International Taxation Conference 2018

Joint Conference between

Foundation for International Taxation, India

&

INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION, AMSTERDAM

Session: United Nations Model

Chairman: Nishith Desai *Presentation by: Michael Lennard (Video recording)*

Panel Leader: Uday Ved

Panel Speakers: Rajat Bansal - India, T P Ostwal - India, Radhakishan Rawal - India, Dhruv Sanghavi - The Netherlands, Sol Picciotto, UK

December 08, 2018

Q1 – Changes in the UN Model Convention

What do the changes in the UN Model Convention aim at?
Do the overall changes align with the BEPS and the MLI?

Q2 – Changes in Article 1 (Hybrid Entities)

Article 1

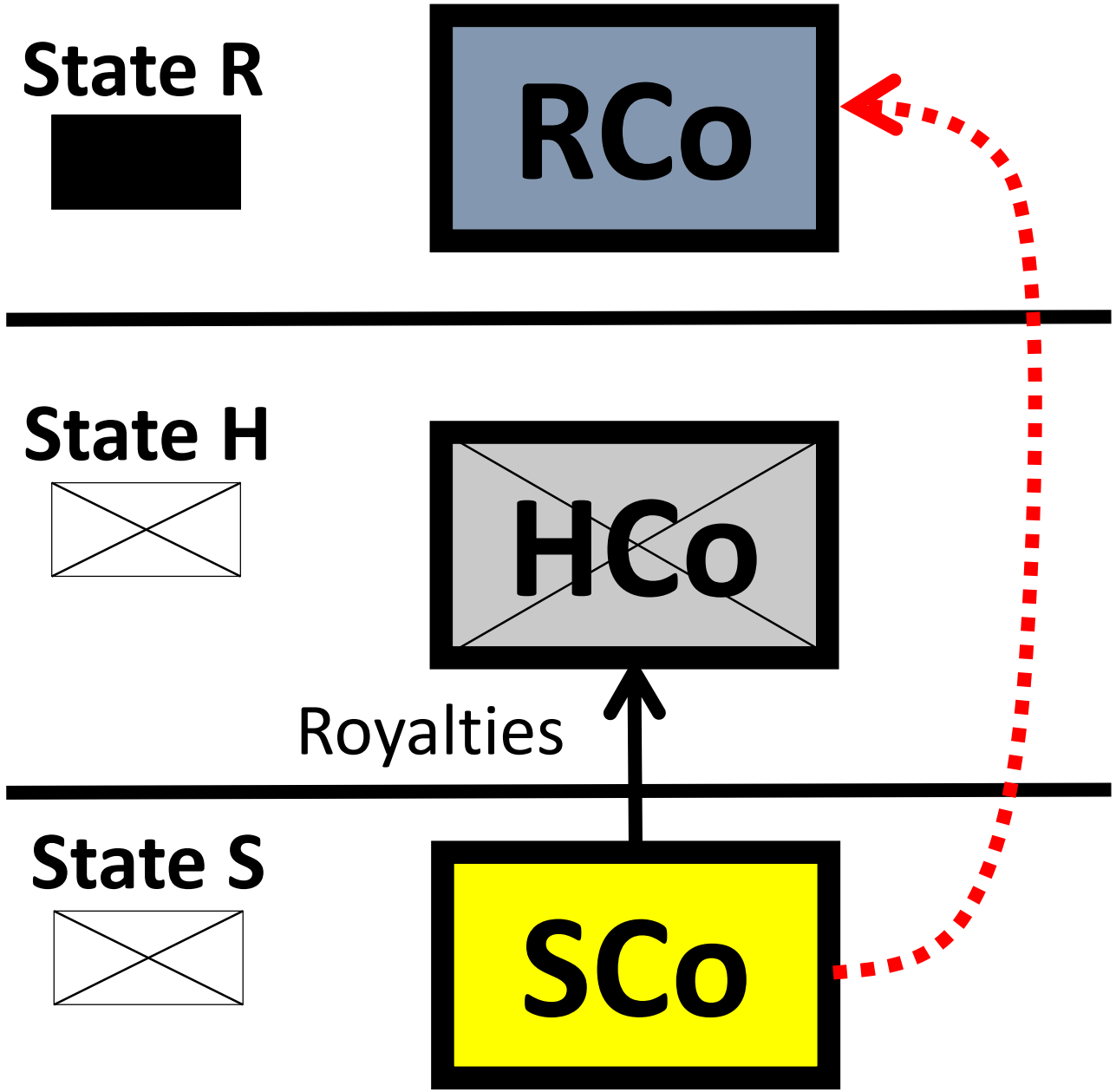
2. For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under [paragraph 3 of Article 7], paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 A [25 B] and 28.

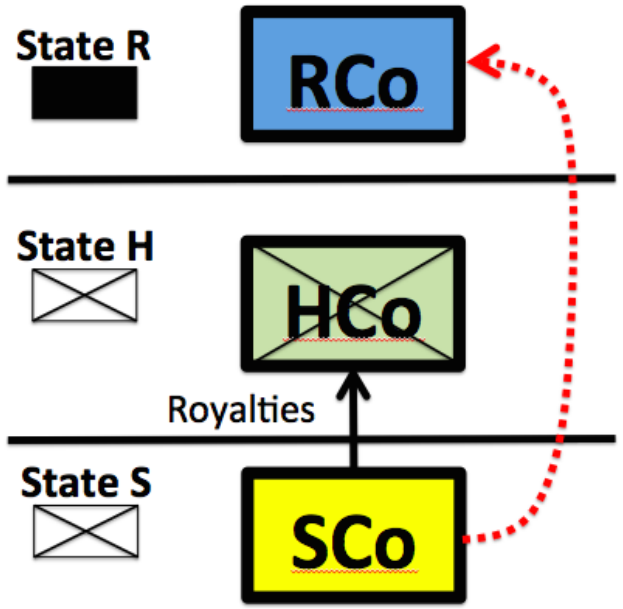
Question a: Why is it important to include these provisions in tax treaties?

Question b: India has made a reservation against these provisions in the MLI. Are there any legal or policy concerns emanating from the hybrid entities proposal?

Q2 – Changes in Article 1 – denial of treaty benefits?



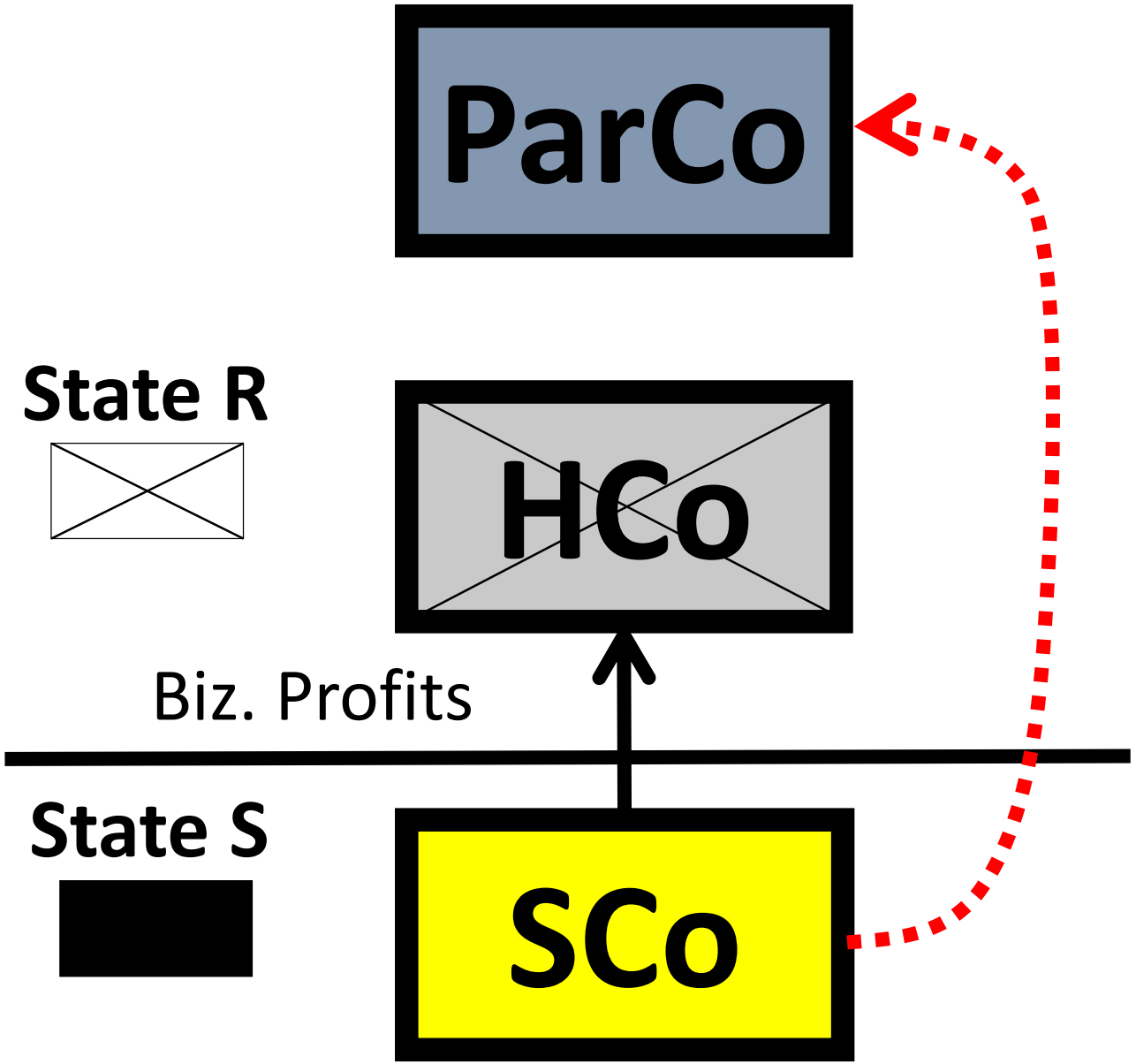
Does Article 1(2) deny treaty benefits? - DS



Article 1(2):

"For the purposes of this Convention, 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 State **shall be considered to be income of a resident** of a Contracting State **but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident** of that State."

Q2 – Changes in Article 1 – certainty of avoidance of JDT



Without Art. 1(2):

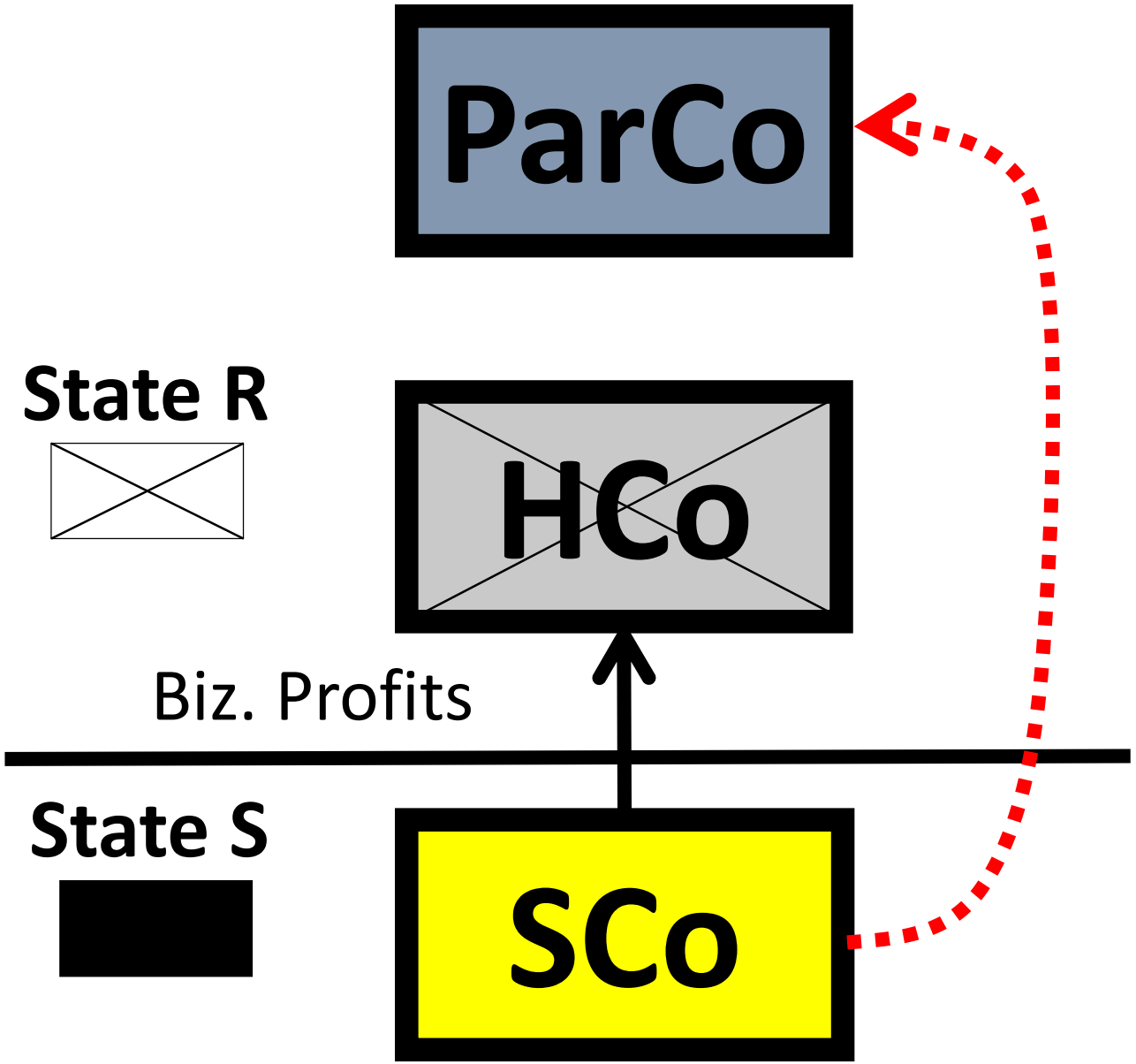
AAR in Schellenberg Wittmer

State S attributes the business profits to HCo, which is a “person” (defined in Article 3(1)(a))

However, HCo is not “liable to tax”, therefore not a resident of State H

→ No tax treaty entitlement

Q2 – Changes in Article 1 – certainty of avoidance of JDT



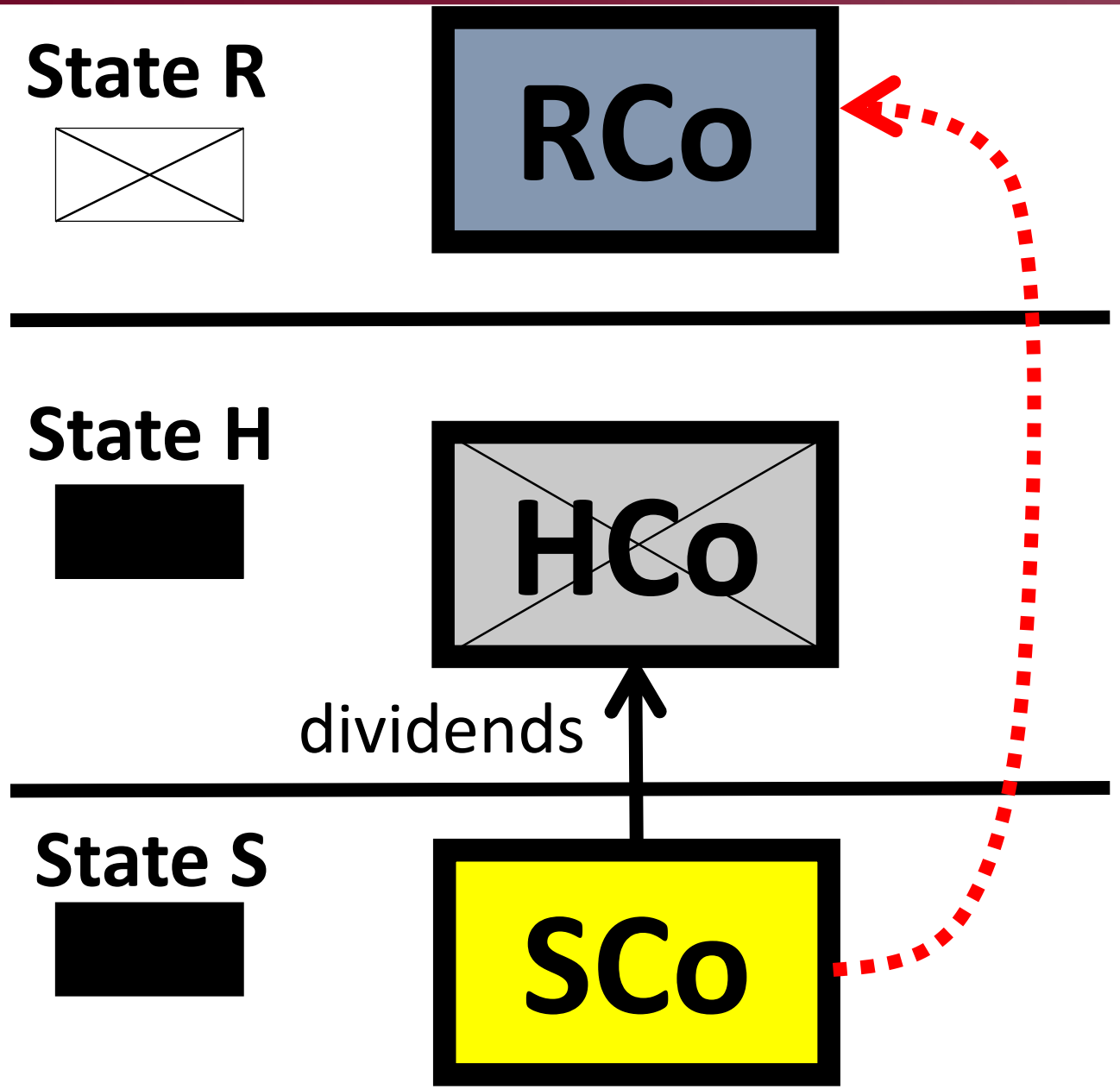
With Art. 1(2):

"For the purposes of this H-S Tax Treaty, 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 State **shall be considered to be income of a resident of a State H** but only to the extent that the income is treated, **for purposes of taxation by State H, as the income of a resident of State H**."

State S should treat the income as being received by a resident of State H and apply the tax treaty…

In the absence of attribution to a PE in State S, the business profits shall be taxable only in State H

Q2 – Changes in Article 1 – Legal issues



H-S tax treaty: Div WHT 10%
R-S tax treaty: Div WHT 5%

Legal issue:
2014 para. 6.5, Comm. Art. 1: both tax treaties apply, lower WHT!

Inconsistent with `BO´

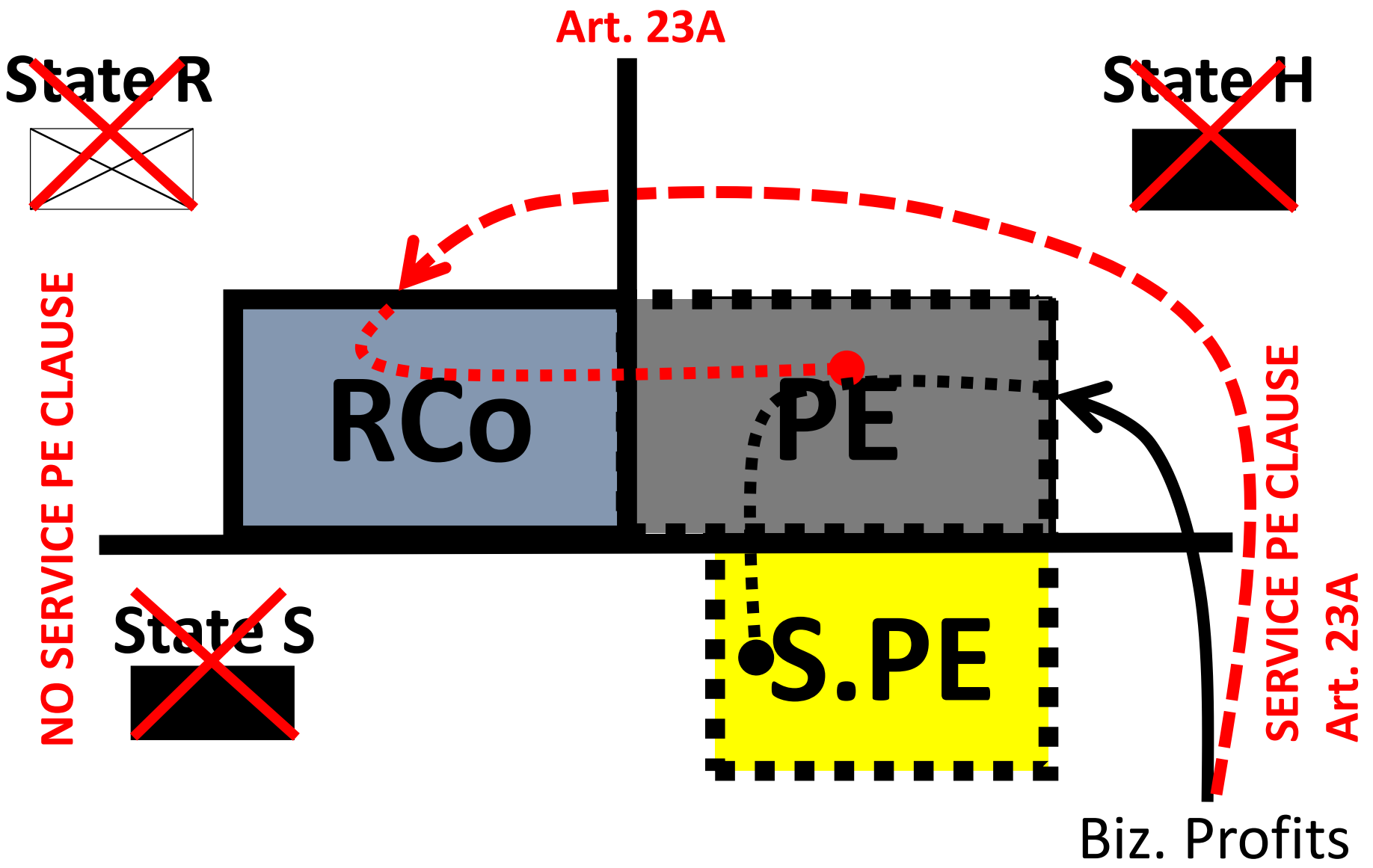
There can only be 1 BO!

Double Taxation:

Para 3 absolves both State R and State H from relieving double taxation caused *inter se*.

Both states only provide relief Against State S taxes

Q2 – Changes in Article 1 – Economic anomaly



Q3 – Changes in Article 4

1st sentence:

"Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, ~~then it shall be deemed to be a resident only of the State in which its place of effective management is situated~~ the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors."

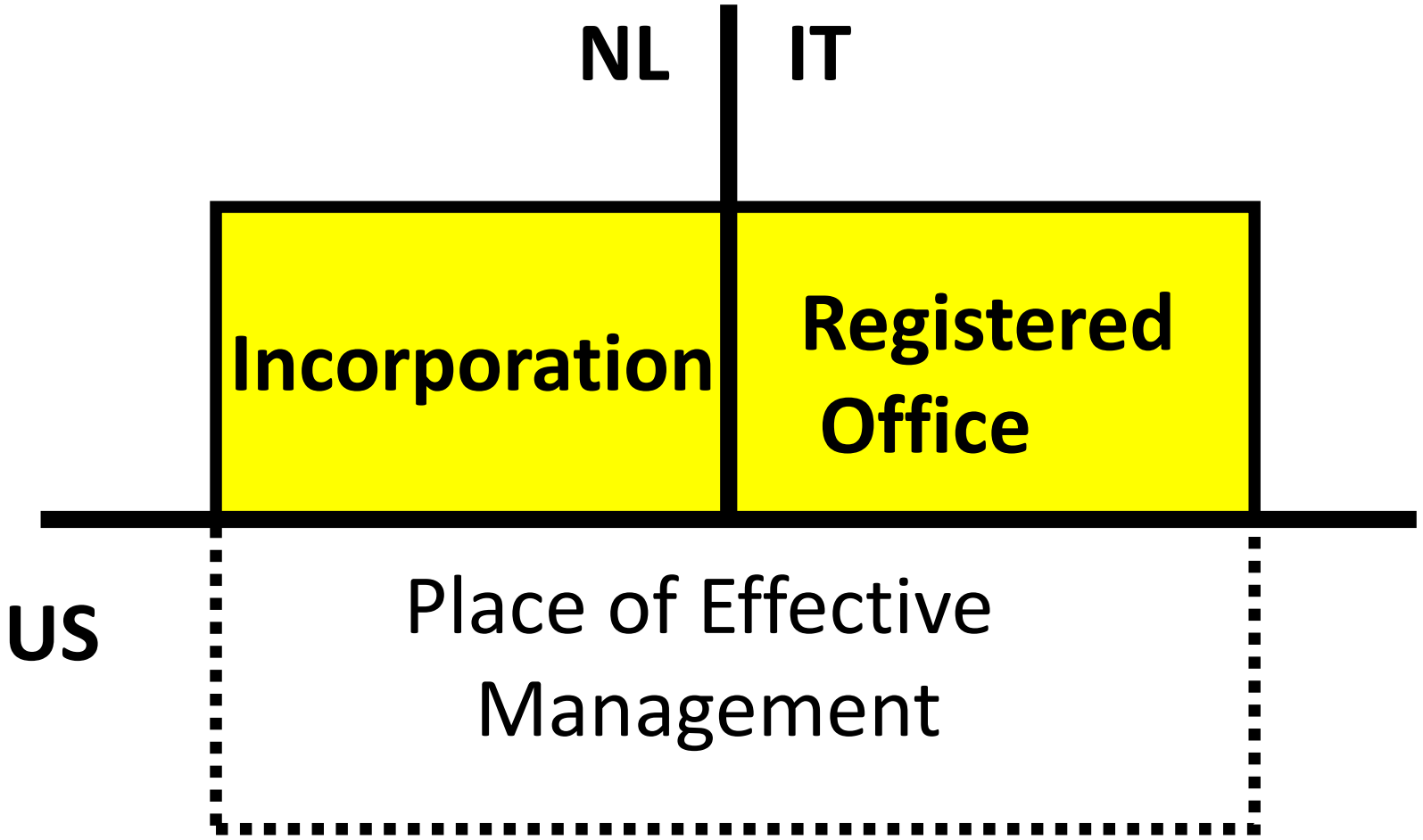
2nd sentence:

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

Q3 – Changes in Article 4

- *What do you think – how practical is this process and what could be the Competent Authorities' approach to deal with such instances?*
- *If the Competent Authorities take, say more than a year to determine the residential status of the person – how and in which state the income should be offered to by the person?*
- *What was the need for this reform? Are there any benefits to the change of the tiebreaker rule?*

Q3 – Changes in Article 4 – need for reform



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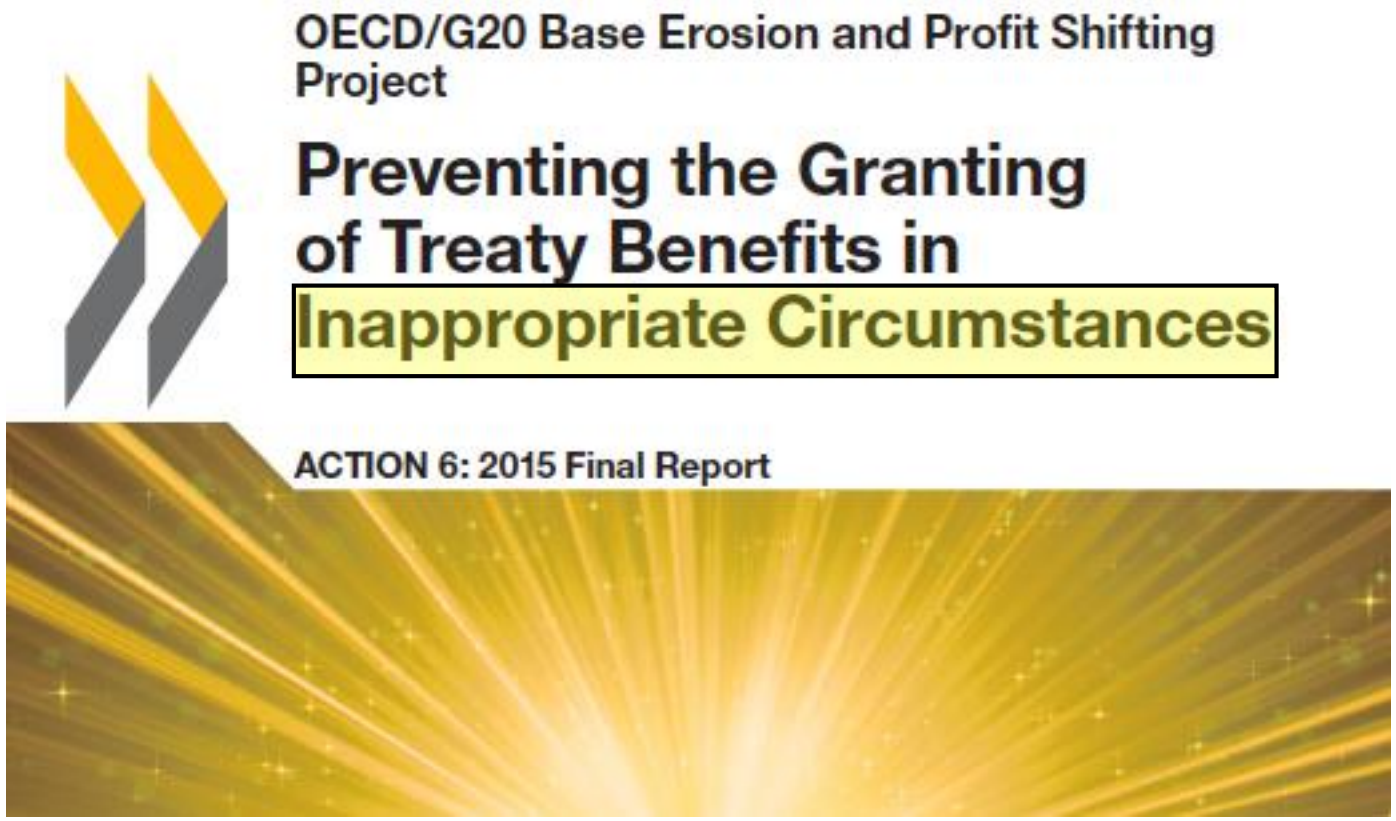

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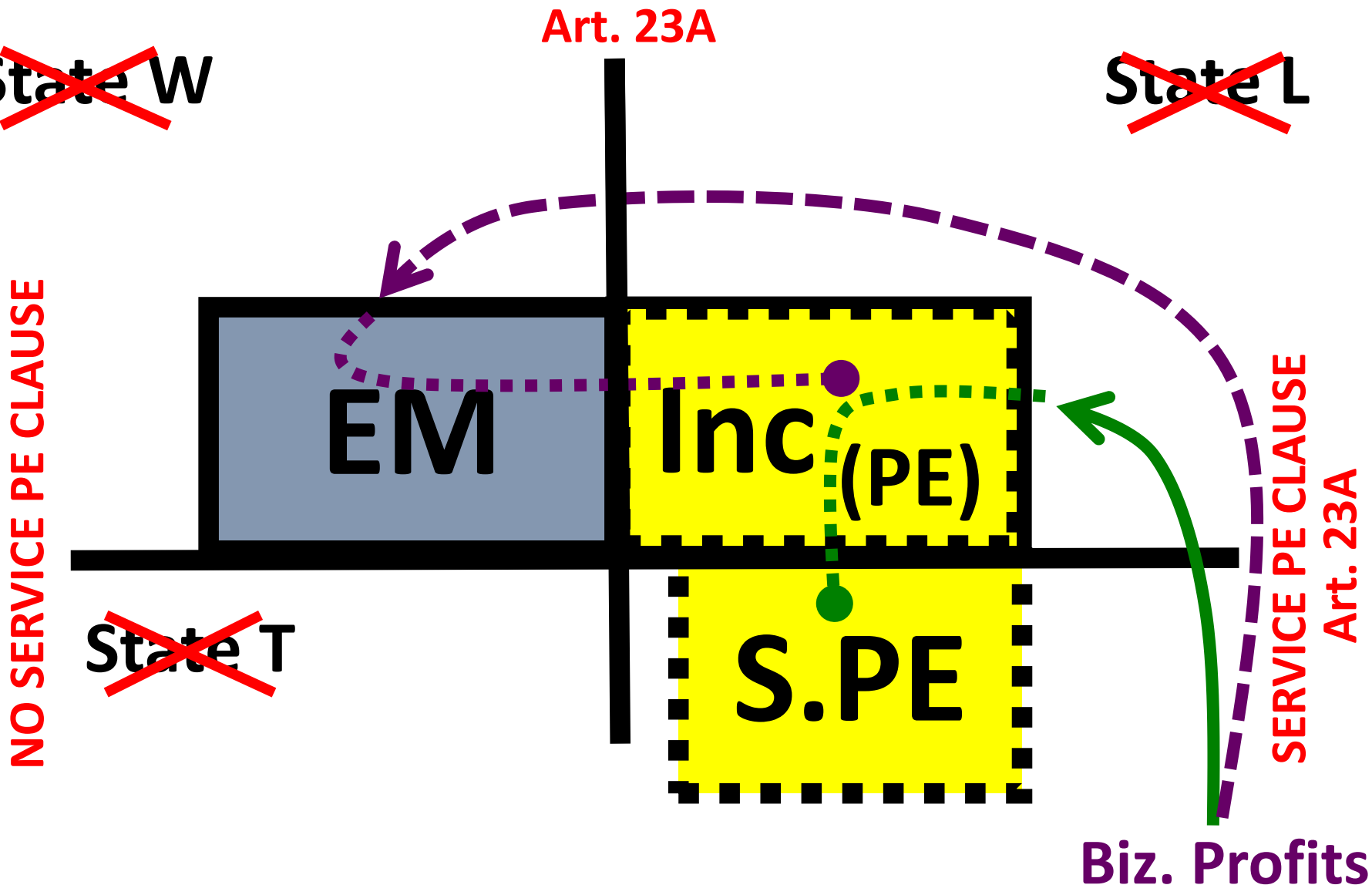

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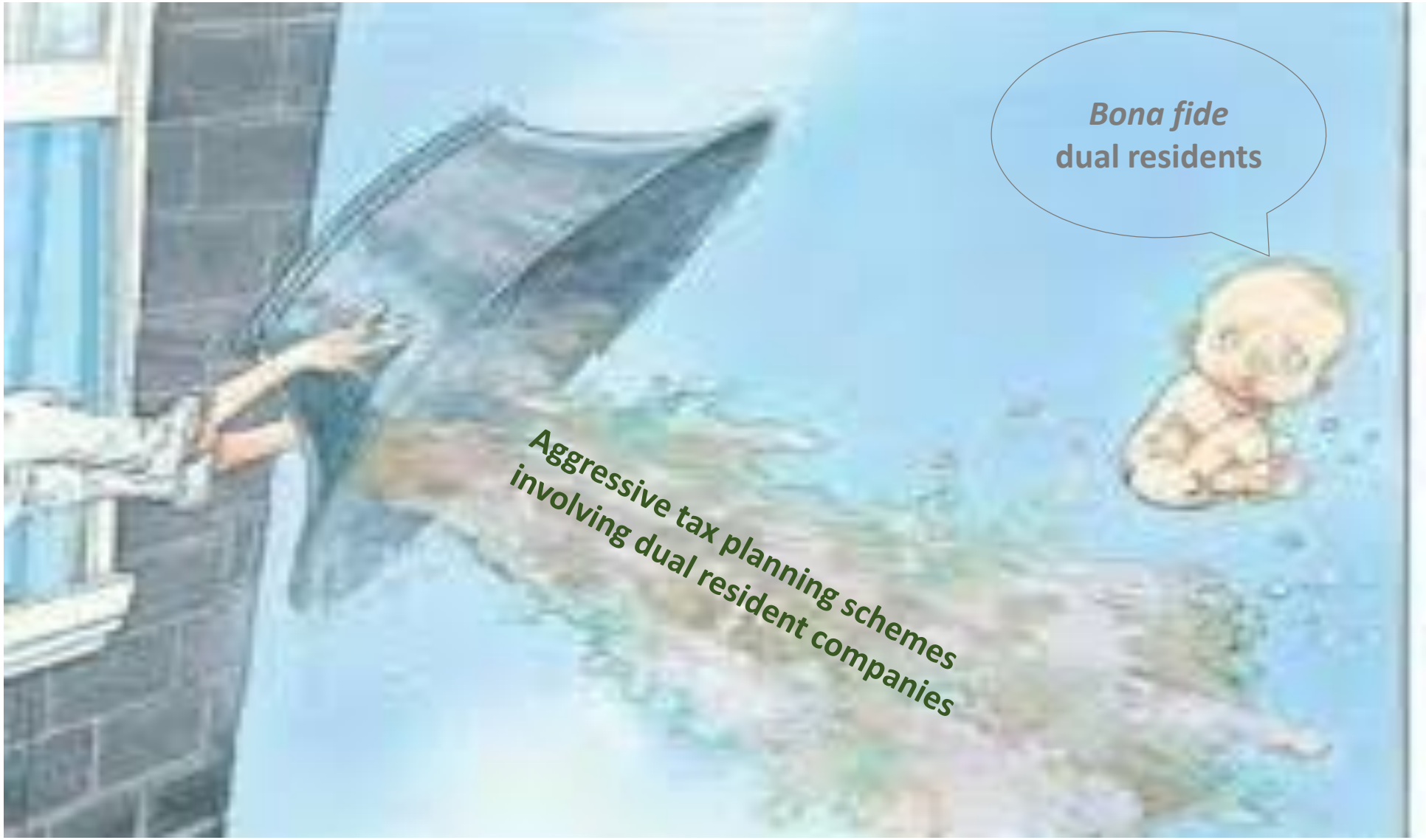


Q4 – Fees for Technical Services

Article 12A

Q5 – Changes in Article 29(9) – The Principal Purpose Test

9. Notwithstanding the other provisions of this Convention,

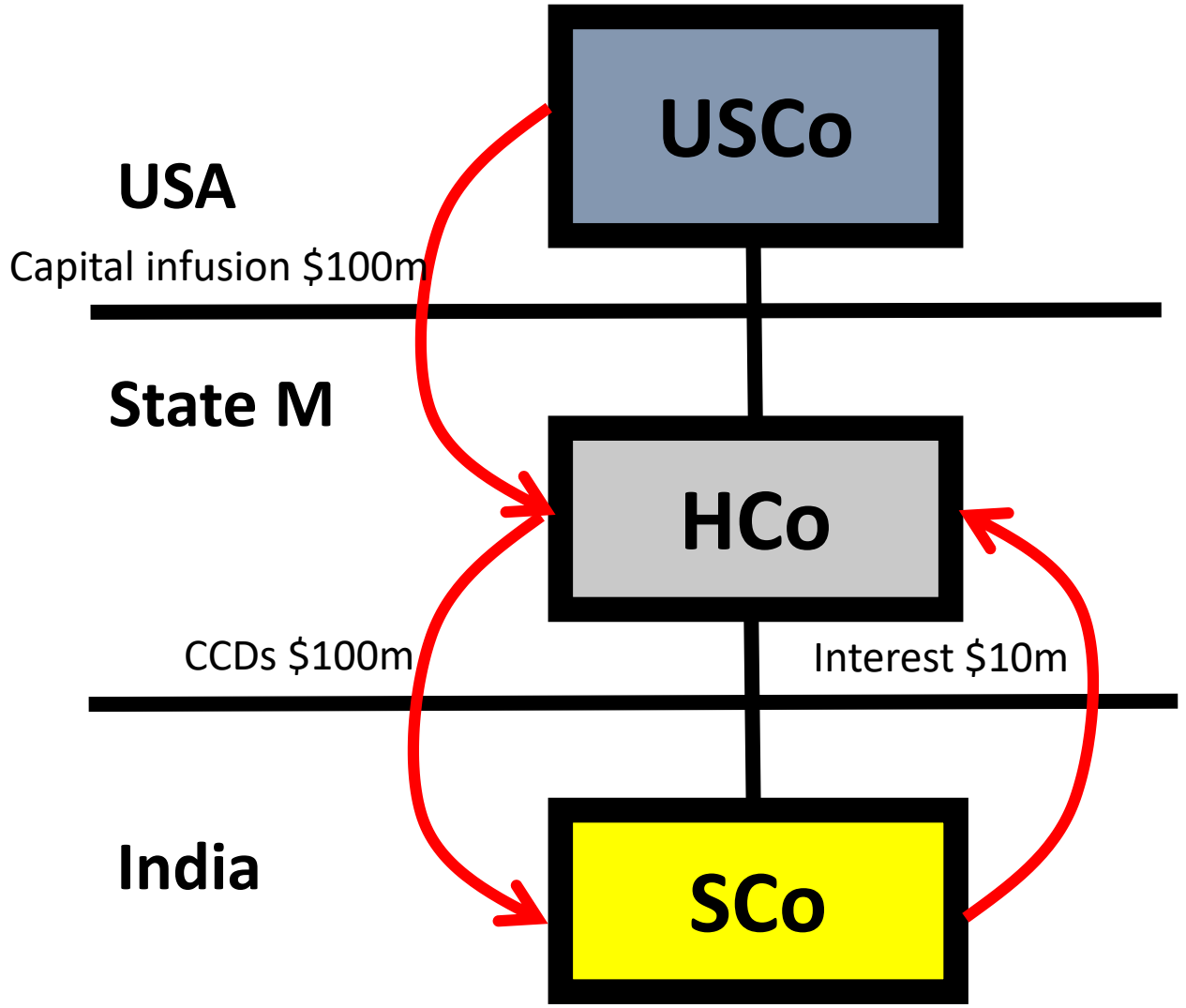
a benefit under this Convention shall not be granted in respect of an item of income or capital

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 this Convention.

Q5 – Changes in Article 29 (continued) – RK

- ***PPT Vs treaty shopping / MLI – paragraph 9 of Article 29 of the UN Model Convention:***



Q6 – Changes in Article 5

Splitting of contracts – paragraph 3 of Article 5 – Article 14 MLI, para. 11 of UN Comm:

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

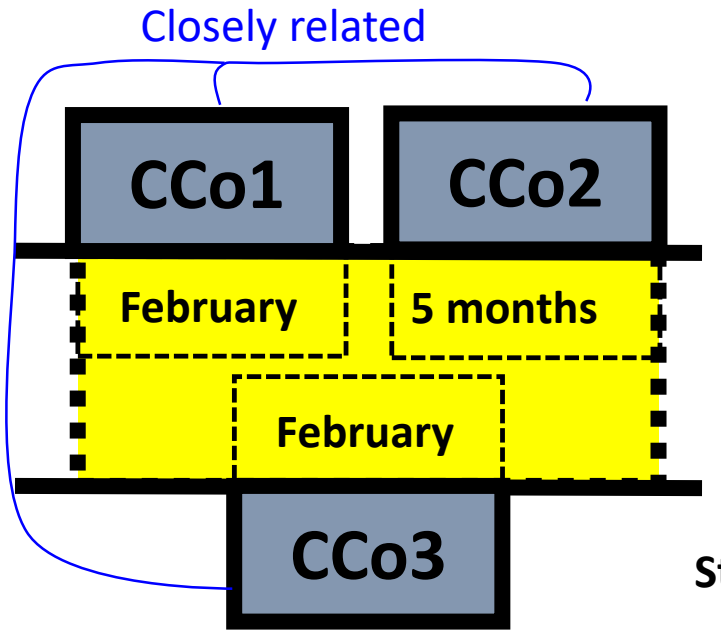
For the sole purpose of determining whether the [six] month period referred to in paragraph 3 has been exceeded,

a) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site or construction[, assembly] or installation project [or supervisory activities in connection therewith] and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding [six] months, and

b) connected activities are carried on at the same building site, or construction[, assembly] or installation project [or supervisory activities in connection therewith,] 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 period of time during which the first-mentioned enterprise has carried on activities at that building site or construction[, assembly] or installation project [or supervisory activities in connection therewith].

Q6 – Changes in Article 5



With measure

State R

CCo 1 PE? → NoPE!

State S

Fails test a) → its own activities do not exceed 30 days.

CCo 3 PE? → NoPE!

State T

Fails test a) → its own activities do not exceed 30 days.

CCo 2 PE? → NoPE!

Issue: PPT / GAAR?

Passes test a) → its own activities exceeds an aggregate of 30 days
But fails test b) → actitivies of closely related enterprises CCo1 and CCo 3 do not exceed 30 EACH!

Q6 – Changes in Article 5 (continued)

Service PE:

"3. The term "permanent establishment also encompasses:

a. ….

b. The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue ~~(for the same or a connected project)~~ within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned."

Illustration:

An entity A from Country X has serviced 3 contracts in Country Y during a twelve month period with the days spent on each project as under:

Contract 1 – 100 days;
Contract 2 – 50 days;
Contract 3 – 70 days.

In light of the updated paragraph 3(b) in Article 5, what would be the implications arising in context of an existence of a PE for entity A?

Q6 – Changes in Article 5 (continued)

Anti-fragmentation:

4.1 Paragraph 4 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 State and

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article,

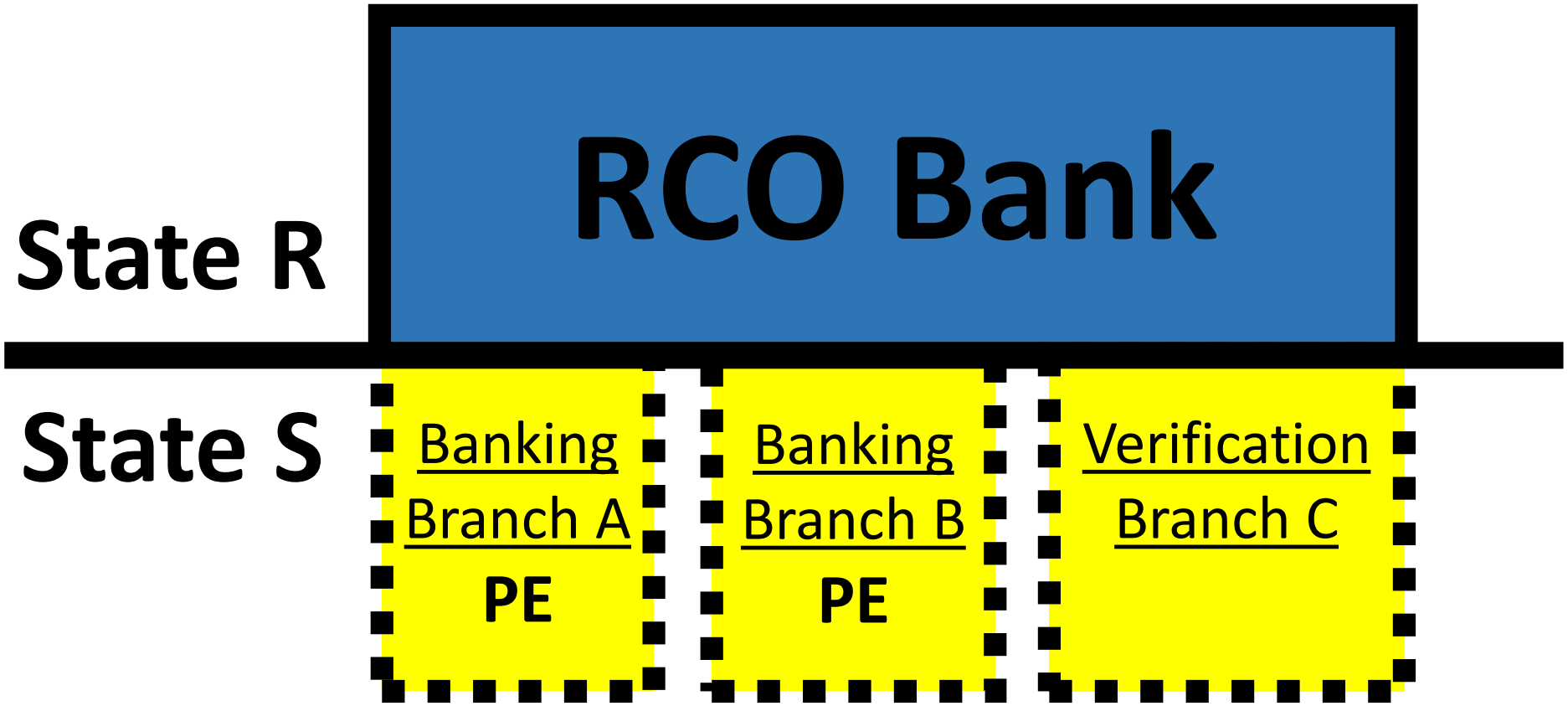
or

b) …

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.

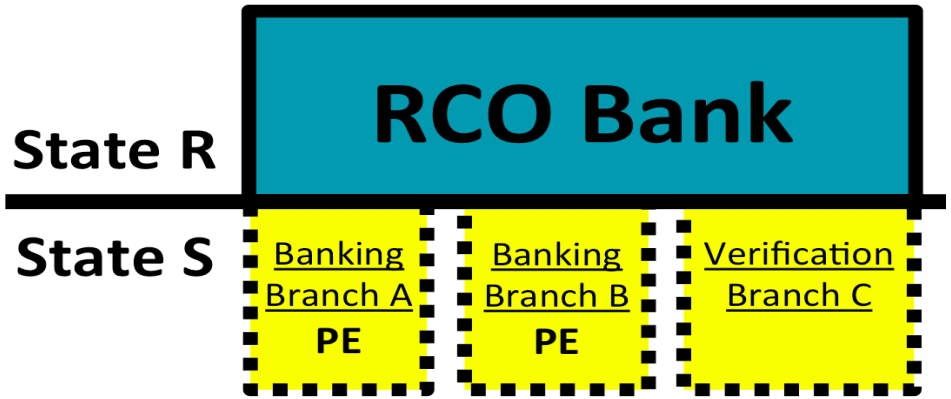
Q6 – Changes in Article 5 (continued)

Example A (2017 Comm Art. 5/81)



Q6 – Changes in Article 5 (continued)

Example A (2017 Comm Art. 5/81)



3 step analysis:

1st step: Does RCo carry on business at another place in State S?

→ Yes, Branch A and Branch B

2nd Step: Does that other place constitute RCo's PE in State S?

→ Yes, Branch A and Branch B are Art. 5(1) PE's

3rd Step: Do RCo's business activities at Branch A or Branch B and Branch C constitute complimentary functions?

→ Yes → **a PE!**

Q6 – Changes in Article 5 (continued)

4.1 Paragraph 4 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 State and

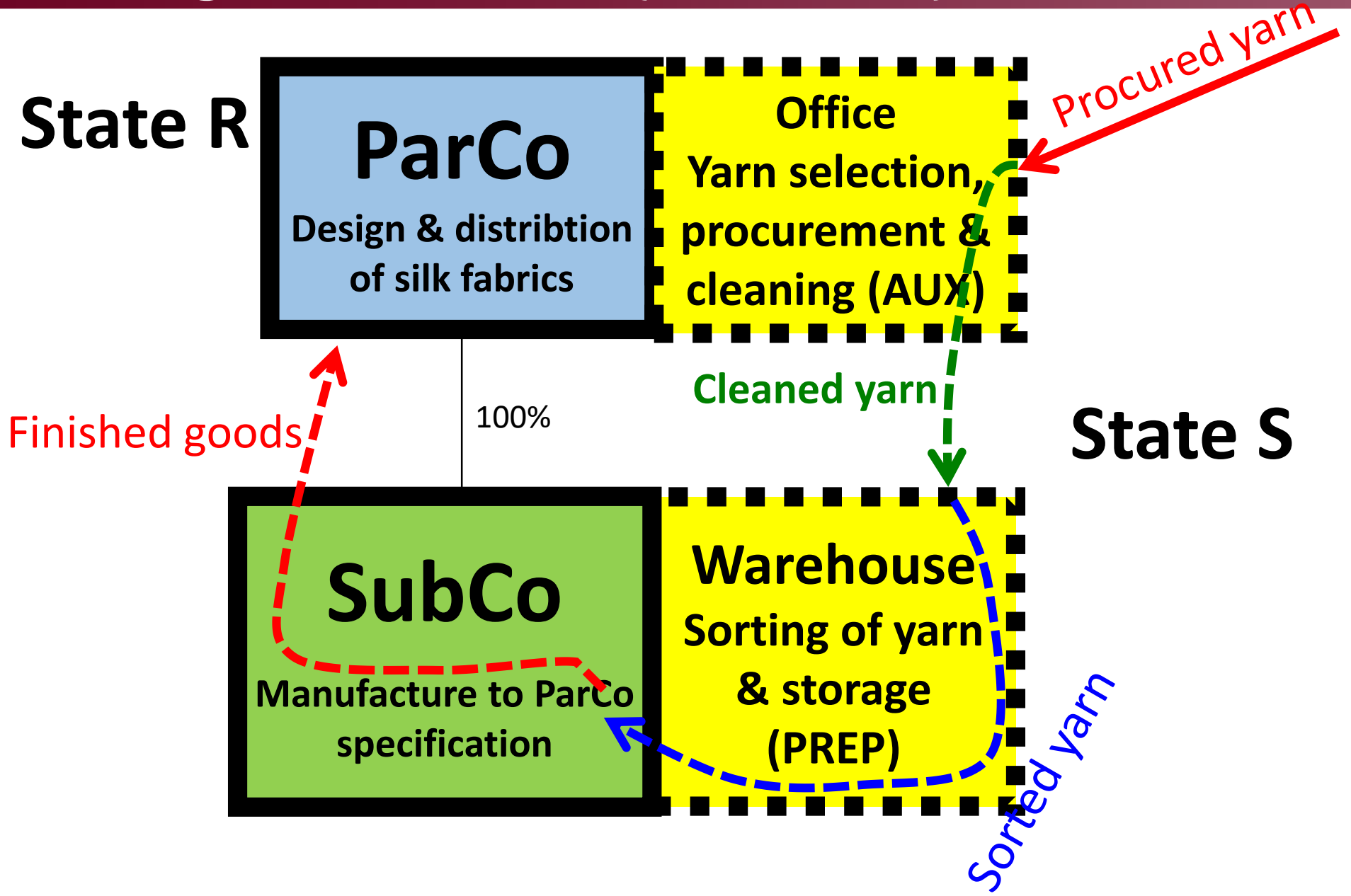
a) …,

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,

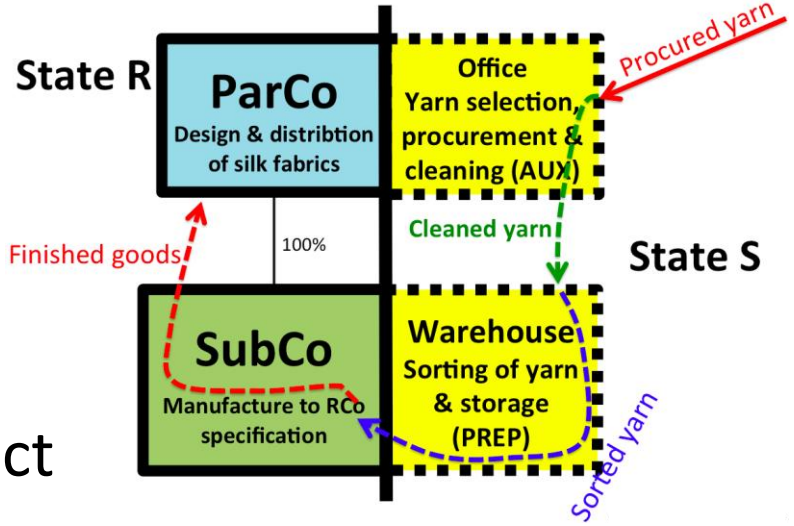
provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

Q6 – Changes in Article 5 (continued)



Q6 – Changes in Article 5 (continued) -

Do ParCo, SubCo or both have a PE in State S?



3 step analysis under Art. 5(4.1)(a):

1st step: Do closely related enterprise conduct business in State S?

→ Yes, ParCo and SubCo carry on biz in State S, and are closely related enterprises (>50% shareholding, Art. 5(8))

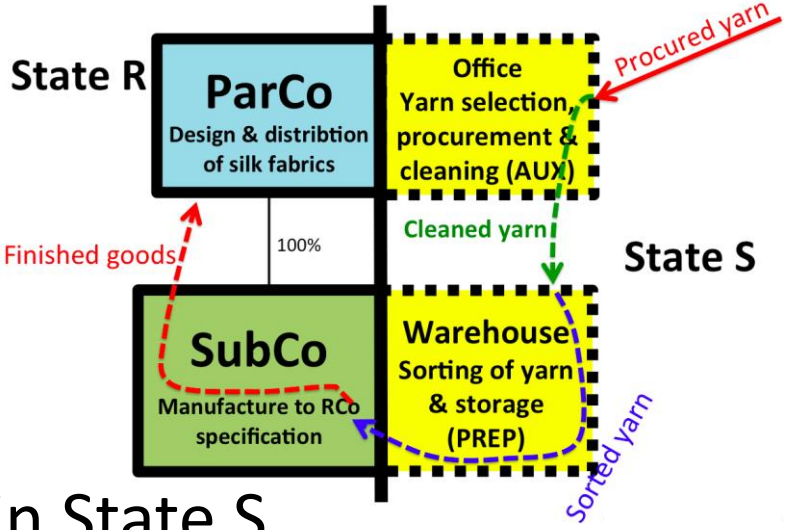
2nd step: Do either of them carry on business through a PE in State S?

→ Not as yet (individually, both fall under the 5(4) exception)

3rd step: not yet relevant… check 5(4.1)(b)

Q6 – Changes in Article 5 (continued)

Do ParCo, SubCo or both have a PE in State S?



Analysis under Art. 5(4.1)(b):

Is the overall activity of ParCo and SubCo in State S preparatory or auxiliary?

- from the perspective of ParCo:

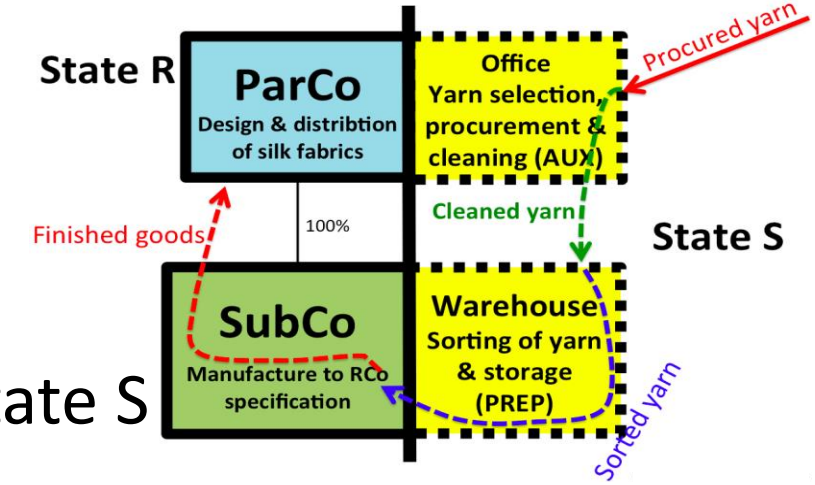
  Main activity = design and distribution

  purchase + cleaning + sorting + storage

  → Yes, AUX

  ∴ ParCo has no PE in State S

Q6 – Changes in Article 5 (continued)



Analysis under Art. 5(4.1)(b):

Is the overall activity of ParCo and SubCo in State S preparatory or auxiliary?

- from the perspective of SubCo:

  Main activity = Manufacture of silk fabrics

  sorting + storage → AUX

  However, selection+purchase+cleaning form essential elements of the manufacturing process

  No, overall activity cannot be viewed as PREP/AUX

  → the warehouse constitutes SubCo's PE in State S

Impact on digital economy

Thank you