tripled from USD 2 trillion in 1980 to USD 7.2 trillion by 2013. This increase shall be properly reflected in the amount of taxes they pay instead of being accumulated in tax havens.
- Soon, a fully digital world disrupting some fundamental assumptions of the international tax system could emerge. The Block chain technology, collaborative economy, AI, robotics and 3D printing started already changing the taxation landscape.
- **The current PE threshold** is not sufficient for fair allocation of profits. The **unilateral measures** in countries such as France, Italy, Israel, India, as well as at the EU level show a search for a **new nexus** to capture companies with a solely digital presence. **Developing countries**, such as India, argue that paying capacity of the consumer is made possible due to the state's contribution via public goods, law, order, market facilitation, infrastructure and redistribution.

- The reluctant states might eventually agree **to limitations to their fiscal sovereignty** in favour of globally accepted standards, as digitalization limits their legitimacy and ability to tax.
- **Multilateralism** as a 'new tax principle' could be the response to the global solutions needed given the fact that unilateral measures proved insufficient to stop double non-taxation.

14.2.3 OECD's BEPS Measures and the Ambition to Reach International Consensus on Key Taxation Matters

- The **OECD supports the principle of aligning the application of tax rules with the legal form** unless the legal reality is totally disconnected from the economic reality.
- The broader tax challenges, including nexus, characterization and data, also largely remain unaddressed.
- It remains unclear whether there is **consensus** at the OECD level whether the digital economy should and can be ring-fenced or not.
- The lack of consensus on **value creation** leads to a multitude of profit allocation methods, which somewhat diverge from the arm's length principle.
- **Possible scenarios for taxing the digital economy** include specific taxes for the digital sector, to continue work on BEPS measures, especially regarding transfer pricing and value creation by amending the PE concept, granting more power to source countries via withholding taxes, radically changing the tax system by adopting a destination-based tax and integrating the digital sector in a formula-based transfer pricing regime, a formulary apportionment regime such as profit-splitting method or robust VAT measures to ensure compliance and collection.

14.3 OECD's interim report on tax challenges arising from digitalization – March 2018

14.3.1 This report gave an overview of rapid advancement of digitalization of the economy and how businesses are transforming themselves into more efficient and cost saving enterprises with the help of technology. The digital transformation is changing the way people interact with each other and society more generally, raising a number of pressing issues in the areas of

jobs and skills, privacy and security, education, health as well as in many other policy areas. Digitalization is an important source of entrepreneurship, lowering barriers to entry and more broadly affecting the business environment by bringing down transaction costs, increasing price transparency and improving productivity. It is now easier for businesses to communicate with suppliers, customers and employees using internet-based tools, and developments in ICT are also leading to the emergence of new and transformed business tools.

14.3.2 The global internet traffic has been constantly growing as per CISCO report 2016. An enormous amount of data is now generated by these constantly connected users and devices. Today, the annual volume of data created across the globe is estimated to double every year, with more than 44 zettabytes of data[24] expected to have been produced by 2020[25].This data is being collected by businesses and Governments, and combined with advances in data analytics and technology diffusion, are providing the insights necessary to transform and shape the way people behave and organizations operate.

14.3.3 Work under the OECD/ G20 BEPS project on the tax challenges arising from digitalization

Under Action 1 of the BEPS project OECD/G20 could not finalize the report on the tax challenges raised by the digitalization of the economy, as there was lot of further work to be done in that regard. To carry out this work, the Task Force on the Digital Economy (TFDE) was established as a subsidiary body of the Committee on Fiscal Affairs (CFA), with the participation of more than 45 countries[26] including all OECD and G20 members. In preparing the 2015 BEPS Action 1 Report, the TFDE drew from previous work on this topic, including the 1998 Ottawa report on *Electronic Commerce: Taxation Framework Conditions*[27], as well as the work of the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits[28].

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[24]*One zettabyte is equivalent to a trillion gigabytes, with a trillion being 1 000 billion).*
[25]*International Data Corporation (2014)*
[26]*References in this report to "country" or "countries" should be read as a reference to "country or jurisdiction" and "countries and jurisdictions", respectively.*
[27]*OECD (2001)*
[28]*OECD (2005)*

The 2015 BEPS Action Report, *Addressing the Tax Challenges of the Digital Economy*, was released in October 2015 as part of the BEPS package. The full BEPS package was endorsed by the G20 Leaders in November 2015, more than 110 countries and jurisdictions having committed to its implementation as members of the Inclusive Framework on BEPS, which was established in June 2016.

14.3.4 The Broader tax challenges raised by digitalization

Action 1 report identified broader tax challenges arising from digitalization, notably in relation to nexus, data and characterization. These challenges go beyond BEPS and chiefly relate to the question of how taxing rights on income generated from cross border activities in the digital age should be allocated among countries.

Action 1 also recognized that in the area of indirect taxation, new challenges arose in particular with respect to the collection of Value added tax (VAT)/ Goods and Services Tax (GST) on the continuously growing volumes of goods and services that are purchased online by private consumers from foreign suppliers.

In respect of the above mentioned challenges, Action 1 gave broad recommendation as under

- Indirect tax concerns have to be addressed by the countries by implementing the OECD's international VAT/GST guidelines, and in particular the destination principle for determining the place of taxation of cross border supplies, and consider implementing the mechanisms for the effective collection of VAT/GST presented in the guidelines.
- In order to address broader direct tax issues raised by digitalization, the TFDE analyzed three options, namely
  - (i) a new nexus rule in the form of a "significant economic presence" test
  - (ii) a withholding tax which could be applied to certain types of digital transactions, and
  - (iii) an equalization levy, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction.

None of these options were ultimately recommended in Action 1 report, however it was concluded that countries could introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. It was agreed to continue to monitor developments in respect of the digital economy, with a further report to be delivered by 2020.

14.3.5 The Interim Report on the Tax Challenges arising from digitalization - 2018

TFDE continued its work from where Action 1 Report left off, by continuously mobilizing interaction and liaisoning with stake holders, which led to the preparation of this interim Report.

Detailed study of different digitalized business models and an in-depth analysis revealed that the most salient common characteristics of digitalized businesses are as under

- **Cross-jurisdictional scale without mass**. Digitalization has allowed businesses in many sectors to locate various stages of their production processes across different countries, and at the same time access a greater number of customers around the globe. Digitalization also allows some highly digitalized enterprises to be heavily involved in the economic life of a jurisdiction without any, or any significant, physical presence, thus achieving operational local scale without local mass.
- **Reliance on intangible assets, including IP.** The analysis also shows that digitalized enterprises are characterized by the growing importance of investment in intangibles, especially IP assets which could either be owned by the business or leased from a third party. For many digitalized enterprises, the intense use of IP assets such as software and algorithms supporting their platforms, websites and many other crucial functions are central to their business models.
- **Data, user participation and their synergies with IP**. Data, user participation, network effects and the provision of user-generated content are commonly observed in the business models of more highly digitalized businesses. The benefits from data analysis are also likely to increase with the amount of collected information linked to a specific user or customer. The important role that user participation can play is seen in the case of social networks, where without data, network

effects and user-generated content, the businesses would not exist as we know them today. In addition, the degree of user participation can be broadly divided into two categories: active and passive user participation. However, the degree of user participation does not necessarily correlate with the degree of digitalization: for example, cloud computing can be considered as a more highly digitalized business that involves only limited user participation.

14.3.6 However, the tax issues raised by digitalization are technically complex, and this interim report identifies the different views among countries on whether and to what extent the features of highly digitalized business models and digitalization more generally should result in changes to the international tax rules. Overall, there is support for undertaking a coherent and concurrent review of two key aspects of the existing tax framework, nexus and profit allocation rules that would consider the impacts of digitalization.

14.3.7 There is no consensus on the merits of, or need for, interim measures, and therefore this report does not make a recommendation for their introduction. Chapter 6recognizes that a number of countries do not agree that features such as "scale without mass", a heavy reliance on intangible assets or "user contribution" provide a basis for imposing an interim measure and consider that an interim measure will give rise to risks and adverse consequences irrespective of any limits on the design of such a measure, including as a result of uncertainty and double taxation. Countries that are in favour of the introduction of interim measures acknowledge that such challenges may arise but consider that at least some of the possible adverse consequences can be mitigated through the design of the measure and that, pending a consensus-based global solution, there is a strong imperative to act to ensure that the tax paid by certain businesses in their jurisdictions is commensurate with the value that they consider is being generated in their jurisdictions. Where jurisdictions wish to proceed with consideration of interim measures, they have identified a number of considerations that they believe need to be taken into account as guidance to limit the potential for divergence and possible adverse side effects.

14.3.8 Such guidance given for the jurisdictions for introduction of any interim measures is broadly as under

- The interim measures should be compliant with international

obligations i.e. the measure must not come into conflict with tax treaties: membership of EU, European Economic Area and World Trade Organization.

- Interim measures should be temporary ceasing to apply once a global response to the tax challenges raised by digitalization has been agreed and is implemented.
- Given the potential adverse consequences of introducing an interim measure, it is important that the measure is as targeted as possible at those businesses that are perceived to constitute the highest risk.
- A key objective of an interim measure should be to balance the underlying policy objective of trying to address the rapidly emerging challenges raised by the digitalization of the economy while avoiding the risk of over taxation on taxpayers caught by the measure.
- The interim measures should be such that it minimizes impact on start-ups, business creation, and small businesses more generally.
- Compliance cost for taxpayers and tax administrations and complexity of the measure should always be a key consideration in tax policy design of an interim measure.

14.4 Addressing the Tax Challenges of the Digitalization of the Economy - Policy Note – January 2019

14.4.1 TFDE, as a follow up action to interim Report submitted in March, 2018, brought out policy Note on 23rd January, 2019. The Policy Note, proposes two pillar approach, on a without prejudice basis, which could form basis for consensus among member countries of the Inclusive Framework. Pillar One addresses the broader challenges of the digitalized economy and focuses on the allocation of taxing rights. Pillar Two addresses the remaining BEPS issues. Two Pillar approach would recognize the digitalization of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalized businesses. The following three proposals have been discussed under Pillar One.

- *User Participation:* This is based on allocate more taxing rights to market or user jurisdictions in situations where value is created by a business activity through participation in the user or market jurisdiction that is not recognized in the framework for allocating profits.

- *Market/User Contribution*: This proposal would apply to digitalized business models based on advertisement in a third country or the platform on the gig economy. This would recognize the value created by users of the digital services[29].
- *Marketing Intangibles:* The second approach has some commonalities with the first approach. Under this approach, there is a need to recognize the "marketing intangibles" which belongs to the market. When implementing both the nexus and the transfer pricing rules, there should be recognition of the value created by the marketing intangibles. There should be a taxing right belonging to the market jurisdiction. This broad proposal would not only address the digital economy but also addresses the traditional economy.
- *SEP:* The third proposal has already been the discussed in the BEPS Action plan 1 Report. There should be a nexus where there is a certain degree of sales in a jurisdiction. This should result in a new allocation of taxing rights. This has been supported by many developing countries like India, Columbia, etc.

On nexus, the Inclusive Framework agreed to explore different concepts, including changes to the permanent establishment threshold, such as the concept of "significant economic presence" which was discussed in the Action 1 Report or the concept of "significant digital presence", as well as special treaty rules.

The inclusive framework will be driven by right balance between accuracy and simplicity. This means that any solution needs to be administrable by tax administrations and taxpayers alike and take account of the different levels of development and capacity of members.

14.4.2 Under the second pillar, the Inclusive Framework agreed to explore on a "without prejudice" basis taxing rights that would strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits. These proposals recognize that in part the tax challenges of the digitalization of the economy form part of the larger landscape relating to remaining BEPS challenges and further reflect more recent developments such as US tax reform. The proposal under

[29]*As mentioned by Mr. Pascal Saint Amans in the OECD Webcast on the OECD Tax Talks on January 29th ,2019*

this pillar would be designed to address the continued risk of profit shifting to entities subject to no or very low taxation through the development of two inter-related rules, i.e. an income inclusion rule and a tax on base eroding payments.

14.4.3 The above proposals are only at discussion stage and no agreement has been reached so far. The whole effort is to mobilize consensus on one of these proposals which can be considered as more effective. It is also observed that any new rules to be developed should not result in taxation when there is no economic profit nor should that result in double taxation. It is also agreed that importance must be duly given for tax certainty and the need for effective dispute prevention and dispute resolution tools.

14.4.4 With the above mentioned parameters in the approach members of Inclusive Framework agreed that this work would be conducted on a "without prejudice basis."

14.4.5 Finally, inclusive framework decided to mandate the Steering Group to elaborate a detailed "program of work" to be placed before the next coming meeting in May, 2019.

14.5 OECD - Program of Work to Develop a Consensus Solution to the Tax Challenges Arising from Digitalization of the Economy

14.5.1 In continuation to Policy Note released on 29th January, 2019 TFDE agreed to examine four proposals involving two pillars which could form the basis for consensus. Pillar One focuses on the allocation of taxing rights (new taxing right) and seeks to undertake a coherent and concurrent review with the profit allocation and nexus rules. Pillar Two focuses on other BEPS issues and to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the taxes are paid at a very low rate in the source jurisdiction.

14.5.2 Thereafter, OECD has developed a "Program of Work" which would deal with technical issues that are grouped in the following three categories:

(a) Computation of Profits which will be subjected to new taxing rights which profits are to be allocated among the various market jurisdictions.

(b) The design of a new nexus rule that would capture a novel concept of business presence in a market jurisdiction where there is no physical presence of the enterprise.

(c) Different instruments to ensure implementation of the new taxing rights and efficient administration of the same including effective elimination of double taxation and resolution of tax disputes.

14.5.3 The IF expressed its deep concern that every member country should wait for a consensus approach in this regard and any unilateral and uncoordinated actions from different member countries would only undermine the relevance and sustainability of the international framework for the taxation of cross border business activities and would adversely impact global investments and growth.

The program of work is designed to provide a path for finding solutions of taxation of digitalized economies through consensus and also to create global anti base erosion rules under Pillar Two.

14.5.4 Pillar One – New Profit Allocation and Nexus Rules

The new taxing right requires quantification of amount of profits to be apportioned among the market jurisdictions where products/services of MNEs are sold.

New Profit Allocation Rules

Some of the methodologies shortlisted by TFDE after due consultation of the stake holders are as under:

Modified Residual Profit Split Method (MRPS):

MRPS starts on the basic presumption that value is created in respective markets by the demand side which contributes to MNE group's non routine profits. Allocation of such non routine profits is not recognized under the existing profit allocation rules. It involves the following four steps:

- Determine total profit to be split
- Remove routine profit, using either current transfer pricing rules or simplified conventions
- Determine the portion of the non-routine profit that is within the scope of the new taxing right, using either current transfer pricing rules or simplified conventions; and
- Allocate such in-scope non-routine profit to the relevant market jurisdictions, using an allocation key.

Fractional Apportionment Method:

This method works on the presumption that there is no distinction between routine and non-routine profits, accordingly determines the overall profits of the MNE group. This method involves the following three steps:

- Determine the profit to be divided
- Select an allocation key, and
- Apply this formula to allocate a fraction of the profit to the market jurisdiction(s)

Distribution- based approaches

This approach targets to address profits arising from routine activities associated with marketing and distribution. The approach is to suggest specific base line profit for marketing and distribution functions in the market jurisdiction. The specific ratio of profits suggested here is more like presumptive profits. In addition to the above fixed base line profit, some portion of the MNE group's non routine profit would also be reallocated to market jurisdictions depending on the facts of each case. The baseline profit (presumptive profit) would also be modified by additional variables such as industry and market differences.

Business line and Regional Segmentation

The above approach of calculating base line profit would be done on the basis of different business lines and different regions / markets. In other words, the base line profit would get adjusted on the basis of different business lines, regions/markets.

Develop rules on treatment of losses and design scoping limitations

It is observed that even treatment of losses must be undertaken under the new taxing right relevant to the market jurisdictions. It is also observed that design scoping limitations that could operate with reference to nature or size of given businesses would also be considered under this approach while determining the scope of the new taxing right.

New Nexus rules

A new non-physical presence nexus rule to allow market jurisdictions to tax portion of the MNE's overall profits relatable to the respective market jurisdictions requires an amended definition of PE rule in Article 5 and

corresponding changes in the Article 7 of the OECD MC. In the context of proposed new taxing right of market jurisdictions, a proper approach has to be evolved in respect, of how a source jurisdiction would exercise the new taxing right and how residence jurisdiction provide relief from double taxation in respect of such income. This whole exercise requires well deliberated approach to identify the tax payer on whom the new taxing rights would be exercised and the corresponding compliance obligations like tax filing etc. cast upon such tax payer. This new taxing right operates in the context of non-physical presence and computed beyond the scope of arm's length principle and hence requires necessary changes to the existing treaties for successful implementation.

14.5.5 Pillar Two – Global Anti – base Erosion Proposal (GloBE)

Pillar Two focuses on taxing rights exercised in the source jurisdiction where such source jurisdiction applies a low effective rate to tax such profits sourced. The proposal under Pillar Two is designed to address the continued risk of profit shifting to entities subject to no or very low taxation through the development of two interrelated rules:

- **An income inclusion rule** that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate; and
- **A tax on base eroding payments** that would operate by way of a denial of a deduction or imposition of source- based taxation (including withholding tax), together with any necessary changes to double tax treaties, for certain payments unless that payment was subject to tax at or above a minimum rate.

The proposal does not change the fact that countries or jurisdiction remain free to set their own tax rate. The GloBE proposal is based on the premise that in the absence of multilateral action, there is a risk of uncoordinated, unilateral action, both to attract more tax base and to protect existing tax base, with adverse consequences for all countries, large and small, developed and developing, as well as taxpayers.

Further work will also be required on rule co-ordination, simplification measures, thresholds and carve-outs to ensure the proposal avoids the risk of double taxation, minimizes compliance and administration costs and that the rules are targeted and proportionate. This work will address the priority in which the rules would be applied and how they interact with other rules in the

broader international framework. In this context it is important to analyze the interaction between this proposal and other BEPS Actions.

14.5.6 Future Work and the Next Steps

Further work would be continued to carried out on the development of a Unified Approach under Pillar One and the key design elements of the GloBE proposal under Pillar Two so that a recommendation on the core elements of long-term solution can be submitted to the Inclusive Framework for agreement at the beginning of 2020.

14.6 Unified Approach – Pillar One – October 2019[30]

14.6.1 In continuation to the Program of Work (PoW) adopted by the Inclusive Framework on BEPS at its meeting 28th and 29th May 2019, and approved by the G20 leaders and Finance Ministers in Japan in June 2019, it is proposed to develop two Pillars on a without prejudice basis. Pillar one deals with allocation of taxing right and nexus rules whereas Pillar Two is concerned with remaining BEPS issues. The Program of Work highlighted the commonalities of three proposals presented to the TFDE to facilitate a consensus solution on Pillar One. The three proposals are "User Participation", "Marketing Intangibles", and "Significant Economic Presence". The Policy Note stated that these proposals would entail solutions that go beyond the arm's length principle.

14.6.2 However, the Programme of Work emphasized the necessity to agree on the outline of the architecture of a unified approach by January 2020, given the goal of arriving at a consensus solution by the end of 2020. As highlighted in the Programme of Work, the stakes are very high. In the balance are: the allocation of taxing rights between jurisdictions; fundamental features of the international tax system, such as the traditional notions of permanent establishment and the applicability of the arm's length principle; the future of multilateral tax co-operation; the prevention of aggressive unilateral measures; and the intense political pressure to tax highly digitalized MNEs.

14.6.3 The Unified Approach proposal was discussed by TFDE at its meeting on 1st October, 2019 and then released for obtaining public comments. On 21st and 22nd November, 2019, a public consultation meeting on the

[30] *OECD – Public Consultation Document – Secretariat Proposal for a "Unified Approach" under Pillar One – 9th October, 2019 – 12th November, 2019*

proposed (Unified Approach) to deal with Pillar One issues was held at OECD Conference Centre in Paris, France. Unified Approach was issued as a Secretariat Proposal for public comments and deliberations.

14.6.3.1 Analysis of "Unified Approach"

The three alternatives set out in the Programme of Work under Pillar One have a number of significant commonalities:

- Though there is some variation in how the proposals address the digitalization issue, to the extent that highly digitalized businesses are able to operate remotely, and/or are highly profitable, all proposals would reallocate taxing rights in favor of the user/market jurisdiction;
- All the proposals envisage a new nexus rule that would not depend on physical presence in the user/market jurisdiction;
- They all go beyond the arm's length principle and depart from the separate entity principle; and
- They all search for simplicity, stabilization of the tax system, and increased tax certainty in implementation.

The nature of the reallocation of taxing rights also differs between the proposals, with the marketing intangibles and user participation proposals reallocating a portion of non-routine profit to the user/market jurisdiction, and the significant economic presence proposal looking at all profits (routine and non-routine) as the starting point.

14.6.3.2 Summary of The Proposal

It is proposed to provide a new taxing right to the market jurisdictions to be applied against a share of deemed residual profits out of MNEs consolidated profit. There is also a proposal to further allocate fixed remuneration for base line marketing and distribution functions that are performed by the MNE in the market jurisdiction. It is further finally proposed that additional profits are to be attributed to such country functions which exceed the baseline activity as explained above. This proposal can be summarized as under:

Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right;

Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and

Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

The above approach is called Three- Tier profit allocation mechanism. The key features to be identified for arriving at a solution are as under:

- **Scope:** The approach covers highly digital business models but goes wider – broadly focusing on consumer-facing businesses with further work to be carried out on scope and carve-outs. Extractive industries are assumed to be out of the scope.
- **New Nexus**: For businesses within the scope, it creates a new nexus, not dependent on physical presence but largely based on sales. The new nexus could have thresholds including country specific sales thresholds calibrated to ensure that jurisdictions with smaller economies can also benefit. It would be designed as a new self-standing treaty provision.
- **New Profit Allocation Rule going beyond the Arm's Length Principle**: It creates a new profit allocation rule applicable to taxpayers within the scope, and irrespective of whether they have an in-country marketing or distribution presence (permanent establishment or separate subsidiary) or sell via unrelated distributors. At the same time, the approach largely retains the current transfer pricing rules based on the arm's length principle but complements them with formula based solutions in areas where tensions in the current system are the highest.
- **Increased Tax Certainty delivered via a Three Tier Mechanism**: The approach increases tax certainty for taxpayers and tax administrations and consists of a three tier profit allocation mechanism, which is mentioned above.

As per Appendix attached to this Unified Approach document,

Amount A is to be calculated as under:

The starting point to determine Amount A would be the identification of MNE group's profit. The relevant measure of profits could be derived from the consolidated financial statements under the Accounting Standards of the Headquarters jurisdiction prepared in accordance with the Generally

Accepted Accounting Principles (GAAP) or the International Financial Reporting Standards (IFRS).

The second step would be to calculate the routine profits by using variety of approaches. Para 55 of the document illustrate this as under:

Consolidated group profits are assumed as Z%.

A portion of that percentage may be regarded as representing routine profit, Assume the same as X%. Then non-routine profits would be Z% - X%, say the same to be Y%.

Y% represents deemed non-routine profits.

Deemed non-routine profit" Y%" is an aggregate of profits attributable to many activities including those not targeted by new taxing right such as customer's data, valuable brand, innovative algorithm and software etc. In other words, deemed non-routine profit would be relatable to such profit which would be subjected to new taxing right in the market jurisdiction and also in respect of items like Brands, Innovative algorithms and software, customer's data etc. Let us say Y% consists of W% which is profits attributable to market jurisdictions and also V% the profits attributable to other factors such as trade intangibles like customer's data and valuable brand etc. The final step would be how the non-routine profit W% would be apportioned among the various market jurisdictions. The same should be done on a previously agreed allocation key, using variables such as sales etc.

Amount B

It is proposed to establish a fixed return (on the basis of industry/region) of profits for certain baseline activities such as routine marketing and distribution activities in a market jurisdiction. It is proposed to have a fixed return to reduce disputes in this area between tax payers and tax administrations. This is more like a presumptive profit approach.

Amount C

In a case where the tax payer performs functions beyond the routine marketing and distribution activities in the market jurisdiction, such additional functions warrant additional attribution of profits which is being classified as Amount C. This amount would be determined by application of arm's length principle. It is observed in the consultation document that determination of

Amount C may overlap with Amount A in some instances. Hence due care must be taken to ensure that there is no double taxation. It is also proposed to have effective dispute prevention and resolution mechanisms especially in the context of Amount C proposed.

14.6.4 Issues and Comments Against Unified Approach

(a) The proposal to take the Group's consolidated profit as the base for calculation of Amount A is prone to several contentions regarding computation of profits as per Accounting Standards, Policies etc. Instead, a formula based on sales recorded in a particular market jurisdiction could be a better base.

(b) The new taxing right proposed to be applied in market jurisdiction is beyond the arm's length principle and on a formulaic approach. Amount C explained is calculated on the basis of arm's length principle whereas Amount A is calculated on a formulary approach. There is strong possibility of overlap and incidence of double taxation.

(c) Amount B is proposed to be calculated on a presumptive basis which sometimes may not work if the functions carried out in the market jurisdiction differ on the basis of business/regional variances. Hence option must be provided even in respect of Amount B to be worked out on the basis of arm's length principle.

(d) Both Amount B and Amount C are based on existing rules of arm's length principle and Permanent Establishment. It obviously means the existing PE rules based on physical presence are applicable both in the context of Amount B and Amount C. Whereas Amount A is in respect of deemed non-routine profits generated in market jurisdiction in the absence of physical presence of MNE Group and therefore a new taxing right is proposed on the basis of a new nexus rule.

(e) A proposal to provide a new taxing right in the market jurisdiction in the absence of physical presence of the MNE Group necessarily requires a corresponding decrease in one or the other countries taxing rights otherwise it would result in double taxation. The consultation document of Unified Approach provides carve outs for industries such as extractive industries (mineral extraction) etc. There is also a representation from International Banking Federation to carve out financial services from this new rule. Any "carve out" approach will lead to disputes and difference in opinion.

A. Scope

The consultation document proposes to target large businesses that have significant consumer basing elements, which obviously means that it makes carve out for other categories. This could potentially throw lot of disputes and differences. In such a scenario it is possible to argue that B2B business model would not be the target for Amount A for the purposes of new taxing right. If that is so, a suitable carve out must be brought which should be dispute free. There is a strong case being made by financial services industry for claiming it to be carved out.

B. Nexus

It appears the Nexus rule is going to be based on sales recorded in market jurisdiction. A particular level of threshold of sales may not be suitable to every country small or big, developed or developing. It is therefore justified to set the threshold for each country based on well laid out parameters.

C. Calculation of group profits for Amount A

Consultation document questions whether standardized adjustments to financial statements profits may be needed to iron out differences in Accounting Standards. This seems to be a herculean task of reconciling the differences between GAAPS and IFRS. This would create lot of subjective issues and disputes.

D. Determination of Amount A

- In order to arrive at the deemed non-routine residual profit for calculation of Amount A the most important controversy would be, what would be the normal profit in different cases of different industries. If the MNE Group has diversified its activities, one activity yielding high profits and other activity yielding low profits, then would there be a mechanism to calculate routine profits separately activity wise? If not done so, this would create distorted results.
- The residual profits would be decided after quantification of routine profits on the basis of DEMPE[31] analysis which forms part of FAR

[31] *D.E.M.P.E. is an acronym in the international tax idiom for Development, Enhancement, Maintenance, Protection and Exploitation. DEMPE functions may be considered the main value-creating activities for any intangible. The allocation of income/profit generated from the exploitation of an intangible among the Group entities is to be based on the quantum of value being added by each entity for the said five*

analysis as per Revised OECD TP Guidelines, 2017. This would ultimately decide the location of the market jurisdiction of the residual profits on the basis of threshold parameters. So this needs to be considered for the purpose of calculation of Amount A.

- The consultation document observes that the new rules would apply equally to both profits and losses. In this scenario whether carry forward of losses is allowed and if so how many years backwards it can be considered. Carry forward of losses is a domestic law issue, which may vary across different tax jurisdictions.
- In respect of the new taxing right in the market jurisdiction, which member of the MNE Group would be a tax payer for the purpose of compliance and tax payments is an issue to be decided for easy administrability?

E. Determination of Amount B

- As per consultation document Amount B is principally governed by the existing rules of Transfer pricing.
- Baseline margins being proposed for marketing and distribution functions should be administered as an optional presumptive approach. In case the specific facts and circumstances justify a higher or lower margins compared to the fixed margin as canvassed by tax authorities / tax payers respectively, the same should be accommodated in the proposed rules. If this is accommodated probably, this may take care of "Amount C" as well here itself.

F. Determination of Amount C

- It is quite possible in some instances Amount C determined may partially overlap with Amount A.
- If arm's length principle is adopted in calculating Amount B by providing an option to question fixed baseline margins for distribution and marketing activities as a rebuttable presumption, then the functions carried out beyond the normal distribution and marketing activity would also be captured in FAR analysis so as to arrive at the appropriate arm's length profit for such activity as a whole. In such a scenario there would be no requirement for the concept of Amount C as the same would be captured in Amount B itself.

activities.

G. Elimination of Double Taxation

- In relation to Amount A, the proposal to bring new taxing right under Unified Approach in the market jurisdiction, should logically lead to a corresponding surrender of such right by another tax jurisdiction where the MNE Group is Head quartered or one of its entity operates. Otherwise this would obviously lead to double taxation. It should be carefully analyzed and worked out as to which tax jurisdiction of the Group entities is legally justified to surrender taxing rights. This would result in a shift of allocation of taxing rights.
- As an alternative approach, tax credit system can be tried to eliminate double taxation. However, even under this approach it is to be decided and identified which jurisdiction would be obliged to administer such tax credits, which were collected by the market jurisdiction under the new taxing right. Even this approach would be equally complicated and not free from disputes.
- In view of above apprehensions, a very robust and effective dispute resolution mechanism should be put in place to avoid undue hardship to the tax payers on account of double taxation risks and increased compliance burden.

14.7 Statement of work - January 2020.

The Statement of Work – January 2020 is an updated Programme of Work ("POW") or Inclusive Framework ("IF") setting out the timeline for the work on Pillar One and the remaining technical challenges to be addressed. This statement is accompanied by an outline of the architecture of a "Unified Approach" to Pillar One, which will serve as the basis for negotiations by the Inclusive Framework.

While the original IF of Unified Approach identified "consumer-facing" businesses, the new version of the Unified Approach identifies two categories of businesses such as

- Automated Digital Services
- Consumer-facing businesses

The IF states that merely using digital means to deliver services involving a high degree of human intervention and judgment is not intended to be covered. The dividing line between covered services and excluded services will need substantial refinement to be administrable.

The IF also states that most activities of the financial services sector (including insurance) take place with commercial customers and would not be in scope, and that there is a "compelling case" for excluding consumer-facing business lines based on the impact of regulation that ensures that residual profits are largely realized in local customer markets.

To reduce compliance and administrative burden, the report has identified Revenue thresholds which include the following:

- Gross Revenue Threshold
- In scope revenue threshold
- De Minimis carveout

Given that Amount A will feature a formula-based allocation mechanism – looking at a portion of deemed residual profits –the following technical issues will require resolution at a later stage, including

- The use of business line/regional segmentation,
- The notion of digital differentiation, and
- Specific revenue-sourcing rules for different business models.

The outline identifies profit before tax as the most favorable profit level indicator and stressed the need for loss carryforward rules to apply. Work to determine how to avoid double counting among Amounts A, B, and C, as well as mechanisms for double taxation relief, will be continued.

Regarding Amount B, the outline notes that the fixed return for baseline marketing and distribution activities is 'based on' the arm's length principle, but will need to account for regional, industry, and functionality differences. A definition of baseline activities will need to be developed but likely will include no/low risk, lack of intangibles, and routine levels of functionality.

Further technical work is envisioned on profit level indicator, fixed percentage at an agreed profit, benchmarking studies, and regional/industry differentiation. The stated goal is for Amount B to operate within the existing treaty network.

14.8 CBDT Draft Report on Profit Attribution To Market Jurisdictions – Proposal to amend Rule 10[32]

14.8.1 Introduction

In April 2019, a Committee of CBDT came out with a report dealing with attribution of profits to a Permanent Establishment in the market jurisdiction I.e. India in the present context. CBDT strongly supported the view that demand side of an enterprise should be considered for profit attribution in the source/ market jurisdiction along with supply side at the resident jurisdiction. CBDT is agreeable with attribution followed by OECD Model prior to 2010 and rejects Authorized OECD Approach (AOA) of OECD brought in 2010 which got incorporated in 2010 OECD Model Convention. Indian Government rejects AOA treating the same as flawed leaning only towards supply side and ignoring demand side and also observes that additional guidance issued by OECD in respect of AOA in the light of Action 7 of BEPS project is of no relevance to Indian tax treaties. The committee constituted by CBDT for formulating the report considered mixed or balanced approach taking care of both supply and demand sides of an enterprise. This is a draft report which sought feedback and comments against the recommendations of the committee in this Report. In section 1 of the report dealing with introduction, challenges of taxation of digitalized businesses also have been discussed. The committee was accorded the following mandate

(i) Examine the existing scheme of profit attribution to PE under Article 7 of Double Taxation Avoidance Agreements.

(ii) Examine the contribution of demand side and supply side factors in profit attribution.

(iii) Recommend the changes needed in rule 10 of Income-tax Rules to provide specific rules on how profits are to be attributed to a non-resident person having PE in India.

Draft report was submitted by committee which the CBDT has made it available for stakeholder comments on 18th April, 2019. The recommendations and observations of the committee are summarized as under.

[32] *CBDT Report on Profit Attribution to Permanent Establishments dated 18th April , 2019.*

14.8.2 Existing Profit Attribution Rule to PE under IT Act and DTAAs

14.8.2.1 Income Attribution to PE under IT Act:

If a non-resident constitutes business connection in India, the taxable income is restricted to the profits attributable to the business activities carried out in India. Such profits are computed on the basis of Books of Accounts and financial statements maintained in India. In the absence of maintenance of proper Books of Accounts, the Assessing Officer (AO) can compute the profit of the non-resident as per Rule 10 in the following manner:

(a) at such percentage of turnover accruing or arising as the income tax authority may consider reasonable;

(b) proportionate profits of the business of non-resident in the same ratio of receipts (accruing or arising) in India to total receipts of the non-resident's business; or

(c) In such manner as the income tax authority may deem suitable.

The current method of income attribution under Rule 10, therefore, allows a broad discretion to the income tax authority without any clear or specific guidance.

14.8.2.2 Profit Attribution under DTAA:

Article 7 of the Model Tax Conventions deals with business profits and the same allocates right of taxation of the PE profits to the source jurisdiction. A PE can be taxed in the source jurisdiction only to the extent such profits are attributable to the PE in that state. The provision in Indian tax treaties is similar to Article 7 of the UN Model Tax Convention (with slight variations), and it has significant similarities with Pre-2010 version in Article 7 of the OECD Model Tax Convention except the force of attraction rule and the limitation of deductibility of expenses. Even under tax treaties profits are attributed to PE as if it were distinct in separate entity based on separate accounts maintained by PE in the source state or attributing profit on the basis of Rule 10 where the separate accounts are not available.

The Committee has observed that 2010 OECD MC, Article 7 was amended in such a manner that if the profits cannot be attributed to PE on the basis of separate accounts, then the income of the PE will have to be determined by undertaking FAR analysis, thereby completely ignoring the demand side factors. E.g.: sales receipts derived from source jurisdiction, etc. The

Committee also observed that India consistently objected this FAR analysis based on AOA approach and Indian treaties are not based on this amended Article 7 of post 2010 OECD MC.

14.8.2.3 Demand side and Supply side factors that contribute to Business Profits

The Committee strongly canvassed that both demand side and supply side factors are equally important for generation of business profits of an enterprise. In other words, both production and sales are essential for generation of profits and neither should be ignored for determining profit attribution for respective jurisdictions. It is therefore advocated that not only the jurisdiction that produces the goods has right to tax but also the jurisdiction of market will also have a right to tax the profits in proportionate manner. The allocation of profits should be done in such a way to avoid double taxation. Three possible approaches have been listed by the Committee which are as under:

(i) *Purely Supply side approach* – that allocates all business profits exclusively to the jurisdiction where goods are produced

(ii) *Purely demand side approach* – that allocates all business profits exclusively to the market where consumer is located

(iii) *A mixed or a balanced approach* - that allocates profits between the jurisdiction where goods are produced and the jurisdiction where consumers are located.

The Committee, in section 5 of the Report, examined the approaches followed in different states in USA and also the approaches adopted in European states and observes that mixed approach is most commonly adopted; though there are also instances of purely demand approach, especially in certain US states. The purely supply side approach does not appear to be followed in any jurisdiction. The Committee also observes that AOA of OECD brought in 2010 shifts the entire attribution of profits to supply side on the basis of FAR analysis and thereby completely ignored the role of the demand side. The AOA suggested by OECD however did not find acceptance among some OECD countries itself, which either follow a mixed approach or a purely demand approach. It was also observed that international tax experts have not endorsed AOA of OECD for attribution of profits as it ignores the demand side role totally.

The Committee observes that India has always conveyed it's disagreement with the revised Article 7 of OECD 2010 based on AOA by not only reserving its right not to include in its tax treaties, but also documented clearly how AOA is flawed and is not a balanced one. It is very evident that AOA approach may be favorable to the interests of certain countries that are net exporters of capital and technology, it is likely to have a very significant adverse impact on all other stake holders, especially the developing economies like India, which are primarily importers of capital and technology.

14.8.2.4 Problems faced under existing Rule 10 and Court Decisions

Existing Rule 10 provided wide discretion to the Assessing Officers which led to considerable tax litigation. It was observed by the Committee "since lack of a universal rule can create uncertainties for taxpayers as well as result in more tax disputes, there appears to be a case for providing a simple and universally applicable rule to bring in greater certainty and predictability among the stakeholders and prevent avoidable tax litigation on this account".

14.8.2.5 Need for clarity in India's approach on PE attribution

The Committee evaluated various options for attribution of profits for the purpose of bringing greater clarity, predictability and objectivity in the process of attribution of profits and reducing tax disputes and litigations on this account, which options are as under:

(a) Formulary Apportionment Method: This method apportions the consolidated global profits of the non-resident enterprise across all the jurisdictions it operates. The main constraint in this method is obtaining information of sales revenue for each jurisdiction along with details of manpower and assets which are not easily available. Hence this method was dropped as practically not feasible.

(b) Fractional Apportionment Approach: The Committee considered the option of Fractional Apportionment based on apportionment of profits derived from India and observed that such an approach is permissible under paragraph 4 of Article 7 of Indian tax treaties as well as under Rule 10 and being based largely on information related to Indian operations, is also practicable. For this purpose, the Committee found considerable merit in a three-factor method based on equal weight accorded to sales, representing demand, and manpower and assets, which represent supply including marketing activities.

Based on Hon'ble Supreme Court decision in the case of *DIT Vs. Morgan Stanley*[292 ITR 416 (SC)], wherein it rules to avoid double taxation, any profits already taxed in the hands of an Indian subsidiary participating in integrated business should be deducted from the attributed profits to PE on the basis of three factor formula.

The term "profits derived from India" has been defined as 'revenue derived from India' * Global operating profit margin

[Where the enterprise is incurring global losses, or its global operational profit margin is less than 2%, the profits derived from India will be taken at 2% of the revenue/ turnover derived from India]

14.8.2.6 Significant Economic Presence as a Nexus for Profit Attribution in case of New Business Models

The Committee made the observations after analyzing thoroughly developments in digitalization of business models and also noted the role and relevance of users in the operations of the digital enterprises. It was also noted that through Finance Act 2018 a new nexus in the form of Significant Economic Presence has been introduced in the Income Tax Act which expands the threshold of business connection to cover business activities of digital enterprises in the market jurisdictions without their physical presence. The Committee also considered extensively the inputs of OECD interim Report of 2018 on *Tax Challenges Arising from Digitalization* and has given the final observations as under:

The Committee, after detailed deliberation, considered the various aspects of users' contribution in the digital economy and also the fact that the role of user has blurred the traditional demand and supply functions. Taking these factors into consideration, the Committee arrived at a unanimous view that user contribution can be a substitute to either assets or employees, and supplement their role in contributing to profits of the enterprise.

However, putting users together with either manpower or assets can pose significant challenges in distributing their respective shares within the assigned weight for their category (i.e. 33% for manpower or 33% for assets). Accordingly, the Committee found it reasonable that for business models in which users contribute significantly to the profits of the enterprise, they should also be taken into account for the purpose of attribution of profits, as the fourth factor for apportionment, in addition to the other three factors of sales, manpower and assets.

The Committee also noted that in its recent amendment of the 2016 proposal for CCCTB, the European Commission has now proposed a new four factor formula, that includes users as the fourth factor, in addition to sales, manpower/wages and assets and is given equal weight of 25% as given to other factors.

The Committee considered the option of following the approach of the EU in CCCTB and assigning users the same weight as other three. However, the Committee also considered that different weights are to be ascribed to different categories of digital businesses depending upon the level of user intensity. The Committee decided to assign a lower weight of 10% to the users for those business models involving low or medium user intensity and assigning a weightage of 20% to users in those business models involving high user intensity. The Committee also decided that since the users carry out the work of employees and are also assets to the company, the relative weightage of employees and assets will be adjusted downwards, keeping the weightage of sales fixed at 30% in both the cases.

14.8.2.7 Final Conclusions and Recommendations

The committee finally proposed the following formula for attribution of profits to PE in India as an amendment to existing Rule 10. Paragraph 199 and 200 of the report are reproduced as under

In view of the above, the Committee makes the following recommendations:

(i) Rule 10 may be amended to provide that in the case of an assessee who is not a resident of India, has a business connection in India and derives sales revenue from India by a business all the operations of which are not carried out in India, the income from such business that is attributable to the operations carried out in India and deemed to accrue or arise in India under clause (i) of sub-section(1) of section 9 of the Act, shall be determined by apportioning the profits derived from India by a three equally weighted factors of sales, employees (manpower & wages) and assets, as under:

Profits attributable to operations in India =

'Profits derived from India'92 x [SI/3xST + (NI/6xNT) +(WI/6xWT) + (AI/3xAT)]

Where,

SI = sales revenue derived by Indian operations from sales in India

ST = total sales revenue derived by Indian operations from sales in India and outside India

NI = number of employees employed with respect to Indian operations and located in India

NT = total number of employees employed with respect to Indian operations and located in India and outside India

WI = wages paid to employees employed with respect to Indian operations and located in India

WT = total wages paid to employees employed with respect to Indian operations and located in India and outside India

AI = assets deployed for Indian operations and located in India

AT = total assets deployed for Indian operations and located in India and outside India

(ii) The amended rules should provide that 'profits derived from Indian operations' will be the higher of the following amounts:

(a) The amount arrived at by multiplying the revenue derived from India x Global Operational profit margin, or

(b) Two percent of the revenue derived from India

(iii) The amended rules should provide an exception for enterprises in case of which the business connection is primarily constituted by the existence of users beyond the prescribed threshold, or in case of which users in excess of such prescribed threshold exist in India. In such cases, the income from such business that is attributable to the operations carried out in India and deemed to accrue or arise in India under clause (i) of sub-section (1) of section 9 of the Act, shall be determined by apportioning the profits derived from India on the basis of four factors of sales, employees (manpower & wages), assets and users. The users should be assigned a weight of 10% in cases of low and medium user intensity, while each of the other three factors should be assigned a weight of 30%, as under:

Profits attributable to operations in India in cases of low and medium user intensity business models=

'Profits derived from India' x [0.3 x SI/ST + (0.15 x NI/NT) +(0.15 x WI/WT) + (0.3 x AI/3xAT)] + 0.1]

In case of digital models with high user intensity, the users should be assigned a weight of 20%, while the share of assets and employees be reduced to 25% each after keeping the weight of sales as 30%, as under:

Profits attributable to operations in India in cases of high user intensity business models =

'Profits derived from India' x [0.3 x SI/ST + (0.125 x NI/NT) +(0.125 x WI/WT) + (0.25 AI/3xAT)] + 0.2]

(iv) *The amended rules should also provide that where the business connection of the enterprise in India is constituted by the activities of an associate enterprise that is resident in India and the enterprise does not receive any payments on accounts of sales or services from any person who is resident in India [or such payments do not exceed an amount of Rs. 10,00,000] and the activities of that associated enterprise have been fully remunerated by the enterprise by an arm's length price, no further profits will be attributable to the operation of that enterprise in India.*

(v) *However, where the business connection of the enterprise in India is constituted by the activities of an associate enterprise that is resident in India and the payments received by that enterprise on account of sales or services from persons resident in India exceeds the amount of Rs. 10,00,000 then profits attributable to the operation of that enterprise in India will be derived by apportionment using the three factors or four factors as may be applicable in his case and deducting from the same the profits that have already been subjected to tax in the hands of the associated enterprise. For this purpose, the employees and assets of the associated enterprise will deemed to be employed or deployed in the Indian operations and located in India.*

The Committee recommends the amendment of rule 10 accordingly. The Committee also recommended that an alternative can be amendment of the IT Act itself to incorporate a provision for profit attribution to a PE.

14.8.2.8 Conclusion:

The report submitted by the committee of CBDT is still in the draft stage pending finalization. Various stake holders have given their comments and suggestions against the draft report. Some important points for discussion and debate on this report are as under:

i. New formula suggested is proposed to be applied in respect of every non-resident having presence in India either through physical or non-physical approach. In other words, proposal under this draft report targets all businesses whereas Unified Approach of OECD targets only such businesses which are customer facing etc. with some carve outs.

ii. In other words, additional attribution of profits to market jurisdiction is proposed in respect of every business under CBDT report whereas the same is proposed only in respect of specified businesses such as customer facing etc. under the Unified Approach.

iii. The formula proposed under CBDT Report is similar to CCCTB of European Union whereas formula suggested by Unified Approach is more complex and takes the consolidated Group's profit as the starting point.

iv. CBDT Report opts for fractional apportionment method whereas Unified Approach proposes a formula which is a blend of formulary apportionment and arm's length principle apportionment.

v. CBDT Report is based on countries' customary approach allowed as per Article 7(4) of the UN Model Convention, which is being proposed through amendment under Rule 10. It is a debate among scholars whether the said customary approach under Rule 10 would be in conflict with the transfer pricing provisions brought into IT Act from 2001 along with the CBDT circulars no. 14/2001 and 5/2004 which also endorses India's agreement with the arm's length principle.

vi. Whether proposed amendment to Rule 10 would apply only in cases where separate accounts are not maintained for the PE in India and also in cases where such Books of Accounts are rejected by the tax authorities?

vii. CBDT Report proposes a deemed minimum profits attribution of 2% of revenues derived from India in cases where non-resident enterprises have global losses. One important point missed out in this deeming

fiction is that even Indian operations of the non-resident might be resulting in losses in such cases.

viii. The fourth factor proposed by the CBDT report to take care of Significant Economic Presence (SEP) nexus in case of new business models along with user intensity parameters is subject to the overall consensus being developed by OECD/G20 inclusive framework where India is also an active participant.

Annexure

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

The Parties to this Convention,

Recognising that governments lose substantial corporate tax revenue because of aggressive international tax planning that has the effect of artificially shifting profits to locations where they are subject to non-taxation or reduced taxation;

Mindful that base erosion and profit shifting (hereinafter referred to as "BEPS") is a pressing issue not only for industrialised countries but also for emerging economies and developing countries;

Recognising the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created;

Welcoming the package of measures developed under the OECD/G20 BEPS project (hereinafter referred to as the "OECD/G20 BEPS package");

Noting that the OECD/G20 BEPS package included tax treaty-related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution;

Conscious of the need to ensure swift, co-ordinated and consistent implementation of the treaty- related BEPS measures in a multilateral context;

Noting the need to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements 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 those agreements for the indirect benefit of residents of third jurisdictions);

Recognising the need for an effective mechanism to implement agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement;

Have agreed as follows:

PART I.
SCOPE AND INTERPRETATION OF TERMS

Article 1 – Scope of the Convention

This Convention modifies all Covered Tax Agreements as defined in subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms).

Article 2 – Interpretation of Terms

1. For the purpose of this Convention, the following definitions apply:

a) The term "Covered Tax Agreement" means an agreement for the avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered):

   i) that is in force between two or more:

      A) Parties; and/or

      B) jurisdictions or territories which are parties to an agreement described above and for whose international relations a Party is responsible; and

   ii) with respect to which each such Party has made a notification to the Depositary listing the agreement as well as any amending or accompanying instruments thereto (identified by title, names of the parties, date of signature, and, if applicable at the time of the notification, date of entry into force) as an agreement which it wishes to be covered by this Convention.

b) The term "Party" means:

   i) A State for which this Convention is in force pursuant to Article 34 (Entry into Force); or

   ii) A jurisdiction which has signed this Convention pursuant to subparagraph b) or c) of paragraph 1 of Article 27 (Signature and Ratification, Acceptance or Approval) and for which this Convention is in force pursuant to Article 34 (Entry into Force).

c) The term "Contracting Jurisdiction" means a party to a Covered Tax Agreement.

d) The term "Signatory" means a State or jurisdiction which has signed this Convention but for which the Convention is not yet in force.

2. As regards the application of this Convention at any time by a Party, any term not defined herein shall, unless the context otherwise requires, have the meaning that it has at that time under the relevant Covered Tax Agreement.

PART II.
HYBRID MISMATCHES

Article 3 - Transparent Entities

1. For the purposes of a Covered Tax Agreement, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting Jurisdiction shall be considered to be income of a resident of a Contracting Jurisdiction but only to the extent that the income is treated, for purposes of taxation by that Contracting Jurisdiction, as the income of a resident of that Contracting Jurisdiction.

2. Provisions of a Covered Tax Agreement that require a Contracting Jurisdiction to exempt from income tax or provide a deduction or credit equal to the income tax paid with respect to income derived by a resident of that Contracting Jurisdiction which may be taxed in the other Contracting Jurisdiction according to the provisions of the Covered Tax Agreement shall not apply to the extent that such provisions allow taxation by that other Contracting Jurisdiction solely because the income is also income derived by a resident of that other Contracting Jurisdiction.

3. With respect to Covered Tax Agreements for which one or more Parties has made the reservation described in subparagraph a) of paragraph 3 of Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents), the following sentence will be added at the end of paragraph 1: "In no case shall the provisions of this paragraph be construed to affect a Contracting Jurisdiction's right to tax the residents of that Contracting Jurisdiction."

4. Paragraph 1 (as it may be modified by paragraph 3) shall apply in

place of or in the absence of provisions of a Covered Tax Agreement to the extent that they address whether income derived by or through entities or arrangements that are treated as fiscally transparent under the tax law of either Contracting Jurisdiction (whether through a general rule or by identifying in detail the treatment of specific fact patterns and types of entities or arrangements) shall be treated as income of a resident of a Contracting Jurisdiction.

5. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4;

c) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4 which denies treaty benefits in the case of income derived by or through an entity or arrangement established in a third jurisdiction;

d) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements;

e) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements and denies treaty benefits in the case of income derived by or through an entity or arrangement established in a third jurisdiction;

f) for paragraph 2 not to apply to its Covered Tax Agreements;

g) for paragraph 1 to apply only to its Covered Tax Agreements that already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements.

notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 4 that is not subject to a reservation under subparagraphs c) through e) of paragraph 5, and if so, the

article and paragraph number of each such provision. In the case of a Party that has made the reservation described in subparagraph g) of paragraph 5, the notification pursuant to the preceding sentence shall be limited to Covered Tax Agreements that are subject to that reservation. Where all Contracting

Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1 (as it may be modified by paragraph 3) to the extent provided in paragraph 4. In other cases, paragraph 1 (as it may be modified by paragraph 3) shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1 (as it may be modified by paragraph 3).

Article 4 – Dual Resident Entities

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.

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

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply to its Covered Tax Agreements that already address cases where a person other than an individual is a resident of more than one Contracting Jurisdiction by requiring the competent authorities of the Contracting Jurisdictions to endeavour to reach mutual agreement on a single Contracting Jurisdiction of residence;

c) for the entirety of this Article not to apply to its Covered Tax Agreements that already address cases where a person other than an individual is a resident of more than one Contracting Jurisdiction by denying treaty benefits without requiring the competent authorities of the Contracting Jurisdictions to endeavour to reach mutual agreement on a single Contracting Jurisdiction of residence;

d) for the entirety of this Article not to apply to its Covered Tax Agreements that already address cases where a person other than an individual is a resident of more than one Contracting Jurisdiction by requiring the competent authorities of the Contracting Jurisdictions to endeavour to reach mutual agreement on a single Contracting Jurisdiction of residence, and that set out the treatment of that person under the Covered Tax Agreement where such an agreement cannot be reached;

e) to replace the last sentence of paragraph 1 with the following text for the purposes of its Covered Tax Agreements: "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.";

f) for the entirety of this Article not to apply to its Covered Tax Agreements with Parties that have made the reservation described in subparagraph e).

4. Each Party that has not made a reservation described in subparagraph a) of paragraph 3 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 2 that is not subject to a reservation under subparagraphs b) through d) of paragraph 3, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1. In other cases, paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.

Article 5 – Application of Methods for Elimination of Double Taxation

1. A Party may choose to apply either paragraphs 2 and 3 (Option A), paragraphs 4 and 5 (Option B), or paragraphs 6 and 7 (Option C), or may choose to apply none of the Options. Where each Contracting Jurisdiction to a Covered Tax Agreement chooses a different Option (or where one Contracting Jurisdiction chooses to apply an Option and the other chooses to apply none of the Options), the Option chosen by each Contracting Jurisdiction shall apply with respect to its own residents.

Option A

2. Provisions of a Covered Tax Agreement that would otherwise exempt income derived or capital owned by a resident of a Contracting Jurisdiction from tax in that Contracting Jurisdiction for the purpose of eliminating double taxation shall not apply where the other Contracting Jurisdiction applies the provisions of the Covered Tax Agreement to exempt such income or capital from tax or to limit the rate at which such income or capital may be taxed. In the latter case, the first-mentioned Contracting Jurisdiction shall allow as a deduction from the tax on the income or capital of that resident an amount equal to the tax paid in that other Contracting Jurisdiction. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income or capital which may be taxed in that other Contracting Jurisdiction.

3. Paragraph 2 shall apply to a Covered Tax Agreement that would otherwise require a Contracting Jurisdiction to exempt income or capital described in that paragraph.

Option B

4. Provisions of a Covered Tax Agreement that would otherwise exempt income derived by a resident of a Contracting Jurisdiction from tax in that Contracting Jurisdiction for the purpose of eliminating double taxation because such income is treated as a dividend by that Contracting Jurisdiction shall not apply where such income gives rise to a deduction for the purpose of determining the taxable profits of a resident of the other Contracting Jurisdiction under the laws of that other Contracting Jurisdiction. In such case, the first-mentioned Contracting Jurisdiction shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other Contracting Jurisdiction. Such deduction shall not, however, exceed that part of the income tax, as computed before the

deduction is given, which is attributable to such income which may be taxed in that other Contracting Jurisdiction.

5. Paragraph 4 shall apply to a Covered Tax Agreement that would otherwise require a Contracting Jurisdiction to exempt income described in that paragraph.

Option C

6. a) Where a resident of a Contracting Jurisdiction derives income or owns capital which may be taxed in the other Contracting Jurisdiction in accordance with the provisions of a Covered Tax Agreement (except to the extent that these provisions allow taxation by that other Contracting Jurisdiction solely because the income is also income derived by a resident of that other Contracting Jurisdiction), the first-mentioned Contracting Jurisdiction shall allow:

   i) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other Contracting Jurisdiction;

   ii) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other Contracting Jurisdiction.

   Such deduction shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable to the income or the capital which may be taxed in that other Contracting Jurisdiction.

b) Where in accordance with any provision of the Covered Tax Agreement income derived or capital owned by a resident of a Contracting Jurisdiction is exempt from tax in that Contracting Jurisdiction, such Contracting Jurisdiction may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

7. Paragraph 6 shall apply in place of provisions of a Covered Tax Agreement that, for purposes of eliminating double taxation, require a Contracting Jurisdiction to exempt from tax in that Contracting Jurisdiction income derived or capital owned by a resident of that Contracting Jurisdiction which, in accordance with the provisions of the Covered Tax Agreement, may be taxed in the other Contracting Jurisdiction.

8. A Party that does not choose to apply an Option under paragraph 1 may reserve the right for the entirety of this Article not to apply with respect to one or more identified Covered Tax Agreements (or with respect to all of its Covered Tax Agreements).

9. A Party that does not choose to apply Option C may reserve the right, with respect to one or more identified Covered Tax Agreements (or with respect to all of its Covered Tax Agreements), not to permit the other Contracting Jurisdiction(s) to apply Option C.

10. Each Party that chooses to apply an Option under paragraph 1 shall notify the Depositary of its choice of Option. Such notification shall also include:

a) in the case of a Party that chooses to apply Option A, the list of its Covered Tax Agreements which contain a provision described in paragraph 3, as well as the article and paragraph number of each such provision;

b) in the case of a Party that chooses to apply Option B, the list of its Covered Tax Agreements which contain a provision described in paragraph 5, as well as the article and paragraph number of each such provision;

c) in the case of a Party that chooses to apply Option C, the list of its Covered Tax Agreements which contain a provision described in paragraph 7, as well as the article and paragraph number of each such provision.

An Option shall apply with respect to a provision of a Covered Tax Agreement only where the Party that has chosen to apply that Option has made such a notification with respect to that provision.

PART III.
TREATY ABUSE

Article 6 – Purpose of a Covered Tax Agreement

1. A Covered Tax Agreement shall be modified to include the following preamble text:

> "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),".

2. The text described in paragraph 1 shall be included in a Covered Tax Agreement in place of or in the absence of preamble language of the Covered Tax Agreement referring to an intent to eliminate double taxation, whether or not that language also refers to the intent not to create opportunities for non-taxation or reduced taxation.

3. A Party may also choose to include the following preamble text with respect to its Covered Tax Agreements that do not contain preamble language referring to a desire to develop an economic relationship or to enhance co-operation in tax matters:

"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,".

4. A Party may reserve the right for paragraph 1 not to apply to its Covered Tax Agreements that already contain preamble language describing the intent of the Contracting Jurisdictions to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Covered Tax Agreement for the indirect benefit of residents of third jurisdictions) or applies more broadly.

5. Each Party shall notify the Depositary of whether each of its Covered Tax Agreements, other than those that are within the scope of a reservation under paragraph 4, contains preamble language described in paragraph 2, and if so, the text of the relevant preambular paragraph. Where all Contracting Jurisdictions have made such a notification with respect to that preamble language, such preamble language shall be replaced by the text described in paragraph 1. In other cases, the text described in paragraph 1 shall be included in addition to the existing preamble language.

6. Each Party that chooses to apply paragraph 3 shall notify the Depositary of its choice. Such notification shall also include the list of its Covered Tax Agreements that do not already contain preamble language referring to a desire to develop an economic relationship or to enhance co-operation in tax matters. The text described in paragraph 3 shall be included in a Covered Tax Agreement only where all Contracting Jurisdictions have

chosen to apply that paragraph and have made such a notification with respect to the Covered Tax Agreement.

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.

2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.

3. A Party that has not made the reservation described in subparagraph a) of paragraph 15 may also choose to apply paragraph 4 with respect to its Covered Tax Agreements.

4. Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request.

5. Paragraph 4 shall apply to provisions of a Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.

6. A Party may also choose to apply the provisions contained in paragraphs 8 through 13 (hereinafter referred to as the "Simplified Limitation on Benefits Provision") to its Covered Tax Agreements by making the notification described in subparagraph c) of paragraph 17. The Simplified Limitation on Benefits Provision shall apply with respect to a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply it.

7. In cases where some but not all of the Contracting Jurisdictions to a Covered Tax Agreement choose to apply the Simplified Limitation on Benefits Provision pursuant to paragraph 6, then, notwithstanding the provisions of that paragraph, the Simplified Limitation on Benefits Provision shall apply with respect to the granting of benefits under the Covered Tax Agreement:

a) by all Contracting Jurisdictions, if all of the Contracting Jurisdictions that do not choose pursuant to paragraph 6 to apply the Simplified Limitation on Benefits Provision agree to such application by choosing to apply this subparagraph and notifying the Depositary accordingly; or

b) only by the Contracting Jurisdictions that choose to apply the Simplified Limitation on Benefits Provision, if all of the Contracting Jurisdictions that do not choose pursuant to paragraph 6 to apply the Simplified Limitation on Benefits Provision agree to such application by choosing to apply this subparagraph and notifying the Depositary accordingly.

Simplified Limitation on Benefits Provision

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.

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);

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.

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.

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.

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.

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;

b) the term "principal class of shares" means the class or classes of shares of a company which represents the majority of the aggregate vote and value of the company or the class or classes of beneficial interests of an entity which represents in the aggregate a majority of the aggregate vote and value of the entity;

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.

14. The Simplified Limitation on Benefits Provision shall apply in place of or in the absence of provisions of a Covered Tax Agreement that would limit the benefits of the Covered Tax Agreement (or that would limit benefits other than a benefit under the provisions of the Covered Tax Agreement relating to residence, associated enterprises or non-discrimination or a benefit that is not restricted solely to residents of a Contracting Jurisdiction) only to a resident that qualifies for such benefits by meeting one or more categorical tests.

15. A Party may reserve the right:

a) for paragraph 1 not to apply to its Covered Tax Agreements on the basis that it intends to adopt a combination of a detailed limitation on benefits provision and either rules to address conduit financing structures or a principal purpose test, thereby meeting the minimum standard for preventing treaty abuse under the OECD/G20 BEPS package; in such cases, the Contracting Jurisdictions shall endeavour to reach a mutually satisfactory solution which meets the minimum standard;

b) for paragraph 1 (and paragraph 4, in the case of a Party that has chosen to apply that paragraph) not to apply to its Covered Tax Agreements that already contain provisions that deny all of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person

concerned with an arrangement or transaction, was to obtain those benefits;

c) for the Simplified Limitation on Benefits Provision not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 14.

16. Except where the Simplified Limitation on Benefits Provision applies with respect to the granting of benefits under a Covered Tax Agreement by one or more Parties pursuant to paragraph 7, a Party that chooses pursuant to paragraph 6 to apply the Simplified Limitation on Benefits Provision may reserve the right for the entirety of this Article not to apply with respect to its Covered Tax Agreements for which one or more of the other Contracting Jurisdictions has not chosen to apply the Simplified Limitation on Benefits Provision. In such cases, the Contracting Jurisdictions shall endeavour to reach a mutually satisfactory solution which meets the minimum standard for preventing treaty abuse under the OECD/G20 BEPS package.

17.a) Each Party that has not made the reservation described in subparagraph a) of paragraph 15 shall notify the Depositary of whether each of its Covered Tax Agreements that is not subject to a reservation described in subparagraph b) of paragraph 15 contains a provision described in paragraph 2, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1 (and where applicable, paragraph 4). In other cases, paragraph 1 (and where applicable, paragraph 4) shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1 (and where applicable, paragraph 4). A Party making a notification under this subparagraph may also include a statement that while such Party accepts the application of paragraph 1 alone as an interim measure, it intends where possible to adopt a limitation on benefits provision**,** in addition to or in replacement of paragraph 1, through bilateral negotiation.

b) Each Party that chooses to apply paragraph 4 shall notify the Depositary of its choice. Paragraph 4 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a

notification.

c) Each Party that chooses to apply the Simplified Limitation on Benefits Provision pursuant to paragraph 6 shall notify the Depositary of its choice. Unless such Party has made the reservation described in subparagraph c) of paragraph 15, such notification shall also include the list of its Covered Tax Agreements which contain a provision described in paragraph 14, as well as the article and paragraph number of each such provision.

d) Each Party that does not choose to apply the Simplified Limitation on Benefits Provision pursuant to paragraph 6, but chooses to apply either subparagraph a) or b) of paragraph 7 shall notify the Depositary of its choice of subparagraph. Unless such Party has made the reservation described in subparagraph c) of paragraph 15, such notification shall also include the list of its Covered Tax Agreements which contain a provision described in paragraph 14, as well as the article and paragraph number of each such provision.

e) Where all Contracting Jurisdictions have made a notification under subparagraph c) or d) with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the Simplified Limitation on Benefits Provision. In other cases, the Simplified Limitation on Benefits Provision shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with the Simplified Limitation on Benefits Provision.

Article 8 – Dividend Transfer Transactions

1. Provisions of a Covered Tax Agreement that exempt dividends paid by a company which is a resident of a Contracting Jurisdiction from tax or that limit the rate at which such dividends may be taxed, provided that the beneficial owner or the recipient is a company which is a resident of the other Contracting Jurisdiction and which owns, holds or controls more than a certain amount of the capital, shares, stock, voting power, voting rights or similar ownership interests of the company paying the dividends, shall apply only if the ownership conditions described in those provisions are met throughout a 365 day period that includes the day of the payment of the dividends (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company

that holds the shares or that pays the dividends).

2. The minimum holding period provided in paragraph 1 shall apply in place of or in the absence of a minimum holding period in provisions of a Covered Tax Agreement described in paragraph 1.

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply to its Covered Tax Agreements to the extent that the provisions described in paragraph 1 already include:

   i) a minimum holding period;

   ii) a minimum holding period shorter than a 365 day period; or

   iii) a minimum holding period longer than a 365 day period.

4. Each Party that has not made a reservation described in subparagraph a) of paragraph 3 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 1 that is not subject to a reservation described in subparagraph b) of paragraph 3, and if so, the article and paragraph number of each such provision. Paragraph 1 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that provision.

Article 9 – Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

1. Provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction (or provided that more than a certain part of the property of the entity consists of such immovable property (real property)):

a) shall apply if the relevant value threshold is met at any time during the 365 days preceding the alienation; and

b) shall apply to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions.

2. The period provided in subparagraph a) of paragraph 1 shall apply in place of or in the absence of a time period for determining whether the relevant value threshold in provisions of a Covered Tax Agreement described in paragraph 1 was met.

3. A Party may also choose to apply paragraph 4 with respect to its Covered Tax Agreements.

4. For purposes of a Covered Tax Agreement, gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting Jurisdiction if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction.

5. Paragraph 4 shall apply in place of or in the absence of provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction, or provided that more than a certain part of the property of the entity consists of such immovable property (real property).

6. A Party may reserve the right:

a) for paragraph 1 not to apply to its Covered Tax Agreements;

b) for subparagraph a) of paragraph 1 not to apply to its Covered Tax Agreements;

c) for subparagraph b) of paragraph 1 not to apply to its Covered Tax Agreements;

d) for subparagraph a) of paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision of the type described in paragraph 1 that includes a period for determining whether the

relevant value threshold was met;

e) for subparagraph b) of paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision of the type described in paragraph 1 that applies to the alienation of interests other than shares;

f) for paragraph 4 not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 5.

7. Each Party that has not made the reservation described in subparagraph a) of paragraph 6 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 1, and if so, the article and paragraph number of each such provision. Paragraph 1 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision.

8. Each Party that chooses to apply paragraph 4 shall notify the Depositary of its choice. Paragraph 4 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification. In such case, paragraph 1 shall not apply with respect to that Covered Tax Agreement. In the case of a Party that has not made the reservation described in subparagraph f) of paragraph 6 and has made the reservation described in subparagraph a) of paragraph 6, such notification shall also include the list of its Covered Tax Agreements which contain a provision described in paragraph 5, as well as the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made a notification with respect to a provision of a Covered Tax Agreement under this paragraph or paragraph 7, that provision shall be replaced by the provisions of paragraph 4. In other cases, paragraph 4 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 4.

Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions

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. In such a case, any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other Contracting Jurisdiction, notwithstanding any other provisions of the Covered Tax Agreement.

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).

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 competent authority of the Contracting Jurisdiction to which a request has been made under the preceding sentence by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before either granting or denying the request.

4. Paragraphs 1 through 3 shall apply in place of or in the absence of provisions of a Covered Tax Agreement that deny or limit benefits that would otherwise be granted to an enterprise of a Contracting Jurisdiction which derives income from the other Contracting Jurisdiction that is attributable to a permanent establishment of the enterprise situated in a third jurisdiction.

5. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 4;

c) for this Article to apply only to its Covered Tax Agreements that already contain the provisions described in paragraph 4.

6. Each Party that has not made the reservation described in subparagraph a) or b) of paragraph 5 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 4, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraphs 1 through 3. In other cases, paragraphs 1 through 3 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with those paragraphs.

Article 11 – Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents

1. A Covered Tax Agreement shall not affect the taxation by a Contracting Jurisdiction of its residents, except with respect to the benefits granted under provisions of the Covered Tax Agreement:

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

b) which may affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction if that individual derives income in respect of services rendered to the other Contracting Jurisdiction or a political subdivision or local authority or other comparable body thereof;

c) which may affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction if that individual is also a student, business apprentice or trainee, or a teacher, professor, lecturer, instructor, researcher or research scholar who meets the conditions of the Covered Tax Agreement;

d) which require that Contracting Jurisdiction to provide a tax credit or tax exemption to residents of that Contracting Jurisdiction with respect to the income that the other Contracting Jurisdiction may tax in accordance with the Covered Tax Agreement (including profits that are attributable to a permanent establishment situated in that other Contracting Jurisdiction in accordance with the Covered Tax Agreement);

e) which protect residents of that Contracting Jurisdiction against certain discriminatory taxation practices by that Contracting Jurisdiction;

f) which allow residents of that Contracting Jurisdiction to request that the competent authority of that or either Contracting Jurisdiction consider cases of taxation not in accordance with the Covered Tax Agreement;

g) which 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;

h) which 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;

i) which 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; or

j) which 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.

2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement stating that the Covered Tax Agreement would not

affect the taxation by a Contracting Jurisdiction of its residents.

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 2.

4. Each Party that has not made the reservation described in subparagraph a) or b) of paragraph 3 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 2, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1. In other cases, paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.

PART IV.
AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

1. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, 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 Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement (as it may be modified by this Convention).

2. Paragraph 1 shall not apply where the person acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise of the other Contracting Jurisdiction carries on business in the first- mentioned Contracting Jurisdiction 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.

3. a) Paragraph 1 shall apply in place of provisions of a Covered Tax Agreement that describe the conditions under which an enterprise

shall be deemed to have a permanent establishment in a Contracting Jurisdiction (or a person shall be deemed to be a permanent establishment in a Contracting Jurisdiction) in respect of an activity which a person other than an agent of an independent status undertakes for the enterprise, but only to the extent that such provisions address the situation in which such person has, and habitually exercises, in that Contracting Jurisdiction an authority to conclude contracts in the name of the enterprise.

b) Paragraph 2 shall apply in place of provisions of a Covered Tax Agreement that provide that an enterprise shall not be deemed to have a permanent establishment in a Contracting Jurisdiction in respect of an activity which an agent of an independent status undertakes for the enterprise.

4. A Party may reserve the right for the entirety of this Article not to apply to its Covered Tax Agreements.

5. Each Party that has not made a reservation described in paragraph 4 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph a) of paragraph 3, as well as the article and paragraph number of each such provision. Paragraph 1 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision.

6. Each Party that has not made a reservation described in paragraph 4 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph b) of paragraph 3, as well as the article and paragraph number of each such provision. Paragraph 2 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that provision.

Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

1. A Party may choose to apply paragraph 2 (Option A) or paragraph 3 (Option B) or to apply neither Option.

Option A

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.

Option B

3. 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, except to the extent that the relevant provision of the Covered Tax Agreement provides explicitly that a specific activity shall be deemed not to constitute a permanent establishment provided that the activity is 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), provided that this activity is of a preparatory or auxiliary character;

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

provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

4. A provision of a Covered Tax Agreement (as it may be modified by paragraph 2 or 3) that lists specific activities deemed not to constitute a permanent establishment shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting Jurisdiction and:

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of a Covered Tax Agreement defining a permanent establishment; or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

5. a)Paragraph 2 or 3 shall apply in place of the relevant parts of provisions of a Covered Tax Agreement that list specific activities that are deemed not to constitute a permanent establishment even if the activity is carried on through a fixed place of business (or provisions of a Covered Tax Agreement that operate in a comparable manner).

b) Paragraph 4 shall apply to provisions of a Covered Tax Agreement (as they may be modified by paragraph 2 or 3) that list specific activities that are deemed not to constitute a permanent establishment even if the activity is carried on through a fixed place of business (or provisions of a Covered Tax Agreement that operate in a comparable manner).

6. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for paragraph 2 not to apply to its Covered Tax Agreements that explicitly state that a list of specific activities shall be deemed not to

constitute a permanent establishment only if each of the activities is of a preparatory or auxiliary character;

c) for paragraph 4 not to apply to its Covered Tax Agreements.

7. Each Party that chooses to apply an Option under paragraph 1 shall notify the Depositary of its choice of Option. Such notification shall also include the list of its Covered Tax Agreements which contain a provision described in subparagraph a) of paragraph 5, as well as the article and paragraph number of each such provision. An Option shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply the same Option and have made such a notification with respect to that provision.

8. Each Party that has not made a reservation described in subparagraph a) or c) of paragraph 6 and does not choose to apply an Option under paragraph 1 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph b) of paragraph 5, as well as the article and paragraph number of each such provision. Paragraph 4 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision under this paragraph or paragraph 7.

Article 14 – 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 first- mentioned 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.

2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement to the extent that such provisions address the division of contracts into multiple parts to avoid the application of a time period or periods in relation to the existence of a permanent establishment for specific projects or activities described in paragraph 1.

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply with respect to provisions of its Covered Tax Agreements relating to the exploration for or exploitation of natural resources.

4. Each Party that has not made a reservation described in subparagraph a) of paragraph 3 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 2 that is not subject to a reservation under subparagraph b) of paragraph 3, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1 to the extent provided in paragraph 2. In other cases, paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.

Article 15 – Definition of a Person Closely Related to an Enterprise

1. For the purposes of the provisions of a Covered Tax Agreement that are modified by paragraph 2 of Article 12 (Artificial Avoidance of Permanent

Establishment Status through Commissionnaire Arrangements and Similar Strategies), paragraph 4 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions), or paragraph 1 of Article 14 (Splitting-up of Contracts), 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.

2. A Party that has made the reservations described in paragraph 4 of Article 12 (Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies), subparagraph a) or c) of paragraph 6 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions), and subparagraph a) of paragraph 3 of Article 14 (Splitting-up of Contracts) may reserve the right for the entirety of this Article not to apply to the Covered Tax Agreements to which those reservations apply.

PART V.
IMPROVING DISPUTE RESOLUTION

Article 16 – Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement, that person may, irrespective of the remedies provided by the domestic law of those Contracting Jurisdictions, present the case to the competent authority of either Contracting Jurisdiction. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to

resolve the case by mutual agreement with the competent authority of the other Contracting Jurisdiction, with a view to the avoidance of taxation which is not in accordance with the Covered Tax Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions.

3. The competent authorities of the Contracting Jurisdictions shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Covered Tax Agreement. They may also consult together for the elimination of double taxation in cases not provided for in the Covered Tax Agreement.

4. a) i) The first sentence of paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement (or parts thereof) that provide that where a person considers that the actions of one or both of the Contracting Jurisdiction result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement, that person may, irrespective of the remedies provided by the domestic law of those Contracting Jurisdictions, present the case to the competent authority of the Contracting Jurisdiction of which that person is a resident including provisions under which, if the case presented by that person comes under the provisions of a Covered Tax Agreement relating to non-discrimination based on nationality, the case may be presented to the competent authority of the Contracting Jurisdiction of which that person is a national.

ii) The second sentence of paragraph 1 shall apply in place of provisions of a Covered Tax Agreement that provide that a case referred to in the first sentence of paragraph 1 must be presented within a specific time period that is shorter than three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement, or in the absence of a provision of a Covered Tax Agreement describing the time period within which such a case must be presented.

b) i) The first sentence of paragraph 2 shall apply in the absence of provisions of a Covered Tax Agreement that provide that the

competent authority that is presented with the case by the person referred to in paragraph 1 shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting Jurisdiction, with a view to the avoidance of taxation which is not in accordance with the Covered Tax Agreement

ii) The second sentence of paragraph 2 shall apply in the absence of provisions of a Covered Tax Agreement providing that any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions.

c) i) The first sentence of paragraph 3 shall apply in the absence of provisions of a Covered Tax Agreement that provide that the competent authorities of the Contracting Jurisdictions shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Covered Tax Agreement.

ii) The second sentence of paragraph 3 shall apply in the absence of provisions of a Covered Tax Agreement that provide that the competent authorities of the Contracting Jurisdictions may also consult together for the elimination of double taxation in cases not provided for in the Covered Tax Agreement.

5. A Party may reserve the right:

a) for the first sentence of paragraph 1 not to apply to its Covered Tax Agreements on the basis that it intends to meet the minimum standard for improving dispute resolution under the OECD/G20 BEPS Package by ensuring that under each of its Covered Tax Agreements (other than a Covered Tax Agreement that permits a person to present a case to the competent authority of either Contracting Jurisdiction), where a person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement, irrespective of the remedies provided by the domestic law of those Contracting Jurisdictions, that person may present the case to the competent authority of the Contracting Jurisdiction of which the person is a resident or, if the case presented by that person comes under a

provision of a Covered Tax Agreement relating to non-discrimination based on nationality, to that of the Contracting Jurisdiction of which that person is a national; and the competent authority of that Contracting Jurisdiction will implement a bilateral notification or consultation process with the competent authority of the other Contracting Jurisdiction for cases in which the competent authority to which the mutual agreement procedure case was presented does not consider the taxpayer's objection to be justified;

b) for the second sentence of paragraph 1 not to apply to its Covered Tax Agreements that do not provide that the case referred to in the first sentence of paragraph 1 must be presented within a specific time period on the basis that it intends to meet the minimum standard for improving dispute resolution under the OECD/G20 BEPS package by ensuring that for the purposes of all such Covered Tax Agreements the taxpayer referred to in paragraph 1 is allowed to present the case within a period of at least three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement;

c) for the second sentence of paragraph 2 not to apply to its Covered Tax Agreements on the basis that for the purposes of all of its Covered Tax Agreements:

    i) any agreement reached via the mutual agreement procedure shall be implemented notwithstanding any time limits in the domestic laws of the Contracting Jurisdictions; or

    ii) it intends to meet the minimum standard for improving dispute resolution under the OECD/G20 BEPS package by accepting, in its bilateral treaty negotiations, a treaty provision providing that:

        A) the Contracting Jurisdictions shall make no adjustment to the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting Jurisdictions after a period that is mutually agreed between both Contracting Jurisdictions from the end of the taxable year in which the profits would have been attributable to the permanent establishment (this provision shall not apply in the case of fraud, gross negligence or wilful default); and

B) the Contracting Jurisdictions shall not include in the profits of an enterprise, and tax accordingly, profits that would have accrued to the enterprise but that by reason of the conditions referred to in a provision in the Covered Tax Agreement relating to associated enterprises have not so accrued, after a period that is mutually agreed between both Contracting Jurisdictions from the end of the taxable year in which the profits would have accrued to the enterprise (this provision shall not apply in the case of fraud, gross negligence or wilful default).

6. a) Each Party that has not made a reservation described in subparagraph a) of paragraph 5 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in clause i) of subparagraph a) of paragraph 4, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the first sentence of paragraph 1. In other cases, the first sentence of paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with that sentence.

b) Each Party that has not made the reservation described in subparagraph b) of paragraph 5 shall notify the Depositary of:

i) the list of its Covered Tax Agreements which contain a provision that provides that a case referred to in the first sentence of paragraph 1 must be presented within a specific time period that is shorter than three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement, as well as the article and paragraph number of each such provision; a provision of a Covered Tax Agreement shall be replaced by the second sentence of paragraph 1 where all Contracting Jurisdictions have made such a notification with respect to that provision; in other cases, subject to clause ii), the second sentence of paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with the second sentence of paragraph 1;

ii) the list of its Covered Tax Agreements which contain a provision that provides that a case referred to in the first sentence of paragraph 1 must be presented within a specific time period that is at least three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Covered Tax Agreement, as well as the article and paragraph number of each such provision; the second sentence of paragraph 1 shall not apply to a Covered Tax Agreement where any Contracting Jurisdiction has made such a notification with respect to that Covered Tax Agreement.

c) Each Party shall notify the Depositary of:

i) the list of its Covered Tax Agreements which do not contain a provision described in clause i) of subparagraph b) of paragraph 4; the first sentence of paragraph 2 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that Covered Tax Agreement;

ii) in the case of a Party that has not made the reservation described in subparagraph c) of paragraph 5, the list of its Covered Tax Agreements which do not contain a provision described in clause ii) of subparagraph b) of paragraph 4; the second sentence of paragraph 2 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that Covered Tax Agreement.

d) Each Party shall notify the Depositary of:

i) the list of its Covered Tax Agreements which do not contain a provision described in clause i) of subparagraph c) of paragraph 4; the first sentence of paragraph 3 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that Covered Tax Agreement;

ii) the list of its Covered Tax Agreements which do not contain a provision described in clause ii) of subparagraph c) of paragraph 4; the second sentence of paragraph 3 shall apply to a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that Covered Tax Agreement.

Article 17 – Corresponding Adjustments

1. Where a Contracting Jurisdiction includes in the profits of an enterprise of that Contracting Jurisdiction — and taxes accordingly — profits on which an enterprise of the other Contracting Jurisdiction has been charged to tax in that other Contracting Jurisdiction and the profits so included are profits which would have accrued to the enterprise of the first-mentioned Contracting Jurisdiction if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other Contracting Jurisdiction shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Covered Tax Agreement and the competent authorities of the Contracting Jurisdictions shall if necessary consult each other.

2. Paragraph 1 shall apply in place of or in the absence of a provision that requires a Contracting Jurisdiction to make an appropriate adjustment to the amount of the tax charged therein on the profits of an enterprise of that Contracting Jurisdiction where the other Contracting Jurisdiction includes those profits in the profits of an enterprise of that other Contracting Jurisdiction and taxes those profits accordingly, and the profits so included are profits which would have accrued to the enterprise of that other Contracting Jurisdiction if the conditions made between the two enterprises had been those which would have been made between independent enterprises.

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 2;

b) for the entirety of this Article not to apply to its Covered Tax Agreements on the basis that in the absence of a provision referred to in paragraph 2 in its Covered Tax Agreement:

   i) it shall make the appropriate adjustment referred to in paragraph 1; or

   ii) its competent authority shall endeavour to resolve the case under the provisions of a Covered Tax Agreement relating to mutual agreement procedure;

c) in the case of a Party that has made a reservation under clause ii) of

subparagraph c) of paragraph 5 of Article 16 (Mutual Agreement Procedure), for the entirety of this Article not to apply to its Covered Tax Agreements on the basis that in its bilateral treaty negotiations it shall accept a treaty provision of the type contained in paragraph 1, provided that the Contracting Jurisdictions were able to reach agreement on that provision and on the provisions described in clause ii) of subparagraph c) of paragraph 5 of Article 16 (Mutual Agreement Procedure).

4. Each Party that has not made a reservation described in paragraph 3 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in paragraph 2, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1. In other cases, paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.

PART VI.
ARBITRATION

Article 18 – Choice to Apply Part VI

A Party may choose to apply this Part with respect to its Covered Tax Agreements and shall notify the Depositary accordingly. This Part shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement only where both Contracting Jurisdictions have made such a notification.

Article 19 – Mandatory Binding Arbitration

1. Where:

a) under a provision of a Covered Tax Agreement (as it may be modified by paragraph 1 of Article 16 (Mutual Agreement Procedure)) that provides that a person may present a case to a competent authority of a Contracting Jurisdiction where that person considers that the actions of one or both of the Contracting Jurisdictions result or will result for that person in taxation not in accordance with the provisions of the Covered Tax Agreement (as it may be modified by the Convention), a person has presented a case to the competent authority of a

Contracting Jurisdiction on the basis that the actions of one or both of the Contracting Jurisdictions have resulted for that person in taxation not in accordance with the provisions of the Covered Tax Agreement (as it may be modified by the Convention); and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to a provision of a Covered Tax Agreement (as it may be modified by paragraph 2 of Article 16 (Mutual Agreement Procedure)) that provides that the competent authority shall endeavour to resolve the case by mutual agreement with the competent authority of the other Contracting Jurisdiction, within a period of two years beginning on the start date referred to in paragraph 8 or 9, as the case may be (unless, prior to the expiration of that period the competent authorities of the Contracting Jurisdictions have agreed to a different time period with respect to that case and have notified the person who presented the case of such agreement),

any unresolved issues arising from the case shall, if the person so requests in writing, be submitted to arbitration in the manner described in this Part, according to any rules or procedures agreed upon by the competent authorities of the Contracting Jurisdictions pursuant to the provisions of paragraph 10.

2. Where a competent authority has suspended the mutual agreement procedure referred to in paragraph 1 because a case with respect to one or more of the same issues is pending before court or administrative tribunal, the period provided in subparagraph b) of paragraph 1 will stop running until either a final decision has been rendered by the court or administrative tribunal or the case has been suspended or withdrawn. In addition, where a person who presented a case and a competent authority have agreed to suspend the mutual agreement procedure, the period provided in subparagraph b) of paragraph 1 will stop running until the suspension has been lifted.

3. Where both competent authorities agree that a person directly affected by the case has failed to provide in a timely manner any additional material information requested by either competent authority after the start of the period provided in subparagraph b) of paragraph 1, the period provided in subparagraph b) of paragraph 1 shall be extended for an amount of time equal to the period beginning on the date by which the information was requested and ending on the date on which that information was provided.

4. a) The arbitration decision with respect to the issues submitted to arbitration shall be implemented through the mutual agreement concerning the case referred to in paragraph 1. The arbitration decision shall be final.

b) The arbitration decision shall be binding on both Contracting Jurisdictions except in the following cases:

i) if a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. In such a case, the case shall not be eligible for any further consideration by the competent authorities. The mutual agreement that implements the arbitration decision on the case shall be considered not to be accepted by a person directly affected by the case if any person directly affected by the case does not, within 60 days after the date on which notification of the mutual agreement is sent to the person, withdraw all issues resolved in the mutual agreement implementing the arbitration decision from consideration by any court or administrative tribunal or otherwise terminate any pending court or administrative proceedings with respect to such issues in a manner consistent with that mutual agreement.

ii) if a final decision of the courts of one of the Contracting Jurisdictions holds that the arbitration decision is invalid. In such a case, the request for arbitration under paragraph 1 shall be considered not to have been made, and the arbitration process shall be considered not to have taken place (except for the purposes of Articles 21 (Confidentiality of Arbitration Proceedings) and 25 (Costs of Arbitration Proceedings)). In such a case, a new request for arbitration may be made unless the competent authorities agree that such a new request should not be permitted.

iii) if a person directly affected by the case pursues litigation on the issues which were resolved in the mutual agreement implementing the arbitration decision in any court or administrative tribunal.

5. The competent authority that received the initial request for a mutual agreement procedure as described in subparagraph a) of paragraph 1 shall,

within two calendar months of receiving the request:

a) send a notification to the person who presented the case that it has received the request; and

b) send a notification of that request, along with a copy of the request, to the competent authority of the other Contracting Jurisdiction.

6. Within three calendar months after a competent authority receives the request for a mutual agreement procedure (or a copy thereof from the competent authority of the other Contracting Jurisdiction) it shall either:

a) notify the person who has presented the case and the other competent authority that it has received the information necessary to undertake substantive consideration of the case; or

b) request additional information from that person for that purpose.

7. Where pursuant to subparagraph b) of paragraph 6, one or both of the competent authorities have requested from the person who presented the case additional information necessary to undertake substantive consideration of the case, the competent authority that requested the additional information shall, within three calendar months of receiving the additional information from that person, notify that person and the other competent authority either:

a) that it has received the requested information; or

b) that some of the requested information is still missing.

8. Where neither competent authority has requested additional information pursuant to sub paragraph b) of paragraph 6, the start date referred to in paragraph 1 shall be the earlier of:

a) the date on which both competent authorities have notified the person who presented the case pursuant to subparagraph a) of paragraph 6; and

b) the date that is three calendar months after the notification to the competent authority of the other Contracting Jurisdiction pursuant to subparagraph b) of paragraph 5.

9. Where additional information has been requested pursuant to subparagraph b) of paragraph 6, the start date referred to in paragraph 1 shall be the earlier of:

a) the latest date on which the competent authorities that requested

additional information have notified the person who presented the case and the other competent authority pursuant to subparagraph a) of paragraph 7; and

b) the date that is three calendar months after both competent authorities have received all information requested by either competent authority from the person who presented the case.

If, however, one or both of the competent authorities send the notification referred to in subparagraph b) of paragraph 7, such notification shall be treated as a request for additional information under subparagraph b) of paragraph 6.

10. The competent authorities of the Contracting Jurisdictions shall by mutual agreement (pursuant to the article of the relevant Covered Tax Agreement regarding procedures for mutual agreement) settle the mode of application of the provisions contained in this Part, including the minimum information necessary for each competent authority to undertake substantive consideration of the case. Such an agreement shall be concluded before the date on which unresolved issues in a case are first eligible to be submitted to arbitration and may be modified from time to time thereafter.

11. For purposes of applying this Article to its Covered Tax Agreements, a Party may reserve the right to replace the two-year period set forth in subparagraph b) of paragraph 1 with a three-year period.

12. A Party may reserve the right for the following rules to apply with respect to its Covered Tax Agreements notwithstanding the other provisions of this Article:

a) any unresolved issue arising from a mutual agreement procedure case otherwise within the scope of the arbitration process provided for by this Convention shall not be submitted to arbitration, if a decision on this issue has already been rendered by a court or administrative tribunal of either Contracting Jurisdiction;

b) if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions, a decision concerning the issue is rendered by a court or administrative tribunal of one of the Contracting Jurisdictions, the arbitration process shall terminate.

Article 20 – Appointment of Arbitrators

1. Except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules, paragraphs 2 through 4 shall apply for the purposes of this Part.

2. The following rules shall govern the appointment of the members of an arbitration panel:

a) The arbitration panel shall consist of three individual members with expertise or experience in international tax matters.

b) Each competent authority shall appoint one panel member within 60 days of the date of the request for arbitration under paragraph 1 of Article 19 (Mandatory Binding Arbitration). The two panel members so appointed shall, within 60 days of the latter of their appointments, appoint a third member who shall serve as Chair of the arbitration panel. The Chair shall not be a national or resident of either Contracting Jurisdiction.

c) Each member appointed to the arbitration panel must be impartial and independent of the competent authorities, tax administrations, and ministries of finance of the Contracting Jurisdictions and of all persons directly affected by the case (as well as their advisors) at the time of accepting an appointment, maintain his or her impartiality and independence throughout the proceedings, and avoid any conduct for a reasonable period of time thereafter which may damage the appearance of impartiality and independence of the arbitrators with respect to the proceedings.

3. In the event that the competent authority of a Contracting Jurisdiction fails to appoint a member of the arbitration panel in the manner and within the time periods specified in paragraph 2 or agreed to by the competent authorities of the Contracting Jurisdictions, a member shall be appointed on behalf of that competent authority by the highest ranking official of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development that is not a national of either Contracting Jurisdiction.

4. If the two initial members of the arbitration panel fail to appoint the Chair in the manner and within the time periods specified in paragraph 2 or agreed to by the competent authorities of the Contracting Jurisdictions, the

Chair shall be appointed by the highest ranking official of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development that is not a national of either Contracting Jurisdiction.

Article 21 – Confidentiality of Arbitration Proceedings

1. Solely for the purposes of the application of the provisions of this Part and of the provisions of the relevant Covered Tax Agreement and of the domestic laws of the Contracting Jurisdictions related to the exchange of information, confidentiality, and administrative assistance, members of the arbitration panel and a maximum of three staff per member (and prospective arbitrators solely to the extent necessary to verify their ability to fulfil the requirements of arbitrators) shall be considered to be persons or authorities to whom information may be disclosed. Information received by the arbitration panel or prospective arbitrators and information that the competent authorities receive from the arbitration panel shall be considered information that is exchanged under the provisions of the Covered Tax Agreement related to the exchange of information and administrative assistance.

2. The competent authorities of the Contracting Jurisdictions shall ensure that members of the arbitration panel and their staff agree in writing, prior to their acting in an arbitration proceeding, to treat any information relating to the arbitration proceeding consistently with the confidentiality and nondisclosure obligations described in the provisions of the Covered Tax Agreement related to exchange of information and administrative assistance and under the applicable laws of the Contracting Jurisdictions.

Article 22 – Resolution of a Case Prior to the Conclusion of the Arbitration

For the purposes of this Part and the provisions of the relevant Covered Tax Agreement that provide for resolution of cases through mutual agreement, the mutual agreement procedure, as well as the arbitration proceeding, with respect to a case shall terminate if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions:

a) the competent authorities of the Contracting Jurisdictions reach a mutual agreement to resolve the case; or

b) the person who presented the case withdraws the request for arbitration or the request for a mutual agreement procedure.

Article 23 – Type of Arbitration Process

1. Except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules, the following rules shall apply with respect to an arbitration proceeding pursuant to this Part:

a) After a case is submitted to arbitration, the competent authority of each Contracting Jurisdiction shall submit to the arbitration panel, by a date set by agreement, a proposed resolution which addresses all unresolved issue(s) in the case (taking into account all agreements previously reached in that case between the competent authorities of the Contracting Jurisdictions). The proposed resolution shall be limited to a disposition of specific monetary amounts (for example, of income or expense) or, where specified, the maximum rate of tax charged pursuant to the Covered Tax Agreement, for each adjustment or similar issue in the case. In a case in which the competent authorities of the Contracting Jurisdictions have been unable to reach agreement on an issue regarding the conditions for application of a provision of the relevant Covered Tax Agreement (hereinafter referred to as a "threshold question"), such as whether an individual is a resident or whether a permanent establishment exists, the competent authorities may submit alternative proposed resolutions with respect to issues the determination of which is contingent on resolution of such threshold questions.

b) The competent authority of each Contracting Jurisdiction may also submit a supporting position paper for consideration by the arbitration panel. Each competent authority that submits a proposed resolution or supporting position paper shall provide a copy to the other competent authority by the date on which the proposed resolution and supporting position paper were due. Each competent authority may also submit to the arbitration panel, by a date set by agreement, a reply submission with respect to the proposed resolution and supporting position paper submitted by the other competent authority. A copy of any reply submission shall be provided to the other competent authority by the date on which the reply submission was due.

c) The arbitration panel shall select as its decision one of the proposed resolutions for the case submitted by the competent authorities with respect to each issue and any threshold questions, and shall not include a rationale or any other explanation of the decision. The

arbitration decision will be adopted by a simple majority of the panel members. The arbitration panel shall deliver its decision in writing to the competent authorities of the Contracting Jurisdictions. The arbitration decision shall have no precedential value.

2. For the purpose of applying this Article with respect to its Covered Tax Agreements, a Party may reserve the right for paragraph 1 not to apply to its Covered Tax Agreements. In such a case, except to the extent that the competent authorities of the Contracting Jurisdictions mutually agree on different rules, the following rules shall apply with respect to an arbitration proceeding:

a) After a case is submitted to arbitration, the competent authority of each Contracting Jurisdiction shall provide any information that may be necessary for the arbitration decision to all panel members without undue delay. Unless the competent authorities of the Contracting Jurisdictions agree otherwise, any information that was not available to both competent authorities before the request for arbitration was received by both of them shall not be taken into account for purposes of the decision.

b) The arbitration panel shall decide the issues submitted to arbitration in accordance with the applicable provisions of the Covered Tax Agreement and, subject to these provisions, of those of the domestic laws of the Contracting Jurisdictions. The panel members shall also consider any other sources which the competent authorities of the Contracting Jurisdictions may by mutual agreement expressly identify.

c) The arbitration decision shall be delivered to the competent authorities of the Contracting Jurisdictions in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. The arbitration decision shall be adopted by a simple majority of the panel members. The arbitration decision shall have no precedential value.

3. A Party that has not made the reservation described in paragraph 2 may reserve the right for the preceding paragraphs of this Article not to apply with respect to its Covered Tax Agreements with Parties that have made such a reservation. In such a case, the competent authorities of the Contracting Jurisdictions of each such Covered Tax Agreement shall endeavour to reach agreement on the type of arbitration process that shall

apply with respect to that Covered Tax Agreement. Until such an agreement is reached, Article 19 (Mandatory Binding Arbitration) shall not apply with respect to such a Covered Tax Agreement.

4. A Party may also choose to apply paragraph 5 with respect to its Covered Tax Agreements and shall notify the Depositary accordingly. Paragraph 5 shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement where either of the Contracting Jurisdictions has made such a notification.

5. Prior to the beginning of arbitration proceedings, the competent authorities of the Contracting Jurisdictions to a Covered Tax Agreement shall ensure that each person that presented the case and their advisors agree in writing not to disclose to any other person any information received during the course of the arbitration proceedings from either competent authority or the arbitration panel. The mutual agreement procedure under the Covered Tax Agreement, as well as the arbitration proceeding under this Part, with respect to the case shall terminate if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions, a person that presented the case or one of that person's advisors materially breaches that agreement.

6. Notwithstanding paragraph 4, a Party that does not choose to apply paragraph 5 may reserve the right for paragraph 5 not to apply with respect to one or more identified Covered Tax Agreements or with respect to all of its Covered Tax Agreements.

7. A Party that chooses to apply paragraph 5 may reserve the right for this Part not to apply with respect to all Covered Tax Agreements for which the other Contracting Jurisdiction makes a reservation pursuant to paragraph 6.

Article 24 – Agreement on a Different Resolution

1. For purposes of applying this Part with respect to its Covered Tax Agreements, a Party may choose to apply paragraph 2 and shall notify the Depositary accordingly. Paragraph 2 shall apply in relation to two Contracting Jurisdictions with respect to a Covered Tax Agreement only where both Contracting Jurisdictions have made such a notification.

2. Notwithstanding paragraph 4 of Article 19 (Mandatory Binding

Arbitration), an arbitration decision pursuant to this Part shall not be binding on the Contracting Jurisdictions to a Covered Tax Agreement and shall not be implemented if the competent authorities of the Contracting Jurisdictions agree on a different resolution of all unresolved issues within three calendar months after the arbitration decision has been delivered to them.

3. A Party that chooses to apply paragraph 2 may reserve the right for paragraph 2 to apply only with respect to its Covered Tax Agreements for which paragraph 2 of Article 23 (Type of Arbitration Process) applies.

Article 25 – Costs of Arbitration Proceedings

In an arbitration proceeding under this Part, the fees and expenses of the members of the arbitration panel, as well as any costs incurred in connection with the arbitration proceedings by the Contracting Jurisdictions, shall be borne by the Contracting Jurisdictions in a manner to be settled by mutual agreement between the competent authorities of the Contracting Jurisdictions. In the absence of such agreement, each Contracting Jurisdiction shall bear its own expenses and those of its appointed panel member. The cost of the chair of the arbitration panel and other expenses associated with the conduct of the arbitration proceedings shall be borne by the Contracting Jurisdictions in equal shares.

Article 26 – Compatibility

1. Subject to Article 18 (Choice to Apply Part VI), the provisions of this Part shall apply in place of or in the absence of provisions of a Covered Tax Agreement that provide for arbitration of unresolved issues arising from a mutual agreement procedure case. Each Party that chooses to apply this Part shall notify the Depositary of whether each of its Covered Tax Agreements, other than those that are within the scope of a reservation under paragraph 4, contains such a provision, and if so, the article and paragraph number of each such provision. Where two Contracting Jurisdictions have made a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of this Part as between those Contracting Jurisdictions.

2. Any unresolved issue arising from a mutual agreement procedure case otherwise within the scope of the arbitration process provided for in this Part shall not be submitted to arbitration if the issue falls within the scope of a case with respect to which an arbitration panel or similar body has previously been set up in accordance with a bilateral or multilateral convention that

provides for mandatory binding arbitration of unresolved issues arising from a mutual agreement procedure case.

3. Subject to paragraph 1, nothing in this Part shall affect the fulfilment of wider obligations with respect to the arbitration of unresolved issues arising in the context of a mutual agreement procedure resulting from other conventions to which the Contracting Jurisdictions are or will become parties.

4. A Party may reserve the right for this Part not to apply with respect to one or more identified Covered Tax Agreements (or to all of its Covered Tax Agreements) that already provide for mandatory binding arbitration of unresolved issues arising from a mutual agreement procedure case.

PART VII. FINAL PROVISIONS

Article 27 – Signature and Ratification, Acceptance or Approval

1. As of 31 December 2016, this Convention shall be open for signature by:

a) all States;

b) Guernsey (the United Kingdom of Great Britain and Northern Ireland); Isle of Man (the United Kingdom of Great Britain and Northern Ireland); Jersey (the United Kingdom of Great Britain and Northern Ireland); and

c) any other jurisdiction authorised to become a Party by means of a decision by consensus of the Parties and Signatories.

2. This Convention is subject to ratification, acceptance or approval.

Article 28 – Reservations

1. Subject to paragraph 2, no reservations may be made to this Convention except those expressly permitted by:

a) Paragraph 5 of Article 3 (Transparent Entities);

b) Paragraph 3 of Article 4 (Dual Resident Entities);

c) Paragraphs 8 and 9 of Article 5 (Application of Methods for Elimination of Double Taxation);

d) Paragraph 4 of Article 6 (Purpose of a Covered Tax Agreement);

e) Paragraphs 15 and 16 of Article 7 (Prevention of Treaty Abuse);

f) Paragraph 3 of Article 8 (Dividend Transfer Transactions);

g) Paragraph 6 of Article 9 (Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property);

h) Paragraph 5 of Article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions);

i) Paragraph 3 of Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents);

j) Paragraph 4 of Article 12 (Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies);

k) Paragraph 6 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions);

l) Paragraph 3 of Article 14 (Splitting-up of Contracts);

m) Paragraph 2 of Article 15 (Definition of a Person Closely Related to an Enterprise);

n) Paragraph 5 of Article 16 (Mutual Agreement Procedure);

o) Paragraph 3 of Article 17 (Corresponding Adjustments);

p) Paragraphs 11 and 12 of Article 19 (Mandatory Binding Arbitration);

q) Paragraphs 2, 3, 6, and 7 of Article 23 (Type of Arbitration Process);

r) Paragraph 3 of Article 24 (Agreement on a Different Resolution);

s) Paragraph 4 of Article 26 (Compatibility);

t) Paragraphs 6 and 7 of Article 35 (Entry into Effect); and

u) Paragraph 2 of Article 36 (Entry into Effect of Part VI).

2. a) Notwithstanding paragraph 1, a Party that chooses under Article 18 (Choice to Apply Part VI) to apply Part VI (Arbitration) may formulate one or more reservations with respect to the scope of cases that shall be eligible for arbitration under the provisions of Part VI (Arbitration). For a Party which chooses under Article 18 (Choice to Apply Part VI) to apply Part VI (Arbitration) after it has become a Party to this Convention, reservations pursuant to this subparagraph shall be made at the same time as that Party's notification to the Depositary pursuant to Article 18 (Choice to Apply Part VI).

b) Reservations made under subparagraph a) are subject to acceptance. A reservation made under subparagraph a) shall be considered to have been accepted by a Party if it has not notified the Depositary that it objects to the reservation by the end of a period of twelve calendar months beginning on the date of notification of the reservation by the Depositary or by the date on which it deposits its instrument of ratification, acceptance, or approval, whichever is later. For a Party which chooses under Article 18 (Choice to Apply Part VI) to apply Part VI (Arbitration) after it has become a Party to this Convention, objections to prior reservations made by other Parties pursuant to subparagraph a) can be made at the time of the first- mentioned Party's notification to the Depositary pursuant to Article 18 (Choice to Apply Part VI). Where a Party raises an objection to a reservation made under subparagraph a), the entirety of Part VI (Arbitration) shall not apply as between the objecting Party and the reserving Party.

3. Unless explicitly provided otherwise in the relevant provisions of this Convention, a reservation made in accordance with paragraph 1 or 2 shall:

a) modify for the reserving Party in its relations with another Party the provisions of this Convention to which the reservation relates to the extent of the reservation; and

b) modify those provisions to the same extent for the other Party in its relations with the reserving Party.

4. Reservations applicable to Covered Tax Agreements entered into by or on behalf of a jurisdiction or territory for whose international relations a Party is responsible, where that jurisdiction or territory is not a Party to the Convention pursuant to subparagraph b) or c) of paragraph 1 of Article 27 (Signature and Ratification, Acceptance or Approval), shall be made by the responsible Party and can be different from the reservations made by that Party for its own Covered Tax Agreements.

5. Reservations shall be made at the time of signature or when depositing the instrument of ratification, acceptance or approval, subject to the provisions of paragraphs 2, 6 and 9 of this Article, and paragraph 5 of Article 29 (Notifications). However, for a Party which chooses under Article 18 (Choice to Apply Part VI) to apply Part VI (Arbitration) after it has become a Party to this Convention, reservations described in subparagraphs p), q), r) and s) of paragraph 1 of this Article shall be made at the same time as that

Party's notification to the Depositary pursuant to Article 18 (Choice to Apply Part VI).

6. If reservations are made at the time of signature, they shall be confirmed upon deposit of the instrument of ratification, acceptance or approval, unless the document containing the reservations explicitly specifies that it is to be considered definitive, subject to the provisions of paragraphs 2, 5 and 9 of this Article, and paragraph 5 of Article 29 (Notifications).

7. If reservations are not made at the time of signature, a provisional list of expected reservations shall be provided to the Depositary at that time.

8. For reservations made pursuant to each of the following provisions, a list of agreements notified pursuant to clause ii) of subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms) that are within the scope of the reservation as defined in the relevant provision (and, in the case of a reservation under any of the following provisions other than those listed in subparagraphs c), d) and n), the article and paragraph number of each relevant provision) must be provided when such reservations are made:

a) Subparagraphs b), c), d), e) and g) of paragraph 5 of Article 3 (Transparent Entities);

b) Subparagraphs b), c) and d) of paragraph 3 of Article 4 (Dual Resident Entities);

c) Paragraphs 8 and 9 of Article 5 (Application of Methods for Elimination of Double Taxation);

d) Paragraph 4 of Article 6 (Purpose of a Covered Tax Agreement);

e) Subparagraphs b) and c) of paragraph 15 of Article 7 (Prevention of Treaty Abuse);

f) Clauses i), ii), and iii) of subparagraph b) of paragraph 3 of Article 8 (Dividend Transfer Transactions);

g) Subparagraphs d), e) and f) of paragraph 6 of Article 9 (Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property);

h) Subparagraphs b) and c) of paragraph 5 of Article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions);

i) Subparagraph b) of paragraph 3 of Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents);

j) Subparagraph b) of paragraph 6 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions);

k) Subparagraph b) of paragraph 3 of Article 14 (Splitting-up of Contracts);

l) Subparagraph b) of paragraph 5 of Article 16 (Mutual Agreement Procedure);

m) Subparagraph a) of paragraph 3 of Article 17 (Corresponding Adjustments);

n) Paragraph 6 of Article 23 (Type of Arbitration Process); and

o) Paragraph 4 of Article 26 (Compatibility).

The reservations described in subparagraphs a) through o) above shall not apply to any Covered Tax Agreement that is not included on the list described in this paragraph.

9. Any Party which has made a reservation in accordance with paragraph 1 or 2 may at any time withdraw it or replace it with a more limited reservation by means of a notification addressed to the Depositary. Such Party shall make any additional notifications pursuant to paragraph 6 of Article 29 (Notifications) which may be required as a result of the withdrawal or replacement of the reservation. Subject to paragraph 7 of Article 35 (Entry into Effect), the withdrawal or replacement shall take effect:

a) with respect to a Covered Tax Agreement solely with States or jurisdictions that are Parties to the Convention when the notification of withdrawal or replacement of the reservation is received by the Depositary:

   i) for reservations in respect of provisions relating to taxes withheld at source, where the event giving rise to such taxes occurs on or after 1 January of the year next following the expiration of a period of six calendar months beginning on the date of the communication by the Depositary of the notification of withdrawal or replacement of the reservation; and

   ii) for reservations in respect of all other provisions, for taxes levied with respect to taxable periods beginning on or after 1 January of the year next following the expiration of a period of

six calendar months beginning on the date of the communication by the Depositary of the notification of withdrawal or replacement of the reservation; and

b) with respect to a Covered Tax Agreement for which one or more Contracting Jurisdictions becomes a Party to this Convention after the date of receipt by the Depositary of the notification of withdrawal or replacement: on the latest of the dates on which the Convention enters into force for those Contracting Jurisdictions.

Article 29 – Notifications

1. Subject to paragraphs 5 and 6 of this Article, and paragraph 7 of Article 35 (Entry into Effect), notifications pursuant to the following provisions shall be made at the time of signature or when depositing the instrument of ratification, acceptance or approval:

a) Clause ii) of subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms);

b) Paragraph 6 of Article 3 (Transparent Entities);

c) Paragraph 4 of Article 4 (Dual Resident Entities);

d) Paragraph 10 of Article 5 (Application of Methods for Elimination of Double Taxation);

e) Paragraphs 5 and 6 of Article 6 (Purpose of a Covered Tax Agreement);

f) Paragraph 17 of Article 7 (Prevention of Treaty Abuse);

g) Paragraph 4 of Article 8 (Dividend Transfer Transactions);

h) Paragraphs 7 and 8 of Article 9 (Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property);

i) Paragraph 6 of Article 10 (Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions);

j) Paragraph 4 of Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents);

k) Paragraphs 5 and 6 of Article 12 (Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies);

l) Paragraphs 7 and 8 of Article 13 (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions);

m) Paragraph 4 of Article 14 (Splitting-up of Contracts);

n) Paragraph 6 of Article 16 (Mutual Agreement Procedure);

o) Paragraph 4 of Article 17 (Corresponding Adjustments);

p) Article 18 (Choice to Apply Part VI);

q) Paragraph 4 of Article 23 (Type of Arbitration Process);

r) Paragraph 1 of Article 24 (Agreement on a Different Resolution);

s) Paragraph 1 of Article 26 (Compatibility); and

t) Paragraphs 1, 2, 3, 5 and 7 of Article 35 (Entry into Effect).

2. Notifications in respect of Covered Tax Agreements entered into by or on behalf of a jurisdiction or territory for whose international relations a Party is responsible, where that jurisdiction or territory is not a Party to the Convention pursuant to subparagraph b) or c) of paragraph 1 of Article 27 (Signature and Ratification, Acceptance or Approval), shall be made by the responsible Party and can be different from the notifications made by that Party for its own Covered Tax Agreements.

3. If notifications are made at the time of signature, they shall be confirmed upon deposit of the instrument of ratification, acceptance or approval, unless the document containing the notifications explicitly specifies that it is to be considered definitive, subject to the provisions of paragraphs 5 and 6 of this Article, and paragraph 7 of Article 35 (Entry into Effect).

4. If notifications are not made at the time of signature, a provisional list of expected notifications shall be provided at that time.

5. A Party may extend at any time the list of agreements notified under clause ii) of subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms) by means of a notification addressed to the Depositary. The Party shall specify in this notification whether the agreement falls within the scope of any of the reservations made by the Party which are listed in paragraph 8 of Article 28 (Reservations). The Party may also make a new reservation described in paragraph 8 of Article 28 (Reservations) if the additional agreement would be the first to fall within the scope of such a reservation. The Party shall also specify any additional notifications that may be required under subparagraphs b) through s) of paragraph 1 to reflect the inclusion of

the additional agreements. In addition, if the extension results for the first time in the inclusion of a tax agreement entered into by or on behalf of a jurisdiction or territory for whose international relations a Party is responsible, the Party shall specify any reservations (pursuant to paragraph 4 of Article 28 (Reservations)) or notifications (pursuant to paragraph 2 of this Article) applicable to Covered Tax Agreements entered into by or on behalf of that jurisdiction or territory. On the date on which the added agreement(s) notified under clause ii) of subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms) become Covered Tax Agreements, the provisions of Article 35 (Entry into Effect) shall govern the date on which the modifications to the Covered Tax Agreement shall have effect.

6. A Party may make additional notifications pursuant to subparagraphs b) through s) of paragraph 1 by means of a notification addressed to the Depositary. These notifications shall take effect:

a) with respect to Covered Tax Agreements solely with States or jurisdictions that are Parties to the Convention when the additional notification is received by the Depositary:

   i) for notifications in respect of provisions relating to taxes withheld at source, where the event giving rise to such taxes occurs on or after 1 January of the year next following the expiration of a period of six calendar months beginning on the date of the communication by the Depositary of the additional notification; and

   ii) for notifications in respect of all other provisions, for taxes levied with respect to taxable periods beginning on or after 1 January of the year next following the expiration of a period of six calendar months beginning on the date of the communication by the Depositary of the additional notification; and

b) with respect to a Covered Tax Agreement for which one or more Contracting Jurisdictions becomes a Party to this Convention after the date of receipt by the Depositary of the additional notification: on the latest of the dates on which the Convention enters into force for those Contracting Jurisdictions.

Article 30 – Subsequent Modifications of Covered Tax Agreements

The provisions in this Convention are without prejudice to subsequent modifications to a Covered Tax Agreement which may be agreed between the Contracting Jurisdictions of the Covered Tax Agreement.

Article 31 – Conference of the Parties

1. The Parties may convene a Conference of the Parties for the purposes of taking any decisions or exercising any functions as may be required or appropriate under the provisions of this Convention.

2. The Conference of the Parties shall be served by the Depositary.

3. Any Party may request a Conference of the Parties by communicating a request to the Depositary. The Depositary shall inform all Parties of any request. Thereafter, the Depositary shall convene a Conference of the Parties, provided that the request is supported by one-third of the Parties within six calendar months of the communication by the Depositary of the request.

Article 32 – Interpretation and Implementation

1. Any question arising as to the interpretation or implementation of provisions of a Covered Tax Agreement as they are modified by this Convention shall be determined in accordance with the provision(s) of the Covered Tax Agreement relating to the resolution by mutual agreement of questions of interpretation or application of the Covered Tax Agreement (as those provisions may be modified by this Convention).

2. Any question arising as to the interpretation or implementation of this Convention may be addressed by a Conference of the Parties convened in accordance with paragraph 3 of Article 31 (Conference of the Parties).

Article 33 – Amendment

1. Any Party may propose an amendment to this Convention by submitting the proposed amendment to the Depositary.

2. A Conference of the Parties may be convened to consider the proposed amendment in accordance with paragraph 3 of Article 31 (Conference of the Parties).

Article 34 – Entry into Force

1. This Convention shall enter into force on the first day of the month

following the expiration of a period of three calendar months beginning on the date of deposit of the fifth instrument of ratification, acceptance or approval.

2. For each Signatory ratifying, accepting, or approving this Convention after the deposit of the fifth instrument of ratification, acceptance or approval, the Convention shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit by such Signatory of its instrument of ratification, acceptance or approval.

Article 35 – Entry into Effect

1. The provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a Covered Tax Agreement:

a) with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and

b) with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of six calendar months (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.

2. Solely for the purpose of its own application of subparagraph a) of paragraph 1 and subparagraph a) of paragraph 5, a Party may choose to substitute “taxable period” for “calendar year”, and shall notify the Depositary accordingly.

3. Solely for the purpose of its own application of subparagraph b) of paragraph 1 and subparagraph b) of paragraph 5, a Party may choose to replace the reference to “taxable periods beginning on or after the expiration of a period” with a reference to “taxable periods beginning on or after 1 January of the next year beginning on or after the expiration of a period”, and shall notify the Depositary accordingly.

4. Notwithstanding the preceding provisions of this Article, Article 16 (Mutual Agreement Procedure) shall have effect with respect to a Covered Tax Agreement for a case presented to the competent authority of a Contracting Jurisdiction on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement, except for cases that were not eligible to be presented as of that date under the Covered Tax Agreement prior to its modification by the Convention, without regard to the taxable period to which the case relates.

5. For a new Covered Tax Agreement resulting from an extension pursuant to paragraph 5 of Article 29 (Notifications) of the list of agreements notified under clause ii) of subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms), the provisions of this Convention shall have effect in each Contracting Jurisdiction:

a) with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after 30 days after the date of the communication by the Depositary of the notification of the extension of the list of agreements; and

b) with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of nine calendar months (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the date of the communication by the Depositary of the notification of the extension of the list of agreements.

6. A Party may reserve the right for paragraph 4 not to apply with respect to its Covered Tax Agreements.

7. a) A Party may reserve the right to replace:

i) the references in paragraphs 1 and 4 to "the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement"; and

ii) the references in paragraph 5 to "the date of the communication by the Depositary of the notification of the extension of the list of agreements";

with references to "30 days after the date of receipt by the

Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of Article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the provisions of this Convention with respect to that specific Covered Tax Agreement";

iii) the references in subparagraph a) of paragraph 9 of Article 28 (Reservations) to "on the date of the communication by the Depositary of the notification of withdrawal or replacement of the reservation"; and

iv) the reference in subparagraph b) of paragraph 9 of Article 28 (Reservations) to "on the latest of the dates on which the Convention enters into force for those Contracting Jurisdictions";

with references to "30 days after the date of receipt by the Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of Article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the withdrawal or replacement of the reservation with respect to that specific Covered Tax Agreement";

v) the references in subparagraph a) of paragraph 6 of Article 29 (Notifications) to "on the date of the communication by the Depositary of the additional notification"; and

vi) the reference in subparagraph b) of paragraph 6 of Article 29 (Notifications) to "on the latest of the dates on which the Convention enters into force for those Contracting Jurisdictions";

with references to "30 days after the date of receipt by the Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of Article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the additional notification with respect to that specific Covered Tax Agreement";

vii) the references in paragraphs 1 and 2 of Article 36 (Entry into

Effect of Part VI) to "the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement";

with references to "30 days after the date of receipt by the Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of Article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the provisions of this Convention with respect to that specific Covered Tax Agreement"; and

viii) the reference in paragraph 3 of Article 36 (Entry into Effect of Part VI) to "the date of the communication by the Depositary of the notification of the extension of the list of agreements";

ix) the references in paragraph 4 of Article 36 (Entry into Effect of Part VI) to "the date of the communication by the Depositary of the notification of withdrawal of the reservation", "the date of the communication by the Depositary of the notification of replacement of the reservation" and "the date of the communication by the Depositary of the notification of withdrawal of the objection to the reservation"; and

x) the reference in paragraph 5 of Article 36 (Entry into Effect of Part VI) to "the date of the communication by the Depositary of the additional notification";

with references to "30 days after the date of receipt by the Depositary of the latest notification by each Contracting Jurisdiction making the reservation described in paragraph 7 of Article 35 (Entry into Effect) that it has completed its internal procedures for the entry into effect of the provisions of Part VI (Arbitration) with respect to that specific Covered Tax Agreement".

b) A Party making a reservation in accordance with subparagraph a) shall notify the confirmation of the completion of its internal procedures simultaneously to the Depositary and the other Contracting Jurisdiction(s).

c) If one or more Contracting Jurisdictions to a Covered Tax Agreement

makes a reservation under this paragraph, the date of entry into effect of the provisions of the Convention, of the withdrawal or replacement of a reservation, of an additional notification with respect to that Covered Tax Agreement, or of Part VI (Arbitration) shall be governed by this paragraph for all Contracting Jurisdictions to the Covered Tax Agreement.

Article 36 – Entry into Effect of Part VI

1. Notwithstanding paragraph 9 of Article 28 (Reservations), paragraph 6 of Article 29 (Notifications), and paragraphs 1 through 6 of Article 35 (Entry into Effect), with respect to two Contracting Jurisdictions to a Covered Tax Agreement, the provisions of Part VI (Arbitration) shall have effect:

a) with respect to cases presented to the competent authority of a Contracting Jurisdiction (as described in subparagraph a) of paragraph 1 of Article 19 (Mandatory Binding Arbitration)), on or after the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and

b) with respect to cases presented to the competent authority of a Contracting Jurisdiction prior to the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement, on the date when both Contracting Jurisdictions have notified the Depositary that they have reached mutual agreement pursuant to paragraph 10 of Article 19 (Mandatory Binding Arbitration), along with information regarding the date or dates on which such cases shall be considered to have been presented to the competent authority of a Contracting Jurisdiction (as described in subparagraph a) of paragraph 1 of Article 19 (Mandatory Binding Arbitration)) according to the terms of that mutual agreement.

2. A Party may reserve the right for Part VI (Arbitration) to apply to a case presented to the competent authority of a Contracting Jurisdiction prior to the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement only to the extent that the competent authorities of both Contracting Jurisdictions agree that it will apply to that specific case.

3. In the case of a new Covered Tax Agreement resulting from an extension pursuant to paragraph 5 of Article 29 (Notifications) of the list of agreements notified under clause ii) of subparagraph a) of paragraph 1 of

Article 2 (Interpretation of Terms), the references in paragraphs 1 and 2 of this Article to "the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement" shall be replaced with references to "the date of the communication by the Depositary of the notification of the extension of the list of agreements".

4. A withdrawal or replacement of a reservation made under paragraph 4 of Article 26 (Compatibility) pursuant to paragraph 9 of Article 28 (Reservations), or the withdrawal of an objection to a reservation made under paragraph 2 of Article 28 (Reservations) which results in the application of Part VI (Arbitration) between two Contracting Jurisdictions to a Covered Tax Agreement, shall have effect according to subparagraphs a) and b) of paragraph 1 of this Article, except that the references to "the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement" shall be replaced with references to "the date of the communication by the Depositary of the notification of withdrawal of the reservation", "the date of the communication by the Depositary of the notification of replacement of the reservation" or "the date of the communication by the Depositary of the notification of withdrawal of the objection to the reservation", respectively.

5. An additional notification made pursuant to subparagraph p) of paragraph 1 of Article 29 (Notifications) shall have effect according to subparagraphs a) and b) of paragraph 1, except that the references in paragraphs 1 and 2 of this Article to "the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement" shall be replaced with references to "the date of the communication by the Depositary of the additional notification".

Article 37 - Withdrawal

1. Any Party may, at any time, withdraw from this Convention by means of a notification addressed to the Depositary.

2. Withdrawal pursuant to paragraph 1 shall become effective on the date of receipt of the notification by the Depositary. In cases where this Convention has entered into force with respect to all Contracting Jurisdictions to a Covered Tax Agreement before the date on which a Party's withdrawal becomes effective, that Covered Tax Agreement shall remain as modified by this Convention.

Article 38 – Relation with Protocols

1. This Convention may be supplemented by one or more protocols.

2. In order to become a party to a protocol, a State or jurisdiction must also be a Party to this Convention.

3. A Party to this Convention is not bound by a protocol unless it becomes a party to the protocol in accordance with its provisions.

Article 39 – Depositary

1. The Secretary-General of the Organisation for Economic Co-operation and Development shall be the Depositary of this Convention and any protocols pursuant to Article 38 (Relation with Protocols).

2. The Depositary shall notify the Parties and Signatories within one calendar month of:

a) any signature pursuant to Article 27 (Signature and Ratification, Acceptance or Approval);

b) the deposit of any instrument of ratification, acceptance or approval pursuant to Article 27 (Signature and Ratification, Acceptance or Approval);

c) any reservation or withdrawal or replacement of a reservation pursuant to Article 28 (Reservations);

d) any notification or additional notification pursuant to Article 29 (Notifications);

e) any proposed amendment to this Convention pursuant to Article 33 (Amendment);

f) any withdrawal from this Convention pursuant to Article 37 (Withdrawal); and

g) any other communication related to this Convention.

3. The Depositary shall maintain publicly available lists of:

a) Covered Tax Agreements;

b) reservations made by the Parties; and

c) notifications made by the Parties.

In witness whereof the undersigned, being duly authorised thereto, have signed this Convention Done at Paris, the 24th day of November 2016, in English and French, both texts being equally authentic, in a single copy which shall be deposited in the archives of the Organisation for Economic Co-operation and Development.