GTTC Universities Project 2019

The impact of the MLI on countries’ treaty policy

Winner: Team India (O.P. Jindal Global University)

Finalist: Team Sweden (Stockholm University)
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The GTTC and Its University Project

Prof. Dr. Pasquale Pistone
Academic Chairman of IBFD

The GTTC University Project is a part of the IBFD GTTC Project. This short explanation summarizes the object and purpose.

The IBFD Tax Research Platform is a comprehensive source of information on tax treaties from around the world. As of 1 January 2020, the IBFD TRP included 14,435 entries sole concerning the text of Models and Treaties on international tax matters. Our research and publication teams make all necessary efforts to keep it reliable across the different languages (in some cases, even going as far as translating into English the text of treaties not authenticated in this language) and periodically invent new tools for extracting content and facilitating the analysis of such treaties. This helps all users navigate through the increased complexity of international taxation and facilitates research on tax treaties.

A few years ago, IBFD introduced the Global Tax Treaty Commentaries, which has meanwhile become familiar to all treaty researchers as GTTC. As its name indicates, the GTTC is a unique project for a global approach to the analysis of tax treaties, which combines a top-level theoretical analysis of model tax conventions with a hands-on perusal of their practical implications. Its unique features are also due to the circumstance that it encompasses the study of possible deviations of bilateral treaties across the globe from model conventions and that it is fully integrated in the IBFD Tax Research Platform. Specific hyperlinks allow the readers to cross-check the treaty analyses provided by the authors with the actual wording of the models and bilateral treaties, including relevant case law and further topical studies.

But the GTTC Project offers much more to discover!

The core part of the GTTC Project, which we usually call “Global Tax Treaty Commentaries – Model Articles & Issues”, provides a general analysis of the clauses contained in tax treaties, thus allowing the users to become familiar with possible interpretations of such clauses throughout the world.

However, the GTTC includes a side entrance to its content, through the so-called “Global Tax Treaty Commentaries – Country Policy & Practice”, which allows a per-country analysis of such treaty material and enhances the liaison and links with other parts of the IBFD Tax Research Platform.

This basically means that if someone is interested in knowing the position of a specific country on a specific treaty clause, they can access the GTTC from the Country Policy & Practice section and then continue their navigation to the Model Articles & Issues section through the dedicated hyperlinks that are included in the specific clause. The seamless connections between the two GTTC Pillars was conceived in line with the “single input” concept, which prevents duplications of the content, but allows for common content between the said Pillars. This allows the Country
Policy & Practice section to feed the Model Articles & Issues section along the following concept: the Country Policy & Practice section steers the content of the Model Articles & Issues section towards a selection that allows the latter to meet global interest, while preserving a more comprehensive overview of each country within the boundaries of the Country Policy & Practice section.

However, there is yet another important component of the GTTC Project – namely the GTTC University Project – to which this white paper directly belongs.

The GTTC University Project is a competition between university students' teams to extract tax treaty materials from the IBFD Tax Research Platform on a specific topic of relevance for the overall GTTC Project.

The ultimate goal of the GTTC University Project is the promotion of empirical methodologies for the legal analysis of tax treaties. This reflects a long-standing tradition of IBFD, which has periodically embarked on such studies and then made them available to the global tax community in its journals.¹

The concept of the GTTC University Project is to have university students' teams extract specific data concerning tax treaties and process them under the guidance of their mentors, which are normally university lecturers or professors.

The production cycle of each edition of the GTTC University Project is divided into four phases.

In the first phase, the IBFD academic research team selects the relevant topic for the empirical research and elaborates the technical outline, including the key points and the boundaries within which the students' teams should conduct their analyses.

In the second phase, the students' teams are given free access to the IBFD Tax Research Platform in order to make an overall empirical assessment of the topic from the perspective of their countries' tax treaties. This phase is concluded with written studies that are submitted to an IBFD jury.

In the third phase, the two best teams are invited to present their findings to the IBFD jury in Amsterdam and defend their empirical research in line with the concept of a moot court, thus competing for the award of the best university team.

The fourth and final phase consists of processing this information together with the IBFD academic research team and making it available to the international tax community, in line with the open access concept, on the IBFD Tax Research Platform. This community also includes the GTTC authors themselves, whom the IBFD academic research team

prompts to take into account the outcome of the processed empirical findings in the periodical updates to the GTTC chapters.

IBFD is proud to promote the dissemination of the legal culture of international taxation also through this project and will do its best to further enhance the future editions of the GTTC University Project and the overall shape of the GTTC Project.

We look forward to receiving applications for the future editions of the GTTC University Project and reading any comments on the GTTC and its University Project at gttc@ibfd.org!
The GTTC and Its University Project


Prof. Dr. Pasquale Pistone
Academic Chairman of IBFD

The third edition of the GTTC University Project has put the BEPS Multilateral Instrument, or BEPS MLI, under the scrutiny of empirical analysis in order to determine the initial trends in its actual diffusion throughout global tax treaty practice.

From the perspective of empirical analysis, since the gathering of relevant facts from the IBFD research topic took place on an almost real-time basis, starting about a year after the signature of the BEPS MLI, the studies conducted by the GTTC university research teams have been pioneering this topic. For this reason, in this specific edition, the teams supplemented this information with enquiries directly addressed to the actual players, i.e. the tax authorities and other stakeholders that have directly taken part in the BEPS MLI.

Academic research has clarified that the shift to a multilateral convention interacting with bilateral treaties does not necessarily mean a corresponding development towards multilateralism, also showing the relevance of empirical legal research for determining the actual and potential impact of the BEPS MLI on the tax treaty network around the world. However, the ground-breaking nature of the development concerning the very signature of the BEPS MLI was the main reason for the selection of the topic of this edition of the GTTC University Project.

This unprecedented development – that one single multilateral treaty can steer the convergence of international tax treaties around the world and implement the fight against base erosion and profit shifting – has attracted our attention to asking the university students two sets of questions for their empirical research, according to whether or not their country had signed the BEPS MLI.

For teams from countries that had signed the treaty at the beginning of this project, we asked them to investigate all relevant elements that could allow us to identify the potential relevance of the BEPS MLI. Such elements included evidence gathered in the framework of the signature and ratification process (including the reasons for delaying its

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2 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (7 June 2017), Treaties & Models IBFD [hereinafter BEPS MLI].

completion), the number of covered tax agreements, the boundaries of reservations, the identification of mismatches, the practical effects of the implementation of the BEPS MLI on the tax treaty policy and the country’s interpretation.

The evidence gathered by the competing teams showed an extremely diverse array of solutions.

Some countries decided to limit the use of the BEPS MLI to the strict standards required to secure compliance with the minimum standards in cases in which it was either unlikely or impossible to achieve this at the unilateral or bilateral level. In some specific cases, under the façade of a broad notification policy, the practical application of the BEPS MLI clauses has been, in fact, very limited, thus not making full use of the opportunities provided by the BEPS MLI. This may be justified by the circumstance that the shift to the BEPS MLI is a one-way street, which would prevent countries from moving away from it (i.e. back to the regulation of treaty clauses at the bilateral level) once they accept to make use of it. Besides the specific evidence of the extent to which this has occurred in practice, this conclusion should not be understood as an indicator of the practical failure of the BEPS MLI, but rather of the circumstance that its real effects should not be observed from a short-term perspective, as some commentators initially indicated, but rather from a medium to long-term perspective in a way that is combined with the corresponding developments in the standards of tax treaty clauses contained in the OECD Model Tax Convention (2017). This is particularly evident in respect of the correspondence between article 7 of the BEPS MLI and article 29 of the OECD Model Tax Convention (2017).

Other countries have made much broader use of the BEPS MLI. Europe is perhaps the region where the actual impact of the BEPS MLI is more evident, including its optional part VI on arbitration. However, some non-OECD countries, including, notably, India, have taken into serious consideration the role of the BEPS MLI in steering the tax treaty network towards global convergence. The evidence gathered also indicated that mismatches are less frequent in countries from the same region and in relations involving smaller countries, especially in respect of EU Member States and OECD member countries. In such circumstances, a plausible explanation of this result is that the BEPS MLI is perceived as an opportunity to enhance the effectiveness of such tax treaties in line with a global approach to tackling base erosion and profit shifting. Small countries have somehow almost felt obliged to follow this trend, and from the evidence gathered by some teams, this has also raised some significant controversies in the phases that preceded the actual signature of the BEPS MLI, which, in several countries, did not allow for a proper discussion in the national parliaments.

Furthermore, the evidence also indicated that the goal of preserving an “à la carte menu” for the shift towards multilateral regulation of some tax treaty matters may have generated an excess of flexibility, which has notably increased the complexity in determining the applicable tax treaty rules. Although the OECD Secretariat preserves legal

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4 OECD Model Tax Convention on Income and on Capital (21 Nov. 2017), Treaties & Models IBFD.
certainty with the easily accessible MLI matching database, the resulting reconstruction of treaty interpretation has unavoidably become more complex.

For the university teams from countries that have not (yet) signed the BEPS MLI, the students' teams were asked to find the possible reasons, including those that were officially declared. Furthermore, they conducted an overall assessment of the consistency of the tax treaty network of their countries with the overall goals and content of the BEPS MLI. The output of this research has shown that outside the European region and in countries with stronger negotiation powers, not only the form, but also the substance of the impact of the BEPS MLI has been more marginal. However, this does not prevent some states from already sharing or having significantly inspired some features of the BEPS MLI (as in the case of the United States in respect of the limitation-on-benefits clause). This is also a relevant finding of the empirical research, which shows that the BEPS MLI standards can have, in substance, a broader impact than their formally recorded one and that the resistance to their content may potentially be toned down in the medium to long-term.

The analysis conducted by the competing teams has helped the IBFD academic research team in better perceiving the ongoing developments concerning the implementation of the BEPS MLI in order to spot potential issues for further research that could enhance the content of the GTTC Project. The IBFD academic research team would therefore like to thank and congratulate the winning team from the O.P. Jindal Global University of New Delhi (India), which prevailed in the final over the team from the Stockholm University (Sweden).

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6 The university research teams have therefore been given the opportunity to use the dedicated BEPS MLI tools that alert users of the IBFD Tax Research Platform in connection with bilateral treaty clauses that are affected by the BEPS MLI.
GTTC Universities Project: Third Edition

Introduction

Prof. Dr. Betty Andrade
Managing Editor of the GTTC

In 2018, IBFD launched the third edition of the GTTC Universities Project. 28 universities were invited to participate in this competition. The GTTC Universities Project intends to involve an international collaborative network of professors and students from preselected universities to enhance the Global Tax Treaty Commentaries (GTTC), an authoritative platform aimed at providing a practical approach to global treaty practice.

This edition focused on the national tax treaty policy and tax treaty deviations under the name of “The Impact of the MLI on countries’ Tax Treaty Policy”. The research advancements of the participant universities should be able to answer one specific question: what is/will be the impact of the MLI in bilateral treaty practice?

Each team, composed of three to five students from each participating university, had to develop a working paper according to the guidelines provided. The working papers were evaluated by a jury composed of three judges selected among acknowledged academics and tax professionals on the subject. For the third edition, the jury was composed of Professors Frans Vanistendael, Diane Ring and Luís Flávio Neto.

From the papers submitted, the jury selected the two most outstanding teams to present their results in Amsterdam. For the third edition, the two shortlisted teams were O.P. Jindal Global University (India) and Stockholm University (Sweden). On 5 September 2019, the teams presented their results to the jury members, who, after formulating questions to the teams, deliberated about the results and declared the Indian team the winner of the competition. The intention of this introduction is to provide the reader with a summary of the main conclusions reached by the two finalist teams as reflected in their working papers. Therefore, the rest of the document is a paraphrasing of the most important highlights of the working papers.

In practical terms, the question of the research aims to determine the number of covered tax agreements affected by the MLI provisions, reservations and identification of mismatches and the practical effects of the implementation of the MLI on treaty policy and treaty interpretation.

There are several highlights of the Indian working paper that deserve to be summarized. The Indian team pointed out that India does not have a comprehensive and coherent national tax model or policy. However, domestic statutes are being amended in order to reduce the conflicts of implementation of the MLI.

The Indian team indicated that all of India’s comprehensive tax treaties (on the date of the report, 93 conventions) were notified as covered by the MLI. However, four countries did not list their bilateral treaties with India as covered tax
agreements, while India did list them, preventing the MLI from being implemented in respect of these treaties, creating a mismatch for the implementation of the MLI.

The MLI would have a moderate impact on the bilateral tax treaties with regard to the provisions on permanent establishments, including DAPE (dependent agent permanent establishment)-specific activity exemptions and anti-fragmentation rules. Many countries, like Bangladesh, Brazil, Nepal, the Philippines, Sri Lanka and the United States have not signed the MLI, and therefore, India’s bilateral tax treaties with these countries will remain unchanged. On the other hand, countries like China have chosen not to include their treaties with India as covered tax agreements, and thus, India’s bilateral treaties with such countries will also remain unchanged. Countries like Canada and Sweden have chosen to reserve these provisions from being applicable, and therefore, their tax treaties with India will also remain unchanged. However, in the case of countries like France and Russia, some provisions in their tax treaties with India would be altered with the adoption of the MLI.

India has renegotiated its treaties with Cyprus, Mauritius and Singapore and is attempting to do the same with the Netherlands. However, there is no evidence to suggest that the renegotiation is a consequence of the MLI. It seems that the renegotiation with regard to permanent establishment provisions seems difficult, especially since developed countries have an advantage in such negotiations and seem to be resisting the MLI’s content in this regard.

India has notified all of its covered tax agreements as already having tiebreaker rules, which will now be replaced by article 4(1) of the MLI. In the context of double taxation as addressed by article 4 of the MLI, the place-of-effective-management (POEM) tiebreaker is the prevailing international standard. The adoption of the mutual agreement procedure system in its place, only 2 years after India amended its domestic law to incorporate the POEM into its framework, is bound to create disarray in India’s bilateral network once again. This is because treaty states will be unlikely to adopt a position in such negotiations that is very different from their domestic laws and policy. In addition to the problem that certain treaty partners do not employ the POEM rule domestically, the fact that India’s POEM rule is further qualified by the “active and passive business” test will ensure disagreements and delays in resolution of the residence status. As a result, India may be forced to revisit its own policy.

Regarding article 7 of the MLI, India opted in for the principal purpose test (PPT) clause combined with a simplified limitation-on-benefits clause. However, only 12 other contracting states opted in for the simplified limitation-on-benefits clause, which means that, in practice, most treaties will only be impacted by the incorporation of the PPT clause.

The Indian Income Tax Act specifically points out that the government of India may enter into double tax agreements in order to tackle tax evasion and avoidance, which will be consistent with the preamble of treaties proposed in article 6 of the MLI. Indian case law –including the famous Azadi Bachao Andolan case – has ruled in favour of the validity of arrangements leading to treaty shopping, considering that, from the readings of the preambles of treaties, states may have decided to place protecting and promoting foreign investments over tackling tax avoidance. Considering the changes to the preamble of treaties made in article 6 of the MLI, tax courts may modify their approaches with regard to tax avoidance.
In addition, the Indian general anti-avoidance rule (GAAR) allows the tax authority to scrutinize the substance of the transaction and disregard whether the main purpose of the transaction is to obtain a tax benefit without a commercial or business justification. Case law has provided that taxpayers are prohibited from taking advantage of treaty provisions only if any of the entities is a sham or if the arrangement amounts to a colourable device. The application of the PPT included in the MLI is broader than the domestic GAAR, as the latter is triggered only if the main purpose of the arrangement is to obtain a tax benefit. However, it is possible to apply the domestic GAAR even if the conditions to trigger the PPT are not met in the case that the benefit was in accordance with the object and purpose of the treaty provision. In such a case, the domestic GAAR still allows for the consideration of whether the transaction has valid commercial or business substance, and may lead to disregarding such transaction.

Further, it is still uncertain whether a taxpayer can seek to cover themselves under the domestic GAAR rather than under the PPT rule (in a treaty), based on the contention that the provisions of the GAAR are more beneficial (restrictive). In this case, the taxpayer can establish that even though one of the main purposes (under the PPT) was to obtain a tax benefit, because the main purpose (under the GAAR) was not to gain unintended tax benefits, the benefits of the treaty should not be denied.

The Indian Income Tax Act was amended to adapt its provisions to article 12 of the MLI, including rules on commissionaire arrangements tackling the artificial avoidance of permanent establishment status. In addition, domestic courts have taken an aggressive approach in interpreting when a dependent agent may create a foreign-company permanent establishment in a specific territory. Indian courts have stated that the negotiation of essential elements of the contract – and not of all the elements of the agreement – is reason enough for the agent to be qualified as a permanent establishment of its contractor. This aggressive approach may affect the interpretation of article 12 of the MLI.

Articles 12 and 13 of the MLI mainly focus on physical presence for setting the conditions for permanent establishment status. In 2018, India introduced the concept of a “significant economic presence” in its legislation, covering transactions related to downloading data and software in India (provided that the value of the transactions meets a certain threshold), as well as transactions involving a specific number of users located in India. Conflicts between the MLI and the domestic rule may cause domestic legal issues in the attribution of profits involving digitalized businesses.

India decided to adopt Option A of article 13 of the MLI. It ensures that all activities falling under the specific activity exemption must be of a preparatory or auxiliary nature, irrespective of them being specifically mentioned as exempt. However, the use of the terms “preparatory” and “auxiliary” is still ambiguous, leading to judicial interpretations based on the facts and circumstances of each individual case, increasing uncertainty in the interpretation of said rules.

India has chosen not to adopt mandatory arbitration for its covered tax agreements, as that would impinge on India’s sovereignty in tax matters and hinder its ability to apply its own laws to non-residents and foreign entities.

In the case of Sweden, the Swedish team indicated that the government specified its intention to include as many treaties as possible within the framework of the MLI. With regard to treaties excluded from the list of covered tax
agreements, either they are currently under renegotiation or the government intends to renegotiate them beyond the terms of the MLI. As a result, from the current Swedish treaty network (80 double tax agreements in force), 64 have been notified as covered tax agreements, with 43 reciprocal notifications.

New treaty policy seems to be influenced by the content of the MLI, as is the case of Sweden’s recently renegotiated treaty with Brazil, including the minimum standards proposed in the MLI, such as the preamble, the PPT clause and the mutual agreement procedure clause. However, the amending protocol does not contain a provision complying with article 17 in the MLI regarding corresponding adjustments.

Sweden chose a cautious approach to the MLI and made reservations against all provisions except those that are part of the minimum standard, i.e. articles 6, 7, 16 and 17. The Swedish team indicated that the cautious approach is understandable, given the novelty of a multilateral agreement such as the MLI. However, they mention that an important factor in the success of the MLI is surely the number of countries that participate in it and the degree to which their MLI positions align. Therefore, a cautious approach by which a country makes many reservations could have the effect of lessening the overall effectiveness of the MLI.

In addition to this, Sweden has chosen to apply articles 18-26, regarding mandatory and binding arbitration. Sweden has made three reservations under article 28(2)(a) regarding the scope of arbitration. Sweden reserves the right not to apply Part VI to requests that the competent authorities in both jurisdictions agree are not suitable for arbitration. Such an agreement shall be made before the day on which the arbitration would begin, and the person who presented the request shall be notified about the agreement. Sweden also reserves the right not to apply Part VI to matters regarding persons with dual residency in other cases than physical persons. Furthermore, Sweden reserves the right not to apply Part VI to matters regarding hard-to-value immaterial assets in the case that primary adjustments are made (1) to an open tax year, but concern income relating to a closed tax year, or (2) through the application of domestic law that states a longer period of adjustment, specifically for hard-to-value immaterial assets, which is different from the ordinary time limits for the reconsideration of tax decisions. In addition, Sweden chose to make a reservation against the use of baseball arbitration under article 23(2) of the MLI.

Sweden did not find any convincing evidence that the MLI minimum standards could give rise to domestic legal issues, other than a theoretical conflict between the PPT in article 7(1) of the MLI and the Swedish constitutional requirements on tax legislation, as indicated below.

The Swedish team highlighted that, in order for the parliament to amend the current Swedish double tax agreements to include the provisions of the MLI with regard to Swedish domestic law, the implementing legislation of each one of the double tax agreements has to be amended. Since the treaties are bilateral international agreements, the only change that Sweden can make unilaterally is to change the application of the treaty, i.e. legislate that the treaty text must be applied with the changes that follow from the MLI taken into account. However, no such legislation had been passed at the time of writing the report, and there is no official information regarding the timeline of the legislative efforts. Therefore, although the MLI entered into force, Sweden made a reservation pursuant to article 35(7) of the MLI,
delaying its application until all necessary domestic legal procedures are completed. Thus, it is not yet clear when the provisions will be applied.

Sweden opted for the PPT clause in the implementation of the MLI. The Swedish team also pointed out that the introduction of the PPT clause through the MLI can pose constitutional issues in the Swedish system. The domestic GAAR, introduced in 1995, follows the PPT approach. Although the Swedish Supreme Court has considered that the domestic rule does not clearly go against the principle of certainty, it has acknowledged tension between the GAAR and the constitutional principles. Some scholars have also pointed out that the domestic clause is in breach of the constitutional principles. As the PPT clause has a broader scope than the domestic GAAR and lacks certainty, its practical application may bring up constitutional issues. In any event, it is worth mentioning that Sweden has a number of provisions in existing tax treaties that limit tax treaty benefits based on the PPT or similar tests. This implies that Sweden’s international policy is in agreement with the implementation of the PPT, which influenced the decision adopted by the government with respect to the MLI.

In their work, the Swedish team found a few different notification and reservation mismatches. However, the notification mismatch that they considered most interesting was the Swedish omission of a consultation clause in article 27(4) of its treaty with Kazakhstan. They could not find a reason for why Sweden did not notify this consultation clause, as Sweden has notified all other consultation clauses in its covered tax agreements. This could indicate that Sweden wanted the clause to remain in effect specifically with regard to Kazakhstan. Apart from that, they found that four treaties probably should have had their preambles notified under article 6(5).
Foreword to the Indian report addressing “The impact of the multilateral convention to implement tax treaty related measures to prevent BEPS on countries’ treaty policy: A study of the Indian approach”

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This foreword provides an overview of “The Hidden Canadian Tax Treaty Model” by Ellen Chen, Rachel Meland, Mariana Peres Toledo and Alin Potra, who represented the Faculty of Law of McGill University, Canada, in the 2017-2018 edition of the IBFD university competition.

To compile the Global Tax Treaty Commentaries (GTTC), experts throughout the world provide a qualitative analysis and look at the meaning and application of each article of the OECD Tax Treaty Model. This paper builds on the GTTC effort from a Canadian perspective by providing a quantitative analysis of how the 93 Canadian Tax Treaties align with and deviate from the 2014 OECD and the 2011 UN Tax Treaty Models. Through comparative analysis, this research demonstrates that Canadian treaties follow the general structure of the OECD model (e.g. quantity of articles, topic covered in each article, etc), yet that Canadian treaties consistently—nearly 60% of the time—deviate from the OECD model in their content.

From our analysis, it was possible to determine the existence of what our paper refers to as a hidden Canadian tax treaty model (hereinafter, a “hidden model”), composed of a combination of the text of the articles from the OECD and UN models and articles with consistent deviations from those versions found within Canadian treaties. The paper then compares the Canadian treaties against the hidden model. This work demonstrates that the hidden model is more similar to the body of Canadian treaties than the OECD model in a statistically significant way.

Canada keeps all tax treaty negotiations confidential, therefore, it is difficult to have complete certainty as to the purpose of the hidden model. This paper attempts to identify patterns that could explain its purpose. We considered three hypotheses: (1) whether there were correlations between the deviations from the OECD model and the year in which the treaties were signed; (2) whether the deviations were less significant in treaties between Canada and other OECD states; and (3) whether there were more deviations in treaties with states that are Canada’s major trade partners. With respect to the first two questions, the answer is no: there is no significant statistical correlation between the hypotheses and deviations from the OECD model. On the other hand, for the third hypothesis we found a statistically significant

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7 The treaties used for this analysis was the body of Canadian treaties in force in October 2017.

8 This paper includes in its appendix an article-by-article comparison against the OECD model for each of the 93 Canadian Tax Treaties. The comparison of Canadian tax treaties against the UN model was done by first comparing the OECD model against the UN Model—since the two models are considerably similar—and then by determining when the Canadian bilateral tax treaties followed features exclusive to the UN model.
negative correlation between the hidden model and trading partners by volume of trade. This suggests that treaty negotiations with these larger trading partners are more complex and thus result in treaties that are neither similar to the OECD model nor the hidden model. Further, the results are distinct when it comes to the analysis of a single article instead of a treaty analyzed as a whole. For instance, there did appear to be a correlation between the year in which a treaty was signed and the deviation from the OECD model with respect to articles 4 (resident) and 12 (royalties) when analyzed in isolation.

Similarly, our paper identifies significant outliers: tax treaties that are similar neither to the OECD model nor to the hidden model—most importantly between Canada and the United States. In that case, we identified three factors as the likely reason for the anomaly: geographical proximity; uniquely strong economic ties, and the fact that the United States follows its own model with virtually no exception.

We also observed that some articles consistently divert from the OECD model in virtually all Canadian treaties. This is the case for articles 3 (General Definitions), 8 (Shipping, Inland Waterways, Transport and Air Transport), 12 (Royalties), 23 (Exemption and Credit Method) and 25 (Mutual Agreement Procedure). The paper investigates issues and characteristics, peculiar and exclusive to Canada, that may provide an explanation as to why the country has such a well-defined hidden model for some articles.

Our research could assist in determining the intention of legislators when drafting these treaties. Knowing that legislators opt to consistently delete or add words to Canadian tax treaties provides some evidence of their intentions and purposes. Beyond the results presented in the paper, the methodology and data developed therein allow for the testing of different hypotheses, which highlight deviations from the OECD model and delineate Canadian patterns in tax treaty negotiations.
THE IMPACT OF THE MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BEPS ON COUNTRIES’ TREATY POLICY:
A STUDY OF THE INDIAN APPROACH

Aditi Khemani, Meenakshi Ramkumar, Riya Gupta, Shubham Janghu
Coordinator: Professor Ashrita Prasad Kotha

1. Introduction: Context and Historical Background of the MLI

At present, India is not a member of the Organization for Economic Co-operation and Development (“OECD”). However, the OECD has identified India as one amongst the key partners who contribute to the OECD’s work in a sustained and comprehensive manner through (a) Participation in OECD bodies (b) Adherence to OECD instruments (c) Integration into OECD statistical reporting and informational systems.

India is a member of inclusive framework on BEPS of the OECD. Being an Associate to the inclusive framework on BEPS, India is one of the front runners in the inclusive framework of BEPS initiative. Hence it has strongly engaged with OECD efforts to support G20 in enhancing the equity and fairness of the international tax architecture by fighting tax evasions and tax havens and addressing tax avoidance by large corporations in the international tax regime.

India has signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (“MLI”) on 7 June 2017. Recently, on 12 June 2019 the Union Cabinet chaired by Prime Minister India Mr. Narendra Modi has

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9 The original working document submitted for the competition was edited for publishing purposes, but the original working paper, as well as their annexes considered by the jury, are available at request. Please feel free to contact us at gttc@ibfd.org for more information.

10 OECD has collaborated with India in the areas such as anti-corruption, corporate governance, economic policy, environment, fiscal relations as well as steel taxation, trade and investment.


12 India has participated in selected OECD committees and its subsidiary bodies. It is a member of the Development Centre, the Global Forum on Transparency and Exchange of Information for tax purposes, the International Transport Forum and the Financial Task Force. In terms of India’s engagement in the G20 context, it has played an active role in the Global forum on Steel Excess Capacity and its adherence to the G20/OECD Principles of Corporate Governance.

13 India adheres to twelve OECD legal instruments and plays a prominent role in the development of international standards on international taxation, corporate governance, competition, chemicals, steel and Energy.

approved the ratification of the MLI.  With the press release being out, it is expected that official gazette notification will be soon made.

The Multilateral Convention is the result of the OECD/G20 Project. India’s primary objective behind adopting MLI is to tackle Base Erosion Profit Shifting. i.e. tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no tax locations where there is little or no economic activity resulting in some or no tax being paid on the same.

2. A critical approach to some of the MLI provisions opted in and out by India

2.1. Article 7: Prevention of treaty abuse

Among the several options available to countries under Article 7 for prevention of treaty abuse, India has chosen to apply the Principal Purpose Test ("PPT") along with the Simplified Limitation of Benefits Clause ("SLOB"). The choice made by India depicts its firm stance to prevent treaty abuse to obtain tax benefits via sham transactions/arrangements. By adopting SLOB clause, India has further restricted the availability of tax benefits to restricted "Qualified Persons". However so far as the PPT is concerned, it being a default test, it should apply irrespective of the position adopted by other countries. Since India is only one among 12 countries to have chosen to apply SLOB, only a PPT is likely to apply to India’s double tax conventions since India has not chosen to negotiate a detailed LOB clause with those treaty partners who have not chosen SLOB.

2.2. Article 16: Mutual Agreement Procedure ("MAP")

One of the primary question in MAP is whether there is a duty to negotiate with the competent authority of the other State at the request of a party. The OECD in its commentary to its Model Convention has stated that the competent authorities answered this question in the affirmative. However, if one were to enquire further into the provisions that provide for MAP, it is apparent that this "duty" is extremely diluted with wide discretion afforded to the States. This is due to three reasons: (i) Article 16 of the MLI requires the States to merely “endeavour” to resolve the case by way of


16 See OECD, Commentary on the Articles of the 2005 OECD Model Income and Capital Tax Convention (Jul. 15, 2005), Commentary on Article 25, ¶ 26
MAP, (ii) the competent authority can reject the request if an “objection appears to it to be unjustified” and (iii) the duty is not triggered “if it is not itself able to arrive at a satisfactory solution”.  

Domestic Courts in several jurisdictions further support this position. In the US, while, initially, the taxpayers had the option to request the review of the authorities’ decision regarding unsuitability of their cases for MAP, such option was later on abolished.  

The Court, in the case of *Yamaha Motor Corp. v United States*  

held that it was within the Government’s discretion to prevent the plaintiff access to MAP. This position was supported in *Filler v Comm’t*, where the Court held that the decision regarding initiation of MAP is “an international administrative procedure between the competent authorities of the contracting states”. Similar position can be seen in Germany and Canada. Although the Israeli Courts have recognized that the Government has the discretion to initiate MAP, it has been held that the tax authorities have the obligation to at least consider the case on the merits, thereby, compelling them to exercise their discretionary in a reasonable manner and after application of mind.

Although, it might not be feasible to mandate the competent authorities to initiate MAP in every case, the MLI could mandate the States, in consonance with the Israeli position, to at least consider the case on merits and give an avenue for review to the taxpayer.

### 2.3. Digital Economy

The MLI has retained the physical presence test for determining Permanent Establishment (‘PE’) thereby failing to address issues that arise in digital economy. Existing bilateral treaties also fail to include virtual presence within its PE definition. Most tax treaties are based either on the UN Model Tax Convention or the OECD Model Tax Convention. The two models are similar in terms of structure but differ with regard to some elements. The UN Model provides a wider scope of a taxable nexus for business profits, through a PE by including server based virtual presence within its ambit. However the MLI has failed to provide for the same and retains the OECD model requirement of physical presence.

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18 Rev. Proc. 91-23; 1991-1 C.B. 534, § 1


20 74 T.C. 406 (1980).

21 Ehab Farah (n 7).

22 ibid.
While it is acknowledged that both OECD and the United Nations are striving to address the issues that arise in the digital economy, the MLI could have included a broader understanding of PE. BEPS Action 1 Report on Addressing the Tax Challenges of the Digital Economy (the Action 1 Report) was released on 2015 by OECD and subsequently an interim report was released in 2018. Many proposals including user participation approach, marketing intangibles approach and Significant Economic Presence approach have also been suggested. These suggestions could have been incorporated in the MLI. Many jurisdictions like India have already included some of these suggestions in their domestic framework. It will be interesting to see how the same will be included in the multilateral framework.

3. The MLI and the Domestic Law

3.1. Domestic implementation of the MLI

Article 51 of the Indian Constitution guides the State to "foster respect for international law and treaty obligations in the dealings of organized peoples with one another".23

Like Canada, UK and Australia, Indian Constitution regards treaty-making as an executive act. The executive power of the Central Government is vested in the President (formal head) is aided and advised by the Council of Ministers and the Prime Minister, who in turn hold the real executive authority.24 Therefore, the power to sign and ratify the treaty is within the executive’s realm.25

It is important to note that there is no requirement of a ‘legislative approval’26 under the Indian Constitution. The Constitution merely lays down the process and procedure for legislative implementation under Article 253. It states that notwithstanding the division of legislative powers within the Centre and the States, the Parliament has the power to enact legislation implementing the provisions of the treaty; thereby following a ‘dualist approach’.

Every treaty does not require ‘legislative implementation’ as well. In the case of Berubari,27 the Court held that if the treaty involves a mere interpretation of an award or ascertainment of disputed borders in a foreign land, then there is no need for legislation. However, if the treaty involved cessation or alienation of territory, then the same will be required. Every treaty that affects the rights of people, involves cessation of territory, or modification of domestic law requires

23 Constitution of India 1950, art. 51.


26 Legislative approval would mean assent in any form such as passing an Act or a resolution by the Parliament which signifies ratification of the treaty. For instance, in the US, the power of ratification lies with the Senate. To the contrary, in India, the ratification process is done by the President with the aid and advice of the Council of Ministers.

The impact of the MLI on countries’ treaty policy

legislative implementation.\(^{28}\) Until the moment an Act is passed by the Parliament to change the municipal law, the Courts are bound to apply the unamended law.\(^{29}\) However, it is a recognized principle of interpretation that the Courts must harmonize the national law and international law.\(^{30}\) The Courts can invoke a treaty for the purposes of interpreting the Indian law, unless it conflict with it.\(^{31}\)

For the purposes of quick implementation of tax treaties, Indian Parliament enacted Section 90 of the Income Tax Act that empowers the Central Government to enter into an agreement with another country for the purposes of granting relief from tax, avoidance of double taxation and exchange of information for the purposes avoiding evasion and avoidance.\(^{32}\) The Government, by way of a notification in the Official Gazette of India, has the power to enact rules to implement the provisions of such a treaty. Hence, once a notification has been made, the treaty provisions become enforceable. In case of a conflict between a tax treaty and the Income Tax Act, the former is given precedence.\(^{33}\)

In addition, Article 12 of the MLI (artificial avoidance of PE) has already been adopted in the domestic law of India. The provisions of Section 9 of the Income-tax Act, 1961 (‘IT Act’) have been amended so as to align them with the provisions in the bilateral treaties as modified by Article 12 of the MLI.\(^{34}\) These amendments were made in the domestic legal framework to make the provisions in the treaty effective.\(^{35}\)

Accordingly, clause (i) of sub-section (1) of section 9 of the IT Act has been amended to provide that “business connection” shall also include any business activities carried through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident. It is further amended that the contracts should be (i) in the name of the non-resident; or (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that the non-resident has the right to use; or (iii) for the provision of services by that non-resident.


\(^{29}\) Jolly George Verghese & Anr v The Bank of Cochin, 1980 SCR (2) 913.


\(^{32}\) Income Tax Act 1961, s 90.


\(^{34}\) Department of Revenue (Central Board of Direct Taxes), Government of India, ‘Explanatory Notes to the Provisions of the Finance Act, 2018’ (Circular, No. 8 of 2018).

\(^{35}\) ibid.
3.2. MLI provisions that may arise domestic legal issues

3.2.1. Article 4: Dual Resident Entities

Since 1 April 2017, the Indian corporate residence test was drastically altered. The Income Tax Act 1961 now incorporates the internationally recognized POEM (or Place of Effective Management) test that has been in existence since the 1963 OECD Draft Convention. The domestic test is relevant because Article 3(2) of the OECD Model Convention states that if any term has been left undefined, its meaning shall be drawn from domestic law.

The Mutual Agreement Procedure (MAP) emphasizes the role of Contracting States in deciding residence by mutual agreement on a case-by-case basis. It is pertinent to note that the OECD’s guidance revolves around the place where an entity takes key management and commercial decisions necessary for the conduct of its business. The Indian domestic law, while referring to the same definition under Section 6(3) of the IT Act, put forth an additional and newly devised ‘active and passive income’ test in a circular issued by the Finance Ministry. This places an additional burden on companies with transnational operations, considering the test is subjective leading to increased compliance costs and the risk of added disputes and litigation.

The shift from POEM as an objective and sole determinant to a MAP system involving deliberation could lead to delays in resolution, especially considering the differences in the Indian standards of determination. More specifically, it is noteworthy that India intends to use its domestic law meaning whilst applying the tiebreaker rule. Section 90(2) of the Income Tax Act, 1961 specifies that in agreements entered into with other states, the provisions of the Act itself shall apply to the extent beneficial to the assessee. This will lead to a lack of consensus between competent authorities. The MLI makes it clear that in this event, an entity shall not be entitled to any treaty benefit whatsoever, except as decided by the Contracting States.

However, OECD Secretary General has claimed that MAP will provide taxpayers with greater certainty through improvements to the Mutual Agreement Procedures.

36 See: Article 4(3) of the OECD and UN Model Treaties.

37 Department of Revenue (Central Board of Direct Taxes), Government of India, ‘Guiding Principles for determination of Place of Effective Management (POEM) of a Company’ (Circular No. 6 of 2017).


39 Multilateral Instrument, Article 4, Explanatory Statement.
3.2.2. Article 6: Preamble of a Covered Tax Agreement

Article 6 of the MLI is a minimum standard that seeks to insert a preamble in the tax treaties to provide for an express intention of the signatories to eliminate double taxation without creating any avenues for either non-taxation or reduced taxation by way of tax evasion or avoidance. As India’s has not taken any position in regard to the article, the preamble will not replace anything and would be rather added to the treaties.

Section 90(1) of the Income Tax Act, 1961 (“ITA”) provides that the Government of India may enter into double tax agreements with any foreign Country or specified territory outside India for the following objectives: (1) for protection of taxpayers against double taxation, (ii) for avoidance of double taxation of income, (iii) for exchange of information and for prevention of tax evasion or avoidance of income tax, and (iv) for recovery of income tax under this Act and under the corresponding law in force in that country.

The case of Azadi Bachao Andolan in Indian jurisprudence have also highlighted the objectives incorporated in the preamble clause. In the instant case a circular was issued by the Central Board of Direct Taxes, India to accept certificates of residence issued by the Mauritian Authorities as final proof of residence of taxpayer without any question was challenged. The question before the court was whether India-Mauritius tax treaty was misused by virtue of mere certificate of residence issued by the Mauritian tax authorities. At the time of the matter, the treaty preamble provided – “avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains and for the encouragement of mutual trade and investment”. The Court, while interpreting the preamble and noting that the developing countries often compromise between tax collections and foreign investment, ruled that treaty shopping was legitimate. It further ruled that the Westminster Rule (i.e., the taxpayers are allowed to arrange their affairs in a manner so as to reduce their tax liability) was still good law.

In a subsequent advance ruling, the issue was whether the Mauritian-resident company who intended to sell its stake in an Indian subsidiary to a German company would have an obligation to pay any capital gains. The Authority of Advance Ruling (AAR), relying on Azadi Bachao Andolan, held that even if the arrangement had been set up to obtain tax benefit, such treaty shopping was not objectionable. Further in the case of Wipro Ltd. V. Deputy Commissioner of Income Tax, the Karnataka Court upheld the entitlement of foreign tax credit for a tax holiday enterprise. The Court while interpreting Section 90 of the ITA stated that: “By virtue of amendment made by the Finance Act, 2003, benefit of granting the relief was extended to even in respect of income tax chargeable under the Act. Therefore, the payment.

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41 Union of India and Anr. v. Azadi Bachao Andolan, [2003], 263 ITR 706.


of income tax in both jurisdictions is no more *sine qua non* for granting the relief. This provision has been introduced with the object of promoting mutual economic relations, trade and investment. Even though the judgment did not deal with the preamble directly, the interpretation of section 90 to promote mutual economic relations, trade and investment is imperative.

The above-mentioned cases from Indian Jurisprudence on preamble clauses depict that the Preamble holds significant value in interpretation, and hence, the express mention of dual purpose, *i.e.*, prevention of non-taxation and double taxation, will make the intention of the drafters clear. In light of the changes brought by the MLI and change in approach due to the vigorous approach taken in OECD BEPS Project, the Indian Courts might change its course and illegitimate tax avoidance.\textsuperscript{44}

Another aspect to be kept in mind is whether with the addition of new language the Courts may interpret treaty shopping in a new light, considering the fact that earlier cases legitimized treaty shopping based on fostering economic development, mutual trade relations and foreign investment. However since the addition of new language elucidate the intent of the treaty more clearly, the Courts while passing decisions now, may be less tolerant to tax avoidance and double non-taxation.

### 3.2.3. Article 7: Prevention of Treaty Abuse

As a minimum Standard Article 7 requires the countries to implement at least one of the following anti-abuse measures in their treaties (i) a principal purpose test ("PPT") only which is a general anti abuse rule (ii) a PPT supplemented with either a simplified limitation on benefits ("SLOB") or detailed limitation on benefits provision or (iii) a detailed limitation on benefits ("LOB") provision, supplemented by a mutually negotiated mechanism to deal with conduit arrangement not already covered in tax treaties.

India has chosen to apply the PPT plus the simplified LOB in the MLI. The rationale behind the adoption of the combination of PPT and simplified LOB appears to grant benefits to qualified persons under LOB rule and then identify and scrutinize particular transactions under the lens of the PPT rule as a surrogate.

The PPT test evaluates a transaction on two grounds: whether the principal purpose or one of the principal purposes of an arrangement or transaction is to derive an unintended benefit of a tax treaty or whether obtaining such a benefit is in sync with the object and purpose of the treaty. Thus, in case one of the principal purposes of the transaction is to avail an unintended benefit which is not in line with the object and purpose, then such benefit would be denied to the taxpayer. This is a minimum deterrent and is designed as a subjective test. The simplified LOB test which will

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\textsuperscript{44} Sudarshan Rangan [n 33].
supplement PPT (as per India’s notification) further limits the availability of tax benefits to “Qualified Persons” of a Contracting State. Article 7(9) stipulate the persons who are covered within the purview of “qualified Persons”.

3.2.3.1. Domestic Law

In domestic Law, India has adopted a General Anti Avoidance Rule (“GAAR”), effective from 1 April 2017 in its domestic law. GAAR enables the tax authority to scrutinize the substance of the transaction and to disregard it, if the main purpose of the transaction is to obtain the tax benefit without any commercial or business justification other than to obtain the tax benefit. Before GAAR, tax avoidance has been dealt only through judicial decisions in specific cases. The judicial interpretation of substance over form was first given by Apex Court in *Mc Dowell* case. The Apex Court clarified that “Tax planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid payment of tax by resorting to dubious methods”. It further stated that “the Court are not concerned merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes. No one can get away with a tax avoidance project with the mere statement that there is nothing wrong with it”.

In the case of *Azadi Bachao Andolan* the Apex Court held that an attempt by a resident of a third party to take advantage of existing provisions of double taxation avoidance agreement is only prohibited when such entity is a sham or the arrangement amounts to a colorable device. The tax department cannot alter such arrangement merely because it is detrimental to revenue. This approach was reiterated by the SC in *Vodafone* case (2012). In the absence of any specific provision taxing indirect transfers, the Apex Court held that one has to ‘look at’ the entire transaction as a whole and “not look through” by adopting a dissecting approach. It also clarified that there was a departure in the case of *Azadi Bachao Andolan* from the ratio of the judgment delivered in the case of *Mc Dowell*.

In light of the above, the GAAR enacts a significant difference in approach to one of the substance over form. As per Section 96(1) of the Income Tax Act, the GAAR will characterize an arrangement as Impermissible Avoidance Arrangement (“IAA”) if it fulfills the following conditions:

1. The main purpose of such arrangement is to obtain a tax benefit, and
2. Such arrangement fall within any of the following situations:
   (a) It has created rights and obligations which are ordinarily created between the parties dealing at arm’s length.
   (b) It results in misuse or abuse of provisions of the Act.

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45 ‘India’s MLI Positions: Impact on Availing Treat Benefits’ [n 31].


47 *Union of India and Anr. v. Azadi Bachao Andolan* [n. 34].
(c) Lacks commercial substance or is deemed to have lacked commercial substance as defined in section 97 in whole or in part.
(d) It is entered into in a manner which are not ordinarily employed for bona fide purposes.

While deciding whether a transaction or arrangement falls within the purview of IAA, the approach is substance over form. In brief, in any tax planning, in addition to saving the tax cost, a taxpayer is required to justify what other commercial objective he has achieved to treat his tax planning as permissible under the Act. The characteristic of IAA reflects the Apex Court approach in Mc dowell wherein the Court observed that every taxpayer is entitled to arrange his affairs within the four corners of law and if the transaction has commercial and economic substance, the same cannot be disregarded by the Revenue merely because it leads to reduction in tax liability. The revenue can disregard only those arrangement which are artificial and colorable.

Even though GAAR takes the understanding of Mc dowell and other cases, its scope is much wider under ITA. The same is evident through the definition of ‘lack of commercial substance; as provided under section 97(1) which included round trip financing, accommodating party, element of offsetting or cancelling effect of individual transactions impact of arrangement on business risks and cash flows, location of assets or transaction or a place of residence of any party as one of the elements to treat any tax planning as tax avoidance. The GAAR provision can in fact have the impact of nullifying the decision of Apex Court in the case of Vodafone, insofar as it pertained to the ratio where it was held that treaty shopping is permissible. Thus, it can be concluded that GAAR is not merely a codification of judicial interpretation on doctrine of substance over form but goes much beyond it and is therefore wider in application.

3.2.3.2. Interplay of PPT and GAAR

PPT under MLI is potentially broader in ambit than the General Anti Avoidance Rule under the ITA, as the latter gets triggered only if the “main purpose” of the arrangement is to obtain tax benefit. Further in order to trigger GAAR one of the other elements mentioned in Section 97(1) needs to be satisfied. Therefore, it is unlikely for GAAR to be triggered if the conditions for the application of the PPT clause are met, except in situation wherein the PPT is not applied because the benefit was in accordance with the object and purpose of the treaty provision. However, it is pertinent to note that the GAAR may still be triggered in this situation as it does not provide such a carve out. However, CBDT Circular No. 7 of 2017\(^\text{48}\), has explicitly clarified if a case of tax avoidance is sufficiently addressed by the LOB clause then the GAAR should not be invoked.

Practically it might prove very cumbersome for a taxpayer to prove that one of the purposes of transaction is to obtain tax benefit and further it is in line with the desires object and intent of the convention. Even though Action 6 provides guidance on application of PPT by way of examples, such examples only have persuasive value and it remains prone to varied interpretations. Thus it will be beneficial if clear guideline on PPT rule is provided.

Further it is still questionable as to whether a taxpayer can seek to cover himself under domestic GAAR rather than under PPT rule (in treaty), on the contention that the provisions of GAAR are more beneficial (restrictive). In such case the taxpayer can establish that even though one of the main purposes (under PPT) was to obtain tax benefit, as the main purpose (under GAAR) of the transaction was not to gain unintended tax benefit, the benefits of the treaty should not be denied.

3.2.3. Article 9: Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

Article 9 allows a Contracting State to tax capital gains from the alienation of shares or other participatory rights if more than a certain value of such shares/rights is derived from immovable property situated in that Contracting State. Such value threshold must have been met any time during 365 days preceding the transaction.

In the Indian context, for the purposes of taxing an entity or a transaction, it is necessary to fulfil the requirement of Article 245 of the Indian Constitution (‘Territorial Clause’). The article empowers the Parliament to enact laws for the whole or a part of the Indian territory. It further provides that any law enacted by the Parliament is not invalid merely on the ground that it has extra-territorial operation.

The Courts have been careful in distinguishing between “mak[ing] laws” and laws having “extraterritorial operation”. The Court in GVK Industries dealt with extra-territorial laws. It noted that the article empowers Parliament to enact laws which are in the “interest of, to the benefit of, in defence of, in support or favour of, suitable or appropriate to, in respect of or with reference to “the whole or any part of the territory of India”. The extraterritorial aspect or causes that have some impact or nexus with the Indian State are within the legislative competence of the Parliament “so long as the purpose or object of such legislation is to benefit the people of that nation state”. It rejected the interpretation in an earlier case of ECIL that the “provocation” and “object” have to be either “in” or “within” the territory of India. The Court in GVK Industries further noted that, in International law, the principle of strict territorial jurisdiction has been diluted and it would be not possible to conceive of legislative powers that are restricted to aspects or causes that either arise or expected to arise within the Indian territory.

Resultantly, if the Parliament wants to tax a transaction where foreign parties are involved, the tax authorities need to establish some impact or nexus with India. The Courts have often focused on the transaction rather than the parties.49

If a transaction involves assets situated in India, the tax authorities would be justified to tax such a transaction; however, the same would be hard to justify if the assets were to be situated outside India.50

Even in the case of Vodafone, when the Revenue had attempted to justify taxing the transaction by arguing that as the underlying assets were located in India, the transaction could be taxed in India, the Court rejected the same. The legislature has attempted to overrule the judgment by amending Section 9 of the Income Tax Act. The amendment “clarifies” that “any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India”. The provision creates a legal fiction that equates shares with capital assets. However, the constitutionality of the provision has been doubted as deeming provisions do not allow the Parliament to assume anything. Despite the over breadth of the provision, the Constitution would still demand a nexus with India.51 Hence, for an entity to be taxed under Article 9 of the MLI, the Court will require satisfaction of this constitutional dimension.

3.2.4. Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

3.2.4.1. Interpretational Issues in the meaning of ‘principal role’

The tax authorities in India have been aggressive with regard to decreasing Dependent Agent Permanent Establishment (‘DAPE’) threshold. The OECD commentary states that ‘principal role’ will include soliciting and convincing a customer to enter into a contract.52 The OECD position also suggests that ‘authority to negotiate all elements and details’ of the contract will be considered to be an authority to conclude a contract and but mere attending and participating in negotiations is not sufficient in and of itself. India, however has made a reservation in the OECD commentary and taken the position that the mere attending or participating in negotiations, based on the context, could be sufficient to create a DAPE.53


Indian courts have held that negotiating essential elements of the contract can constitute ‘principal role’ in concluding a contract.\(^{54}\) It is not necessary that all the elements and details of the contract are to be negotiated by the agent to be considered DAPE.\(^{55}\)

As stated above, India has an aggressive stance on the DAPE analysis. India may start to interpret the MLI provisions on DAPE also aggressively. Considering the MLI is at a nascent stage of adoption, there is uncertainty on how the revised threshold will be interpreted by other Contracting States.

### 3.2.4.2. Attribution of Income to DAPE

OECD released a discussion draft on June 22, 2017 to provide supplementary guidance on the attribution of income to PE. This draft suggests that a distributor margin approach should be adopted for attributing profits to a DAPE. However, Indian tax authorities have had a strong preference for using formulary apportionment in most cases.\(^{56}\) It must be borne in mind that jurisprudence in other jurisdictions is evolving to prefer transfer pricing based approach for the same. However, there is no finality to the preferred approach currently and therefore, it remains a key area of uncertainty and a potential domestic conflict.

CBDT had also issued a report on profit attribution to PE in April 2019. Subsequent to the inclusion of the Significant Economic Presence (‘SEP’) test in the domestic law, the report also recommends including user participation as a factor in their factor based formulary approach in calculating profit attributable to non-residents who have SEP. However, the weightage to be given to user participation is yet to be decided. This further creates scope for conflict as there is no clarity on the preferred approach in case of SEP.

### 3.2.4.3. Digital Economy

Articles 12 and 13 of the MLI effectively reduce the threshold for taxing non-residents as PEs with respect to activities conducted through commissionaire agreements and also make it relatively simple to tax a non-resident as PE. It further limits the preparatory and auxiliary activities exemptions with the need to actually be considered preparatory or auxiliary even if specifically exempted. But in the Indian context, taxability based on source revenue does not significantly increase with the MLI. The adoption of MLI will not modify characteristics relevant to the digital economy as they continue to be focused on physical presence.\(^{57}\)

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\(^{54}\) Honda Motor Company Ltd. v. Commissioner of Income Tax, 2018 (6) 6 SCC 70.

\(^{55}\) Ibid (p. 21).

\(^{56}\) 2011 (339) ITR 147 Del.

In India, two primary domestic tax law measures have been adopted to prevent the base erosion issues arising in the digital economy. The first is the introduction of the equalisation levy. India’s Finance Act, 2016 introduced an equalization levy, which is a tax of 6%, levied on payments to foreign companies for online advertising services, when those companies do not hold a permanent establishment in India.\(^5^8\) The second is the expansion of the scope and ambit of the term ‘Business Connection’ defined in an inclusive manner in Section 9 of the IT Act. The Finance Act 2018 introduced Explanation 2A providing that a significant economic presence of a non-resident in India shall constitute a business connection in India. SEP is defined to include transactions with respect to goods and services including the provision for downloading of data and software in India provided the value of the transactions meets a certain threshold. Further it also includes activities that involve interaction or engagement with specified number of users in India. Accordingly, any income attributable to such significant economic presence will be considered as taxable in India.

The restrictive understanding of PE under MLI will override the expansive reading of the domestic provisions on business connection. While the implementation of the MLI and the use of significant economic presence is in its nascent stage, the conflict between the two may cause domestic legal issues in adjudication of cases involving the digital economy.

3.2.3. Article 13: Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

3.2.3.1. Interpretational issues

India decided to adopt Option A of Article 13 of the MLI. It ensures that all activities falling within the specific activity exemption must be of a preparatory or auxiliary nature irrespective of it being specifically mentioned as an exempted. However, there is an innate ambiguity in the meaning of the terms “preparatory” and “auxiliary”. This has led to confusion and in the Indian context, it has been finally interpreted by judicial authorities based on facts and circumstances of each individual case.

In the case of *Motorola Inc. v DCIT*\(^5^9\) the Delhi Tribunal held that activities such as “market survey, industry analysis, economy evaluation, furnishing of product information, ensuring distributorship and their warranty obligation, ensuring technical presentations to potential users, development of market opportunities, providing services and support information, procurement of raw materials and accounting and finance services, for one year by employees of a foreign


\(^5^9\) [2005] 95 ITD 269
company through an office located at the Indian subsidiary’s office qualified as preparatory or auxiliary in nature.\textsuperscript{60} However, in the case of Brown and Sharpe Inc. v. Commissioner of Income Tax\textsuperscript{61}, the Allahabad High Court found that though the activities of a foreign company’s liaison office (‘LO’) in India included preparatory or auxiliary services, the marketing services conducted from the LO could not be treated as preparatory or auxiliary and accordingly a PE was established.\textsuperscript{62}

3.2.4. Article 18-26: Mandatory Arbitration

It has been argued that the mandatory arbitration impedes States’ exercise of sovereignty. In the UN Secretariat Report, three types of challenges to sovereignty that the mandatory arbitration might pose. \textit{First}, conferring power to an external authority (\textit{i.e.}, arbitrator or panel) to decide on tax matters might be regarded as an unconstitutional delegation of power.\textsuperscript{63} 

\textit{Secondly}, although the mandatory arbitration might be constitutional, it might run afoul with the equality jurisprudence if the citizens are afforded similar arbitration procedure. The \textit{last} challenge is connected to the general concern of not sufficiently protecting sovereignty by allowing third parties to interfere and decide upon local matters.

To deal with the first two challenges, UN Secretariat, recognizing that the option to amend the Constitution might be limited, recommended insertion of a ‘Most Favoured Nation’ clause where it would offer arbitration provision if it is granted to another country. Such a move would affirm the good faith of the party and it would assure that if the Constitution is amended in the future, the arbitration provisions would still be available to the taxpayers.

With respect to the last challenge, \textit{i.e.}, general objection of sovereignty, the Report acknowledges that arbitration involves ceding of policy space. The State is the arbiter of deciding the extent of foreign investment allowed, investor-friendliness and amount of policy to be retained; however, it must be transparent in such matters. The Report also seeks to address the concerns regarding involving a third party by proposing ‘baseball arbitration’, which has also found mention in the MLI. For other cases, it argues that since the arbitrators would be bound by customary international law and other treaty interpretation rules, it would provide the States with an extra level of certainty.

The potential legal challenges mentioned in the UN Secretariat Report have also been expressed in the Indian context. However, we believe that such challenges do not stand ground for the reasons indicated below.

3.2.4.1. Excessive Delegation

\textsuperscript{60} Ibid.

\textsuperscript{61} [2014] 369 ITR 704 (All).

\textsuperscript{62} Ibid.

The Court in the case of *Agricultural Market Committee v Shalimar Chemical Works Ltd* \(^\text{64}\) held that the legislature cannot abdicate the 'essential legislative functions'. Such functions refer to the determination of the legislative policy and it cannot be conferred to another authority. Before delegating to an authority, the legislature has to express, either by express mention or implication, the policy and the principles that would guide the authority upon whom the power is being delegated. In deciding whether the legislature has excessively delegated, the Court has to take account of "subject-matter, the scheme, the provisions of the statute including its Preamble and the facts and circumstances and the background on which the statute is enacted." \(^\text{65}\)

Similar to above-stated, it may be argued that the power with the Government to negotiate under Section 90 of the Income Tax Act is unconstitutional. In the case of *Azadi Bachao Andolan v. Union of India*, \(^\text{66}\) the question was whether the Indo-Mauritius Double Taxation Avoidance Convention, 1983 was unconstitutional for excessive delegation. The Court held that even if the treaty were to be assumed to be a delegated legislation, it is constitutionally valid. Section 90 of the Income Tax Act provides clear legislative policy and guidance.

### 3.2.4.2. Sub-delegation

Another potential legal challenge is whether the appointment of arbitrator for settling a dispute constitute unconstitutional sub-delegation of authority \(^\text{67}\). As per the doctrine of *delegatus non potest delegare*, an authority upon whom a power has been delegated (delegate) cannot further delegate the power onto another authority. However, the legislature, either expressly or by implication, can allow the delegate to sub-delegate. As it can be seen from the wording of Section 90, it gives wide discretion to the Government to enter into tax treaties which include dispute resolution mechanism. Hence, the power of sub-delegation can easily be read into the provision.

### 3.2.4.3. Ceding of Sovereignty

Another argument is Government’s action in appointing a third party to adjudicate a tax matter is unconstitutional ceding of sovereignty.

It must be borne in mind that in the Indian context, ‘sovereignty’ forms a part of the ‘basic structure’ of the Constitution. \(^\text{68}\) Any law that abrogates the basic structure is unconstitutional. However, we believe that the sovereignty would not have

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\(^{64}\) (1997) 5 SCC 516.


\(^{68}\) *Kesavananda Bharati v State of Kerala*, (1973) 4 SCC 225.
been compromised because of the MBA. It must be kept in mind that almost every treaty involves ceding of sovereignty to an extent. Whenever a State enters into a tax treaty, it agrees to modify the application of the municipal law.

Therefore, the question should not be whether there is ceding of sovereignty to any extent, but the test must require something more. Govind and Rao argue that, from the Indian constitutional point of view, there is no unconstitutional waiver of sovereignty. They reason that every tax treaty that has been entered into under Section 90 of the Income Tax Act contains a form of MAP that has not been "constitutionally problematic". Mandatory arbitration is nothing but an extension of MAP and not a replacement. The MAP (either supplemented with mandatory arbitration or not) is a form of dispute resolution process that seeks to ensure that the parties tax the assessee in accordance with the treaty’s spirit where differing interpretations are evident.

3.2.4.4. Right to Equality

It can be argued that offering mandatory arbitration to the taxpayers coming under the double tax convention is discriminatory as the same is not being offered to the Indian residents.

Under the Indian jurisprudence, a challenge under Article 14 of the Constitution is upheld if – (i) there is no intelligible differentia in the distinction drawn between the two groups, and (ii) there is a link between the differentiation and the object of the legislation. The Courts have wide latitude to the Government in deciding tax policy. It has also upheld the differences in the rates between residents and non-residents.

For the purposes of mandatory arbitration, there can be no challenge under Article 14 as there is an intelligible differentia and the same will be linked to the object of the legislation (if and when it is enacted to implement mandatory arbitration). The primary distinction between assessee that can avail the mandatory arbitration provisions and the rest is that the former will fall under the ambit of relevant double tax convention. Further, the dispute that would be arbitrated would be related to tax avoidance and double taxation, which will not be present for the resident assessee who would not be connected with the double tax treaty. The government has a legitimate interest in providing preferential treatment to residents and foreign residents to portray the Indian taxation system as taxpayer friendly and transparent, which is necessary for attracting foreign investment. Hence, the differentiation is legitimate and does not run afoul of Article 14.

3. Principle of Reciprocity: potential mismatches

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69 Govind (n 47).

70 Ibid.

71 State of West Bengal v Anwar Ali Sarkar, 1952 AIR 75.

3.1. Treaties reported as covered by the MLI

Article 1 of the MLI states that its provisions will modify only the Covered Tax Agreements (CTA) reported by each jurisdiction in the terms of article 2(1) (a).

India has notified ninety three (93) bilateral comprehensive treaties as CTAs. The bilateral treaties with the following countries have been notified as CTAs, Albania, Armenia, Australia, Austria, Bangladesh, Belarus, Belgium, Bhutan, Botswana, Brazil, Bulgaria, Canada, China, Columbia, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Ethiopia, Fiji, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Indonesia, Ireland, Israel, Italy, Japan, Jordan, Kazakhstan, Kenya, Korea, Kyrgyz Republic, Latvia, Libya, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mauritius, Mexico, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nepal, Netherlands, New Zealand, Norway, Oman, Philippines, Poland, Portugal, Qatar, Romania, Russia, Saud Arabia, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Srilanka, Sudan, Sweden, Swizerland, Syria, Tajikistan, Tanzania, Thailand, Trinidad and Tobago, Turkey, Turkmenistan, Uganda, Ukraine, United Arab Emirates, United Kingdom, Uruguay, United States of America, Uzbekistan, Vietnam and Zambia.

The list covers all comprehensive tax treaties currently in effect in India. However, India has not notified limited tax treaties with Afghanistan, Ethiopia, Iran, Lebanon, Maldives, Pakistan and Yemen. These limited bilateral tax treaties deal exclusively with the exemption of international air fare for certain passenger carriers that are resident in the Contracting States from taxation in India and vice versa. Thus they have not been notified as CTAs.

India has also notified all the respective amending protocols. Amending protocols of the following countries have been included: Armenia, Australia, Austria, Bangladesh, Belarus, Belgium, Brazil, Denmark, Israel, Italy, Japan, Kazakhstan, Kuwait, Mauritius, Morocco, Netherlands, New Zealand, Poland, Singapore, Slovenia, South Africa, Spain, Sweden, Swiss Confederation, Tajikistan, UAE, UK, Uzbekistan and Vietnam.

3.2. Mismatches between the treaties reported by India and those reported by other jurisdictions that may prevent the MLI from being applied on those treaties

China, Luxembourg, Estonia and Mauritius have not listed the bilateral treaty with India as a CTA, while India has listed them preventing the MLI to be implemented to these treaties.

In addition, there is a notification mismatch under Article 2 with regards to the treaties entered into with Croatia, Ireland, New Zealand, Portugal, Turkey, United Kingdom, as either Contracting State consider different dates as date of entry into force of the double tax convention. The same happens in the case of the tax treaty with Germany, but with different dates of entry into force of the Second Protocol.

4. Effects of the MLI on Tax Treaties
4.1. Notifications, options and reservations taken by India in its position with respect to the MLI

4.1.1. Article 4: Dual Resident Entities

Pursuant to Article 4(4), India has notified all 93 of its CTAs as agreements that contain provisions described in Article 4(2) - providing rules for determining whether a person is to be treated as a resident of either Contracting State instead of both. In other words, India has notified all of its CTAs as already having tiebreaker rules, which will now be replaced by 4(1) of the MLI.

None of these agreements are subject to a reservation under Article 4(3)(b) (for already having MAP), 4(3)(c) (for simply denying treaty benefits altogether) or 4(3)(d) (that have MAP but also set out treatment of the entity in case mutual agreement cannot be reached).

4.1.2. Article 6 – Purpose of a Covered Tax Agreement

Article 6 being a minimum standard requires, express intent in the tax treaties (via amendment in preamble language) to exclude opportunities of treaty abuse. Hence, even though India has been silent on its position on Article 6 the MLI, preamble will be added to the existing preamble text, irrespective of India’s treaty partners notifying the same. The impact of India’s choice will significantly impact earlier position/jurisprudence on the elimination of double taxation as discussed above.

4.1.3. Article 7: Prevention of Treaty Abuse

Article 7 of MLI as a minimum standard requires countries to implement at least one of the following measures: (1) a principal purpose test only, (2) a PPT supplemented with either a simplified or a detailed LOB Provision or (3) a detailed LOB provision, supplemented with a mutually negotiated mechanism dealing with convoluted arrangements which have not been already dealt with.

The reason why India has opted for PPT along with SLOB is the following: Firstly, existing PPTs in treaties are either blanket treaties or either dealt under specific articles such as capital gains, royalties, interests, etc. The PPT under MLI focuses on denying ‘all or part’ of the benefits which will ensure that narrower provisions are replaced. Further, the PPT rule under the MLI focuses on ‘one of the main purposes’ unlike the terms ‘main purpose’ or ‘primary purpose’. This change is intended to make the test more stringent since in order to trigger a denial benefit under the PPT, obtaining the benefit need not be ‘primary or dominant’ purpose of the arrangement, it would suffice even if one of its principal purposes was to obtain such benefit.

In addition to the PPT, India has also adopted the SLOB, which limit the availability of tax benefits to ‘Qualified Persons’ as specified in paragraphs 8 to 13 of Article 7 of MLI. However, since India is among the 12 countries to have chosen to apply the SLOB, only a PPT is likely to apply to India’s CTAs since India has not chosen a reservation to negotiate a detailed LOB with treaty partners who have not chosen SLOB. Furthermore, most of India’s treaty partners have also
not chosen the option of symmetrical or asymmetrical application of SLOB, thereby resulting in application of only PPT to those treaties.

In conclusion the Position adopted by India depicts India’s stance of signalling to stringent action against tax avoidance and sham companies, corroborated by its choice of also adopting GAAR - SLOBs are more specific to persons availing treaty benefits and this two step process is more foolproof method of tackling tax avoidance.

4.1.4. Article 8: Dividend Transfer Transactions

Article 8 seeks to modify the provisions of a CTA which limit the tax levied in the country of ‘source’ on payment of dividends. It intends to introduce a minimum holding period of 365 days through which ‘beneficial owner’ test need to be satisfied for the treaty relief to apply. For this, the provision has introduced the testing period as listed down in paragraph 1 of Article 8.

Article 8(2) is a compatibility clause which states that the minimum holding period of Article 8(1) gets added if it is not ruled in the covered tax agreements. Existing provisions will be replaced with Article 8(1) if the country opts in for such clause.

Since Article 8 is not a minimum standard the Parties have the following choices with regard to reservations: (1) reserve the entirety of Article 8, (ii) reserve it only for a subset of CTAs that already contain the provision with a minimum holding period/minimum holding period shorter (or longer) than a 365 days period. As regards to notification, Article 8(4) specifies that for CTAs which do not contain an existing provision, paragraph 1 would get added to the relevant CTA. On the other hand, for CTAs which contain an existing provision it would constitute a situation ‘in place of’ in which case, paragraph 1 will replace the existing provision.

India has made a reservation under para 3(b)(iii) for Article 8 not to apply to a subset of CTAs that already contain provision with minimum holding period longer than 365 days period. Further since India has not reserved applicability of Article 8 in entirety, it has also made relevant notification in pursuant to paragraph 4.

4.1.5. Article 9: Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

The aim behind introduction of Article 9 was to curb the aggressive methods adopted by taxpayers to bypass the applicability of Article 13(4) of the OECD Model Convention leading to base erosion. The Article seeks to curb the mischief by providing that Article 13(4) should only apply to situations where shares/comparable interest derive their value substantially from immovable property at any time during a definite period as opposed to time of alienation. Article 9 expands the scope of applicability of Article 13(4) by bringing in its ambit other participation rights and comparable interests such as interest in a partnership or trust.
India has chosen to apply the optional provision by way of making the choice notification under paragraph 8. This implies that Article 9 will only apply where other treaty partner has also chosen to apply paragraph 4. Part 4 of Article 9 to the MLI provides that in the event of a CTA does not have any provision with respect to the taxation of gains from the alienation of shares that derive their value principally from immovable property then the treaty partner may choose to apply paragraph 4. If a treaty partner adopts paragraph 4 then automatically it cannot apply paragraph 1 of Article 9. However, if a treaty partner opts for paragraph 4 and the other treaty partner opts for paragraph 1, then only paragraph 1 shall apply since paragraph 4 can only be applied when both the parties have opted for it. Further, since India has not made any reservation under Article 6(a), it has made existing provision notification under paragraph 7.

4.1.6. Article 10 – Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions

Article 10 of the MLI is based on Action 6 Report and seeks to curb the mischief of Triangular cases to prevent base erosion profit shifting from the country of source. India has not reserved the applicability of this article. However, it has also not notified any provision in the CTA to which this Article should apply to. Hence, this article will only be applicable to those CTA’s and provisions which have been notified by the respective treaty partners who have also not reserved applicability of Article 10.

4.1.7. Article 11: Application of Tax Agreements to Restrict a Party’s Right to Tax its Own Residents

India is silent on its position with respect to Article 11. Article 11(1) provides that CTA shall not affect the taxation by a Contracting State of its residents except with respect to the benefits granted under specific provision of the CTA. India has not reserved the applicability of Article 11. However, in the absence of an express reservation Article 11 will apply to India’s CTAs (unless the other treaty partner has made a reservation).

4.1.8. Article 12: Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

Since many of the bilateral tax treaties with India already provide for some of the recommended provisions under Article 12 (or a similar version), India has not chosen to exercise its right of reservation and has notified all its treaties with respect to paragraphs 1 and 2 of Article 12. By making this choice India has effectively sought to bring all its treaties in line with the MLI subject to the position of the other Contracting State.

4.1.9. Article 13: Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

India notified option A mentioned in Article 13 of MLI, which includes BEPS Action Plan 7’s recommendations with regard to exemption of specific activities, i.e., the need for every activity that is preparatory or auxiliary in nature to be covered under PE exemptions. Exemption will be available only if activities are in fact preparatory and auxiliary in nature both on a stand-alone basis and when undertaken as a combination of activities. The requirement of the activity to be preparatory or auxiliary on a standalone basis even if specifically exempted increases the ambit of taxable PEs
by including the core activities that have been treated as non-taxable by abusing the existing bilateral tax treaty exemptions.

India seems to have not exercised its right to reserve paragraph 4 of Article 13 on anti-fragmentation, since there is no mention of it in its list of reservations. This position seems to be motivated by the need to prevent abuse of the exemption provision discussed above through the division of the business into smaller units.

4.1.9. Article 14: Splitting-up of Contracts

Rigidity in regulation of permanent establishments in India follows from BEPS Action Plan 7, which widens the definition of the business connection regime making it more robust and strong. The BEPS Action Plan, titled ‘Preventing the Artificial Avoidance of Permanent Establishment Status’, calls for the adoption of the DAPE. Subsequently, India has proposed new rules for Agency Permanent Establishments and Digital Permanent Establishments. Following this precedent India has notified Article 14 in its entirety and amended the definition DAPE in domestic law to ensure that the domestic law is in consonance with the MLI.

4.1.10. Article 15: Definition of a Person Closely Related to an Enterprise

Keeping in mind that Articles 12, 13 and 14 of the MLI all rely on the concept of persons ‘closely related’ to an enterprise, Article 15 provides a definition of the same based on the recommendations found in the BEPS Action Plan 7. As India has notified Articles 12, 13 and 14 it has notified Article 15 as well.

4.1.11. Article 18-26: Arbitration

India has chosen not to adopt mandatory arbitration for its CTAs as it will impinge on her sovereignty in tax matters and hinder the ability of the apply her own laws to non-residents and foreign entities.73

4.2. Indian notifications on existing provisions in listed agreements

India has made a notification on existing provision in listed Agreements under Article 7(17)(a), Article 8(4) and Article 9(7).

India has notified Article 12, Option A of 13, 14 and 15 with respect to all the 93 CTAs. However, India has not notified any country with respect to paragraph 4 of Article 13 as it is silent on its position with regard to this provision.

4.3. Minimum standards of the MLI

4.3.1. Article 16: Mutual Agreement Procedure

Although India has not reserved the second sentence of Article 16(1), it has not yet amended the Income Tax Rules (Rule 44, 44GA and 44H) to reflect the three-year period. The Rules need to be amended to incorporate the same.

Many bilateral treaties already provide for provisions similar to Article 12 of the MLI. However, considering the number of developed countries choosing to reserve provisions relating to PEs, it would be a welcome step to renegotiate the bilateral tax treaties with these countries to ensure they comply with the content of MLI.

4. Effects and Potential Mismatches on Signed CTAs

4.1. Reservations made by India

India has reserved the adoption of certain disposition of the MLI that will not be applicable to all or specific tax treaties, as indicated below.

4.1.1. Article 3: Transparent Entities

India reserved its right for the entirety of Article 3 not to apply to all of its Covered Tax Agreements. This impacts the application of the Article to the following of its CTAs, given that the relevant other Contracting State has opted to apply it: Spain and the United Kingdom.

4.1.2. Article 5: Application of Methods for Elimination of Double Taxation

India reserved its right for the entirety of Article 5 not to apply to all of its Covered Tax Agreements. This obstructs the application of the Article to the following of its CTAs, given that the relevant other Contracting State has opted to apply it and specifically listed the Indian DTAA: Austria, the Netherlands, Slovakia and the Swiss Confederation.

There are certain jurisdictions which have not reserved Article 5 in any manner, and have also chosen particular options, but have not listed their respective Indian DTAA under Article 5. These include Norway, Saudi Arabia, the Netherlands.

74 Mismatches between the Indian notifications made on existing provisions in listed agreements and the notifications provided by other countries in their own Positions are addressed in the tables in the Annexes with article wise mismatch with regard to position of India vis-a-vis position of the other Contracting State. The original working document submitted for the competition was edited for publishing purposes, but the original working paper, as well as their annexes considered by the jury, are available at request. Please feel free to contact us at gttc@ibfd.org for more information.
4.2. Reservations made by other Contracting States preventing the application of the MLI to Indian treaties

In addition, other jurisdictions have included reservations that prevent the application of the MLI to bilateral treaties signed by India, as may be seen below.

4.2.1. Article 4: Dual resident entities

Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Greece, Hungary, Iceland, Italy, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Portugal, Turkey, Qatar, Saudi Arabia, Singapore, Spain, Sweden, Switzerland, Ukraine, UAE have all either reserved Article 4’s application entirely or made reservations with respect to the Indian double tax convention in particular. However, India has opted to apply this to all of its tax treaties.

4.2.2. Article 7: Prevention of treaty abuse

India has chosen the option of Principal Purpose test along with Simplified Limitation of Benefit Clause. However, the SLOB clause shall only be applicable only when other country has also opted for the same. Countries including Australia, Austria, Belgium, Canada, Croatia, Cyprus, Czech Republic, Egypt, Estonia, Fiji, Finland, France, Georgia, Hungary, Ireland, Italy, Japan, Korea, Lithuania, Luxembourg, Malaysia, Malta, New Zealand, Portugal, Qatar, Saudi Arabia, Serbia, Singapore, Slovenia, South Africa, Sweden, Swiss Confederation, Turkey, Ukraine, UAE, United Kingdom have made a reservation on the applicability on SLOB clause.

For countries such as the US and Malaysia it still remains to be seen whether they would opt for SLOB clause as both of them have still not signed the MLI.

4.2.3. Article 8: Dividend transfer transaction

Countries such as Singapore, Sweden, UK, Austria, Bulgaria, Canada, Cyprus, Czech Republic, Estonia, Georgia, Greece, Hungary, Iceland, Italy, Japan, Kazakhstan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Qatar, Saudi Arabia, Switzerland, Turkey, Ukraine, UAE have made an explicit reservation for the applicability of Article 8. This might be primarily because a lot of these countries consider that already existing Beneficial Owner Test to be enough to ensure that exemption form dividend taxation in the source state does not lead to base erosion.

4.2.4. Article 9: Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property

Countries including Singapore, United Kingdom, Bulgaria, Canada, Cyprus, Czech Republic, Denmark, Finland, Georgia, Hungary, Iceland, Kuwait, Latvia, Luxembourg, Malta, Qatar, Northern Ireland, Romania, Singapore, South Africa, Swiss Confederation, Turkey, U.A.E. and Sweden have reserved the applicability of Article 9 in its entirety. The
reluctancy behind most of the countries not adopting Article 9 of MLI must be because of the fact that most of these treaties already contain provisions pertaining to Participation Interest, few other contain provisions that have testing period for the determination of value of threshold. Another reason behind most of the countries are not willing to adopt Article 9 might be that they still want to continue making attempts to retain the balance between ‘source’ taxation and fostering foreign investment while reducing BEPS.

4.2.5. Article 10: Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions

Sweden, UK, UAE, Turkey, Swiss Confederation, South Africa, Saudi Arabia, Serbia, Portugal, Poland, Norway, Luxembourg, Lithuania, Latvia, Kuwait, Korea, Italy, Ireland, Indonesia, Germany, Georgia, Estonia, Egypt, Cyprus, Croatia, Australia, Denmark, Czech Republic, Singapore and France have reserved Article 10 in its entirely. Further, several other countries including India have not yet taken a position on the Article. In any case, it is not likely to such triangular cases in the Indian context and therefore Article 10 will have limited impact or relevance with respect to Indian Operations.

4.2.6. Article 11: Application of Tax Agreements to Restrict a Party’s Right to Tax its Own Residents

Countries such as France, Ireland, Japan, Luxembourg, Singapore and Sweden has reserved the right for the entirety of Article 11 to not apply to India’s CTAs. Accordingly, Article 11 will not affect India’s treaties with these jurisdictions.75

4.2.7. Article 12: Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

Countries like Singapore, Sweden, and the United Kingdom have reserved the entirety of Article 12. This may be the case because existing tax treaties with these countries already contain a provision similar to Article 12.77

4.2.8. Article 13: Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

Sweden has reserved the entirety of Article 13. Thus, India’s treaty with Sweden will remain unchanged with respect to the relevant provisions. France and Singapore have chosen Option B and both do not have a reservation with respect to paragraph 4, thus their treaty with India would remain unchanged with respect to the list of specific activity

75 For details regarding other countries that have reserved Article 11 please refer to Table 3 in the Annexures.

76 Annexes are available at request. Please feel free to write us at gttc@ibfd.org.

77 For details regarding other countries that have reserved Article 12 please refer to Table 3 in the Annexures.
exemptions; but, paragraph 4 would be applicable. The United Kingdom has not opted either of the options under Article 13 nor has it made any specific reservation; but, it has notified India with respect to paragraph 478.

4.2.9. Article 14: Splitting-up of Contracts

United Kingdom, Singapore and Sweden have reserved this Article in its entirety. India’s treaties with these countries would not be modified with respect to this provision79.

4.2.10. Article 15: Definition of a Person Closely Related to an Enterprise

As Singapore and Sweden have made reservations with respect to Articles 12, 13, and 14, they have also made a reservation with respect to this Article 1580.

4.3. Notification of optional provisions which differ from current treaty policy

India has notified choice of optional provisions of certain dispositions of the MLI that differ from the current dispositions adopted by its current tax treaties in the same topic.

4.3.1. Article 7: Prevention of Treaty Abuse

In pursuance to Article 17(7)(c) India has opted for the Simplified LOB provision under Article 7(6) of the MLI. The SLOB provisions limits the availability of tax benefits to “Qualified Persons” of the Contracting State. However, most of India’s existing signed treaties contain (a) only a PPT clause or (b) PPT and LOB clause. Further, since India is one among the twelve countries which have opted for the SLOB clause under MLI, it is likely that only PPT will apply to most of India’s CTAs.

4.3.2. Article 13: Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

India has opted for option A in Article 13 of MLI, which includes BEPS Action Plan 7’s recommendations in relation to exemption of specific activities, i.e., the need for every activity that is preparatory or auxiliary in nature to be covered under PE exemptions. Exemption will be available only if activities are preparatory and auxiliary in nature both on a stand-alone basis, and when undertaken as a combination of activities.

78 For details regarding other countries that have reserved Article 12 please refer to Table 3 in the Annexures.
79 For details regarding other countries that have reserved Article 12 please refer to Table 3 in the Annexures.
80 For details regarding other countries that have reserved Article 15 please refer to Table 3 in the Annexures.
However, in most of India’s existing tax treaties, activities such as ‘storage of goods and merchandise’ and ‘purchase activity’ are not subject to the condition of being ‘preparatory and auxiliary’ in nature, in order to be covered under Permanent Establishment exclusions. Thus these treaties differ from the option A provision chosen by India in Article 13 of the MLI.

India has not reserved paragraph 4 of Article 13 on anti-fragmentation, since there is no mention of it in its list of reservations. However no anti-fragmentation rules are included in India’s existing tax treaties.

5. Conclusions

The impact of various articles of the MLI on the Indian tax policy would differ from provision to provision. Certain changes required by the MLI have taken place in the domestic law and hence no further change would be required. However, in regard to certain other provisions such as MAP, the tax statute and rules will have to be amended.

In the context of double taxation as addressed by Article 4 of the MLI, the POEM tiebreaker is the prevailing international standard. Adoption of the MAP system in its place, only two years after India amended its domestic law to incorporate POEM into its framework, is bound to create disarray in India’s bilateral network once again. This is because treaty states will be unlikely to adopt a position in such negotiations that is very different from their domestic laws and policy. In addition to the problem that certain treaty partners do not employ the POEM rule domestically, the fact that India’s POEM rule is further qualified by the ‘active and passive business’ test will ensure disagreements and delays in resolution. As a result, India may be forced to revisit its own policy.

India does not have a comprehensive and coherent national tax model or policy. The taxation system is governed by statutory provisions, tax authorities and the judiciary. However, it must be noted that domestic statutes have been amended to align the same with the MLI. As discussed above changes are being made to the IT Act to help implement the MLI without any conflict.

The MLI would have a moderate impact on the bilateral tax treaties with regard to the provisions on PE, DAPE specific activity exemptions, and anti-fragmentation. Many countries like Bangladesh, Brazil, Nepal, Philippines, Sri Lanka and USA have not signed the MLI and therefore their bilateral tax treaties will continue to apply unchanged. On the other hand, countries like China have chosen not to include India in their CTAs thus bilateral treaties with such countries will also remain unchanged. Countries like Canada and Sweden have chosen to reserve these provisions from being applicable and therefore their tax treaties will also remain unchanged. However with countries like France and Russian some provisions in the tax treaty would be altered with the adoption of the MLI.

India has renegotiated its treaties with Mauritius, Cyprus and Singapore and is attempting to do the same with the Netherlands. However, there is no evidence to suggest that the renegotiation is a consequence of the MLI. It seems that renegotiation with regard to PE seems difficult, especially since developed countries have an advantage in such negotiations and they seem to be resisting the MLI content with regard to PE.
Foreword to the Swedish report on the “The Impact of the MLI on Countries’ Tax Treaty Policy”

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This report aims to describe as well as analyse the Swedish position to the MLI.

We state in the report that the Swedish government has chosen a cautious approach to the MLI. This is based on the fact that Sweden only opted in for the minimum standards contained in articles 6, 7, 16 and 17 of the MLI.

However, Sweden has listed 64 of its treaties to be covered by the MLI under Article 2 (1). Since the Swedish treaty network consists of upwards of 80 DTA:s this means that about 80% of existing Swedish DTA:s were listed. Based on those facts, it would therefore in our view be incorrect to suggest that, based on its choices, the Swedish government is skeptical toward the MLI as a concept. Rather, the Swedish government appears to have adopted a “wait and see” approach.

This conclusion can be reached based on the draft act which the Swedish government presented to the parliament for it to ratify the MLI. In the draft act the government states that it is concerned that if the application of a provision of the MLI in practice would yield unintended negative effects, there would be no way to rectify that without resorting to a bilateral renegotiation. Therefore, presumably the Swedish government intends to wait and see how the provisions that are not part of the minimum standard work in practice before it commits to them. However, since it will probably take time before any significant data exists concerning whether or not the MLI provisions yield unintended negative effects in practice, it could take a long time before the government is even in a position to opt in for more provisions.

Of course the possibility also exists that the Swedish government will never commit to more than the minimum standard with regard to the MLI. This could be due to a number of reasons. Perhaps in the time that it takes to wait and see, BEPS-related issues will no longer have as high of a priority on the legislative agenda. It could also conceivably be the case that more states and jurisdictions choose a “wait and see” approach to the MLI. This could lessen the incentive to use the MLI in order to implement BEPS changes since the smaller the number of signatories that opt in for provisions in the MLI, the smaller the number of treaties that are impacted will be. As a consequence Sweden, as well as other states and jurisdictions could opt to simply bypass the MLI in favour of bilateral negotiations that carry the added benefit of being tailor made to suit a specific treaty relationship. It is important to note however, that such negotiations would probably be quite slow. As we mention in the report, the newly renegotiated Swedish treaty with Brazil took approximately 10 years to complete.

This leads into one of the key findings of our report; namely that the MLI, disregarding the optional provisions, does not appear to offer a quick way for Sweden to implement the MLI minimum standards. Since Sweden is a dualistic legal system, tax treaties must be implemented into domestic law through legislation in order to take effect domestically. We
have counted 43 CTA:s (at the time of writing) and each of those treaties has separate implementing legislation that needs to be changed to give domestic legal effect to the MLI provisions. Sweden has therefore made a reservation under Article 35 (7) of the MLI, meaning that the MLI will not apply to Swedish treaties until the necessary domestic measures have been undertaken. However, there is currently no official timetable for when all the necessary legislative changes will be put before parliament. This means that the implementation of the minimum standards that was supposed to be swift, risks becoming a drawn out process.

Despite the above stated concerning the Swedish cautious approach, the Swedish government was considerably braver when it came to the optional arbitration provisions of the MLI, being one of only approximately 30 countries that chose to apply them. In spite of this relative boldness, Sweden did choose to delimit its commitment to the arbitration provisions. This was done by making a reservation against the use of baseball arbitration, and also through the use of three self-formulated reservations regarding the scope of cases eligible for arbitration under article 28 (2). This means that the arbitration provisions in the MLI will not apply between Sweden and any state or jurisdiction which has opted to only accept baseball arbitration in the MLI or does not accept the self-formulated reservations. To date, the self-formulated reservations have been accepted by all countries who have opted for the arbitration provision and whose treaties with Sweden are CTA:s.

We state in the report that Sweden should perhaps consider accepting the use of baseball arbitration. That is based partly on the fact that Canada is one such country that has opted to only use baseball arbitration. Therefore as mentioned, the arbitration provisions in the MLI will not be applicable, even though the treaty between Sweden and Canada is a CTA and both countries opted in for the arbitration provisions. If Sweden instead accepts the use of baseball arbitration, it would be a simple way to implement mandatory and binding arbitration in the treaty with Canada, which is a large non-EU economy. Accepting both types of arbitration in the MLI could also be a quick and simple way to, in the future, implement arbitration provisions in treaties with non-EU countries since the EU-countries will be covered by the EU Arbitration Directive 2017/1852.

Another finding we made is that there appears to be some confusion or disagreement between Sweden and its treaty partners regarding whether or not certain existing provisions should be notified under specific articles of the MLI. This led to a number of notification mismatches but they should, we argue, not give rise to any concerns except in one case. That mismatch was in regard to an existing consultation clause in the anti-abuse provision in the treaty with Kazakhstan. Sweden chose not to notify that consultation clause while Kazakhstan did notify it. This, we argue in the report, means that the consultation clause will continue to be applicable after the MLI modifications to the treaty with Kazakhstan.

We were also asked whether or not any provisions in the MLI could give rise to domestic legal issues. The one potential issue which we identified was that the PPT, due to its broad scope and general nature, may conflict with the Swedish constitutional requirement that tax law must be clear, precise and lead to a foreseeable result.

As for what impact the MLI will have on the Swedish treaty policy, it is perhaps too early to say since we have yet to see it applied in practice. In theory at least 43 of the treaties in the Swedish treaty network will henceforth have the minimum standards implemented. And we can see some indications that the minimum standards have also impacted
current Swedish treaty practice. For instance, as we show in the report, the renegotiated treaty with Brazil contains provisions which are identical to Articles 6, 7 and 16 in the MLI.

Something to keep in mind is that whether or not the MLI will affect the Swedish treaty policy beyond the minimum standards is something that only time will tell.
1. Executive Summary

This report was conducted as a part of the third edition of the GTTC Universities Project and follows questions put forth by IBFD. The purpose of the project is to investigate the impact of the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting (MLI) on the tax treaty networks and policies of the participating countries. More specifically, the research was concerned with finding mismatches in the notifications and reservations made by countries to the OECD according to the various provisions in the MLI. Another aim of the research was to investigate potential domestic legal issues that the MLI and its implementation could give rise to. Furthermore, we investigated whether there were any indications that Sweden would have to renegotiate any of the Covered Tax Agreements (hereafter referred to as “CTA”). Our general findings are that Sweden has chosen a cautious approach to the MLI and made reservations against all provisions except those that are part of the minimum standard, i.e. Articles 6, 7, 16 and 17 of the MLI. In addition to this Sweden has chosen to apply Articles 18-26, regarding mandatory and binding arbitration. In doing so, Sweden chose to make a reservation against the use of baseball arbitration under Article 23 (2) of the MLI.

We did not find any convincing evidence that the MLI minimum standards could give rise to domestic legal issues, other than a theoretical conflict between the PPT in Article 7 (1) of the MLI and the Swedish constitutional requirements on tax legislation. However, we did find evidence that the MLI may lead to bilateral renegotiations in order to enact the tax treaty related BEPS measures, but that this seems unlikely.

Regarding the finding of any potential mismatches, one obstacle was the difficulty of defining what constitutes a mismatch. With the definition that we chose, we found one mismatch with regard to the treaty with Kazakhstan under Article 7 (17) (a) where different sub-paragraphs had been notified under an existing paragraph of the Double Taxation Agreement (hereafter referred to as “DTA”). In addition to this, we found four mismatches in regard to notifications under Article 6 (5) of the MLI where Sweden had not notified an existing provision, while the four respective countries

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81 The original working document submitted for the competition was edited for publishing purposes, but the original working paper, as well as their annexes considered by the jury, are available at request. Please feel free to contact us at gttc@ibfd.org for more information.
had and one mismatch where the other country has notified the Swedish treaty but Sweden had not reciprocated. We found no evidence that any reservations made by other countries would result in the MLI not being applicable.

2. Introduction

2.1. Background

Sweden has been a member of the OECD since 1960. Sweden was also a member of the OECD/G20 Inclusive Framework on BEPS as well as the ad hoc group which developed the MLI. The MLI entered into force regarding Sweden on 18 January 2018 although Sweden has made a reservation pursuant to Article 35 (7) of the MLI delaying its application until all necessary domestic legal procedures have been completed. Thus, it is not yet clear when the provisions will be applied.

2.2. Methodology

Most of our findings are based upon the content of the countries’ MLI positions, which were reported to the OECD at the time of signature or upon deposit of an Instrument of Ratification to the OECD. In the case of Sweden and a few other countries, we were able to use their finalized MLI positions i.e. those provided upon deposit of an Instrument of Ratification. However, for the majority of countries whose treaties with Sweden are CTAs, the only available MLI positions were the provisional ones given to the OECD at the time of the countries’ respective signing of the MLI. These could be subject to change by the respective countries until these countries deposit their Instruments of Ratification, thus the choices and notifications contained therein may not reflect their final choices.

Our analysis of the Swedish MLI positions is based partly on the draft act that was presented to the Swedish parliament for it to approve the MLI. It is also based on the referral response from the Swedish tax authority to the draft act as well as our analysis of the Swedish treaty network and the works of legal scholars.

82 These can be found by following this link: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

83 The MLI Positions used in this report were those available through the link above as of June 25th 2019.

84 Draft act: "Prop. 2017/18:61, Multilateral konvention för att genomföra skatteavtalsrelaterade åtgärder".

85 Swedish tax authority referral response to the draft act: Regeringens preliminära ställningstaganden till den multilaterala konventionen för att genomföra skatteavtalsrelaterade åtgärder för att motverka skattebaserosion och flyttnings av vinster, Skatteverket, 2018.
2.3. Definition of mismatch

Part of our task concerned the finding of any “mismatches” between the Swedish MLI notifications and those made by countries whose treaties with Sweden are CTAs under article 2 (1). A definition of the term mismatch was not provided in the document outlining the requirements of the report. In this paper we have used the definition of notification mismatch as stated by the OECD. This definition establishes that only cases where two countries have e.g. notified different paragraphs or sub-paragraphs in existing treaty provisions, are to be regarded as mismatches. In addition to this, cases where one country has notified existing provisions in the CTA with another country under one of the notification clauses of the MLI, but the other country has not made any notification in regard to the same treaty and notification clause, is also considered a mismatch. Furthermore, we have identified the possibility of a reservation mismatch pursuant to Article 28 of the MLI. A reservation mismatch includes, in our view, situations where a party has reserved the adoption of certain dispositions of the MLI, which shall not be applicable for the reserving party with respect to all or some of its CTAs.

2.4. Disposition of the paper

This paper follows the structure of the questions in the invitation provided by the IBFD. Thus, this initial introductory chapter is followed by chapter 2 which examines the MLI and its relationship to Swedish domestic law. In addition to this, chapter 2 also examines whether the MLI may give rise to domestic legal issues and examines which treaties in the Swedish treaty network have been listed and which have been omitted and the reasons therefore.

In Chapter 3 we examine and analyse the mismatches between the Swedish notifications on existing treaty provisions and those of the countries whose treaties with Sweden are CTAs. We also look at the Swedish approach in regard to the minimum standards and provide evidence of other bilateral solutions that are compliant with the MLI. In chapter 4 we look at the effects of the choices of optional provisions and reservations of Sweden and the countries whose treaties with Sweden are CTAs. Finally, in chapter 5, we present our conclusions.

3. The MLI and Domestic Law

Below follows a discussion on the relation between the MLI and the Swedish domestic legal system. The discussion will give the reader an understanding about the Swedish legal system and how international treaties is given effect in Sweden, how this affects the implementation of the MLI and potential domestic legal issues that may arise. Followed by a discussion on what Swedish DTAs have been reported to be CTAs and if the respective counter states have made corresponding notifications.

3.1. Domestic Implementation of the MLI

3.1.1. Treaty adoption process

The Swedish legal system is dualistic, meaning international legal obligations, such as tax treaties, have no legal effect domestically until they have been incorporated into domestic law.\(^{87}\) It is the Swedish government that enters into international treaties on behalf of the country.\(^{88}\)

However, in order for the government to enter into binding treaties which require a change in domestic legislation or which otherwise concern a matter that according to the constitution falls under the exclusive ambit of the parliament, it must have approval from the parliament.\(^{89}\) One area, upon which the parliament has such exclusive power to decide, is taxation.\(^{90}\) As follows from this, all Swedish DTAs need to be voted through and put into effect by the parliament through the passing of implementing legislation which states that the DTA along with its protocols shall apply as law in the country, with the treaty text itself and its protocols usually being annexed to the legislation. The MLI itself was approved by the Swedish parliament in a decision dated 16 May 2018 and the Instrument of Ratification was subsequently deposited on the 22 June 2018.

3.1.2 Adoption of the MLI

As mentioned above, in order for the parliament to amend the current Swedish DTAs to include the provisions of the MLI with regard to Swedish domestic law, the implementing legislation of the DTAs has to be amended. Since the treaties are bilateral international agreements, the only change which Sweden can make unilaterally is to change the application of the treaty i.e. legislate that the treaty text must be applied with the changes that follow from the MLI taken into account. However, no such legislation has been passed at the time of writing and there is no official information regarding the timeline of the legislative efforts.

A way to avoid having to pass new implementing legislation could be to amend the treaty itself by implementing a wording directly in the treaty which could for example state that the treaty must be applied with the changes that follow from the MLI taken into account, thus giving the MLI domestic effect. This would however require a separate bilateral renegotiation for each treaty which is to be amended. Given the wording in the draft act it appears that the Swedish

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\(^{88}\) Chapter 10 section 1 of the Instrument of Government.

\(^{89}\) Chapter 10 section 3 of the Instrument of Government.

government will choose to update each individual implementation law rather than renegotiate the treaties bilaterally.\footnote{Draft act: “Prop. 2017/18:61”, p. 25.} This is to be expected due to it being, as mentioned above, the conventional method used in Sweden to implement and modify tax treaties. It should also be noted that Sweden has made a reservation according to Article 35 (7) of the MLI with the expressed intention of providing time to make the necessary changes to each implementing law.\footnote{Draft act: “Prop. 2017/18:61”, p. 35.} Since Sweden at the time of writing has 43 CTAs which would need to have their implementing laws changed, the MLI does not appear to offer a quick way to enact the BEPS action changes in the CTAs from a Swedish legislative perspective. However, as mentioned the alternative to the domestic approach described above would be to bilaterally renegotiate the treaties. That alternative would likely be even more time consuming than simply changing the implementation laws, due to the generally slow nature of bilateral negotiations.\footnote{For example the newly concluded Swedish treaty with Brazil can be mentioned, where negotiations lasted for approximately 10 years.}

3.1.3 MLI provisions that may give rise to domestic legal issues

One of the MLI provisions adopted by Sweden that can, at least, arguably give rise to domestic legal issues is the PPT in Article 7 (1). In the Swedish constitution there is a requirement that legislation dealing with taxation has to be clear and precise and lead to a foreseeable result. Though tax treaties are international law by their nature, the Swedish dualist legal system does not give international treaties direct domestic legal effect until after they have been incorporated into Swedish law by legislation.\footnote{Warnling-Nerep et al, Statsrättens grunder, Norstedts juridik, fourth edition, 2011, p. 144.} It could thus be argued that the tax treaty itself through this process becomes Swedish domestic law and subject to the demands imposed on tax legislation by the constitution.\footnote{Sundgren, Peter, Legalitetsprincipen och skatteavtal, Skattepunkten, 2009.}

In that sense, the PPT rule could be seen as an issue due to its broad scope and lack of clarity as to how it is to be applied in practice. That being said, the Swedish domestic GAAR in the tax avoidance act has existed in its current form since 1995. It uses a main purpose test and has to date not been held to be in conflict with this constitutional requirement by the Swedish supreme administrative court. However, it should be said that the Swedish supreme administrative court has noted in its case law that there is a tension between the constitutional requirement and the GAAR.\footnote{See for example the Swedish case designation HFD 2015 ref.17.} Furthermore, it should be noted that some scholars argue that the main purpose test in the Swedish tax avoidance law is in fact in breach of the constitutional requirement.\footnote{Hultqvist, Anders, Om bestämdhetskravet i legalitetsprincipen, Skattenytt, 2016, p.730.}
In addition to this, there are perhaps reasons to assume that there is a materially relevant difference in the scope of the Swedish GAAR and the PPT in the MLI. The Swedish GAAR only applies to actions that alone or together with another action, result in a substantial tax benefit and where the main purpose was to avoid taxation to gain tax benefits. Whereas the PPT instead looks at whether the avoidance of tax was one of the principal purposes with the actions. Therefore the scope of the PPT appears to be broader than the Swedish GAAR. The broad scope of the PPT could thus be argued to be even more imprecise and vague than the GAAR and consequently be in conflict with the constitution (although due consideration must be given to the fact that the GAAR is a purely domestic law while the PPT is international law, as mentioned above).

Another relevant point to the question of whether or not the PPT provision could give rise to domestic legal problems is the fact that Sweden is no stranger to PPT provisions in its tax treaty network. For example Article 17 (6) in the treaty with the United States contains a form of LOB which appears to be similar to the PPT in the MLI. It has the following wording:

A resident of a contracting state that is not entitled to benefits pursuant to the preceding paragraphs of this article shall, nevertheless, be granted benefits of the MLI if the competent authority of the other contracting state determines that the establishment, acquisition, or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the convention. The competent authority of the other contracting state shall consult with the competent authority of the first-mentioned State before denying the benefits of the Convention under this paragraph.

The fact that the treaty with the United States dates back to 1994 and no supreme administrative court case law exists with regards to it could be taken to indicate that a PPT using the wording in Article 7 of the MLI, does not give rise to domestic legal issues. This of course does not preclude the possibility that there have been legal issues stemming from the tax authorities’ application of Article 17 (6) which have been solved through the Mutual Agreement Procedure (MAP) and therefore not been made part of publicly available records.

3.1.4. Treaties notified by Sweden as Covered Tax Agreements

The Swedish government clarified in the draft act for the adoption of the MLI that it wanted as many of the tax treaties as possible to be covered by the MLI. The treaties that were not notified under Article 2 (1) are limited tax treaties, tax treaties that are under negotiation, tax treaties that the government wishes to renegotiate beyond the changes that will

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follow from the MLI as well as tax treaties which, for other reasons, are not suitable for being modified by the MLI (for example because they have a divergent structure or terminology).  

Sweden currently has approximately 80 DTAs in force, of which 64 have been notified as CTAs under article 2 (1) with 43 reciprocal notifications. Thus, Sweden has 43 CTAs and the 64 notified treaties do not cover the entire Swedish treaty network. The 64 treaties notified under Article 2 (1) are the treaties with: Albania, Argentina, Armenia, Azerbaijan, Bangladesh, Barbados, Belarus, Belgium, Bolivia, Botswana, Bulgaria, Canada, Chile, China, Cyprus, Czech Republic, Egypt, Estonia, Gambia, Georgia, Greece, Hungary, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mauritius, Mexico, Namibia, The Netherlands, New Zealand, Nigeria, Pakistan, Poland, Romania, Saudi Arabia, Slovak Republic, South Africa, Sri Lanka, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, United Kingdom, United States, Venezuela, Vietnam, Zambia and Zimbabwe.

The 43 reciprocal notifications were made by: Argentina, Armenia, Barbados, Belgium, Bulgaria, Canada, Chile, China, Cyprus, Czech Republic, Egypt, Estonia, Georgia, Greece, Hungary, India, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mauritius, Mexico, The Netherlands, New Zealand, Nigeria, Pakistan, Poland, Romania, Saudi Arabia, Slovakia, South Africa, Tunisia, Turkey, Ukraine and United Kingdom.

3.1.5. Treaties notified by Sweden, but not notified by the other jurisdiction

The only DTA notified by Sweden to be a CTA under Article 2 (1), where the other country has not made a reciprocal notification, is the treaty with Indonesia. We have found no official reason for why Indonesia did not notify the Swedish treaty.

3.1.6. Treaties not notified by Sweden

In total we have found 16 treaties where the Swedish government has chosen not to make a notification under Article 2 (1). It should be emphasized that in six of the excluded treaties by Sweden, the other contracting party in fact listed its agreement with Sweden. These are Australia, Croatia, Singapore, Serbia, France and Portugal. The government stated in its proposal that the treaties with Australia, Singapore, France and Portugal were excluded due to ongoing discussions on renegotiating the treaties. The treaties in force with Croatia and Serbia is the tax treaty with former Yugoslavia, which means it is in effect with multiple States and therefore a modification can result in interpretation difficulties. Sweden has agreed with three countries included in the former Yugoslavia, including Croatia and Serbia.

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100 The Kingdom of Sweden, Status of List of Reservations and Notifications at the Time of Signature, OECD, 2018.

that the old agreement is to be further applied between them. Remaining countries have not entered into such agreements. For that reason, it is the government’s assessment that these agreements should not be covered by the convention.

Sweden has not commented on the ten other treaties not notified. We believe the other countries and jurisdictions are: Bermuda, Brazil, British Virgin Isles, Cayman Islands, Guernsey, Isle of Man, Jersey, Russia, Spain, Taiwan, Germany and Austria. The tax treaties with Bermuda, British Virgin Isles, Cayman Islands, Guernsey, Isle of Man and Jersey are limited treaties and it could be assumed that this is the reason for the exclusion. These tax treaties are presumed to be limited because said jurisdictions are perceived to be tax havens.

Regarding the Brazilian and Russian DTA, these have recently been renegotiated and amended and it is likely that this is the reason for the exclusion of these treaties. As to Spain and Germany, renegotiations are in progress. The DTA with Austria is likely to have been excluded due to the difficult language of the treaty after several previous amendments. It can be assumed that further amendments in accordance with the MLI-provisions is to make it more complicated to implement and a whole new DTA is more desirable for an easier implementation.

Regarding Taiwan, there is no official information as to the exclusion. It could conceivably be related to Swedish foreign policy as the Swedish tax treaty with Taiwan is formally made between the Swedish Trade Council and the Taipei Mission in Sweden. The Swedish government could therefore perhaps be of the view that the treaty does not fall under the scope of the MLI.

3.1.6. Amending protocols

The treaties to which Sweden has included the amending protocols are Barbados, Botswana, China, India, Ireland, Jamaica, Luxembourg, South Africa, USA and Japan. The only country that Sweden included two amending instruments with is Japan.

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102 Protocol amending the convention between Brazil and Sweden for the avoidance of double taxation with respect to taxes of income, 2019; Protocol amending the convention between the government of the Russian Federation and the government of the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Stockholm on 16 May 1986 as amended by an additional protocol deration and the Government of the Kingdom of Sweden for the avoidance of double taxation with respect to taxes of income, 2018.

103 Protocol amending agreement between the Kingdom of Sweden and the Republic of Austria for the avoidance of double taxation with respect to taxes on income and capital, 2006 and 2009.
Sweden left an amending protocol with China from 2017 unreported, the protocol is limited to flight taxes and value-added tax, which is excluded from the MLI scope.\textsuperscript{104} We assume that the protocol was left unreported for these reasons.

4. Effects of the MLI on Swedish Tax Treaties

In this chapter we discuss what mismatches exist between the Swedish MLI Positions and the MLI Positions of the countries whose treaties with Sweden are CTAs. The potential effects of such mismatches are also discussed below. This will be followed by a discussion about alternative bilateral solutions, which nevertheless comply with the minimum standards of the MLI.

4.1 Status of list of notifications, options and reservations

The Swedish tax agreements are the result of bilateral negotiations. The agreements have been negotiated for a very long time. One of the oldest Swedish tax treaties that is applicable is the agreement with Israel, which was signed in 1959 and one of the newest agreements is with Armenia, which was signed in 2016. This is an explanation for the occurrence of relatively large differences in structure and terminology between the treaties. Existing tax treaties may also include tailor-made solutions regarding certain articles of the convention that are appropriate for achieving a certain result in the specific bilateral situation. Generally, the MLI does not allow a particular article to modify only certain tax treaties. The choice of articles that a state or jurisdiction makes, according to the MLI, will in most cases modify all CTAs of a country. However, there are a few exceptions, e.g. the provisions on the elimination of double taxation as well as the provisions on arbitration, where a jurisdiction can leave delimited reservations.

The Swedish government chose a cautious approach with regards to the MLI, opting only for the minimum standards in Article 6 of the MLI (purpose of a covered tax agreement), Article 7 (prevention of treaty abuse), Article 16 (mutual agreement procedure), Article 17 (corresponding adjustments) and part VI (Articles 18–26 on arbitration).\textsuperscript{105} In the draft act the main argument was that, due to the way the MLI is constructed, it is only possible for the parties to expand their international commitments under the MLI after they have ratified it, i.e. withdraw reservations or add more covered tax agreements (CTAs) or provisions. Therefore, in the event that the future application of the MLI would lead to unforeseen negative effects or increased risk of double taxation there would be no way to make new reservations to assuage those effects other than a bilateral renegotiation. Another argument was that, in the majority of cases, every MLI position chosen would apply to every CTA.\textsuperscript{106} No further reasoning was provided as to why this would necessitate a cautious approach, one possible explanation is that the government held the view that there are some provisions of the MLI that

\textsuperscript{104} Protocol amending the agreement between the government of the People’s Republic of China and the government of the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Stockholm on 18 November 1999.

\textsuperscript{105} Draft act: “Prop. 2017/18:61”, p. 11. See also the Swedish reservation under Article 35 (7) concerning the applicability of the MLI.

which it would prefer to have applied only regarding certain CTAs. Below follows a compilation of notification mismatches regarding the MLI Articles that Sweden has opted in for.

4.2 Notification mismatches regarding existing provisions in listed agreements

4.2.1 Notification mismatches under Article 6

Treaties and provisions notified by Sweden under Article 6

Sweden has notified two treaties under Article 6 (5).\(^{107}\) These are the treaties with Bulgaria and Hungary. There are no mismatches regarding the treaties notified by Sweden as both treaties were notified by the respective countries.\(^ {108}\)

Treaties and provisions notified by the other jurisdiction, but not notified by Sweden under Article 6

Sweden has five additional treaties which contain a preamble that appears to fall under the scope of Article 6 (5). These are the treaties with Cyprus, Turkey, Tanzania, Romania, Israel and Barbados. All of these treaties are CTAs except for the treaty with Tanzania. All five countries whose treaties with Sweden are CTAs have notified the treaty with Sweden under Article 6 (5).\(^ {109}\) There is therefore a mismatch in this case with regard to these countries. In their referral response to the MLI draft act, the Swedish Tax Authority questioned why the treaties with Cyprus, Turkey, Tanzania, Romania and Israel were not notified.\(^ {110}\) The Swedish government explained in the draft act that it considers the omitted treaties to only contain preambles which signify a will to enter into an agreement to avoid double taxation while the notified treaties signify a will to avoid double taxation\(^ {111}\) \(^ {112}\). The reasoning used by the Swedish government thus seems to indicate that it considers preambles which refer to a desire to conclude a treaty for the avoidance of double taxation to be different from preambles that only refer to a desire to avoid double taxation and that only the second category fall under the scope of Article 6 (2). However, paragraphs 75-78 in the Explanatory Statement strongly

\(^{107}\) See the Swedish list of notifications and reservations given to the OECD upon Deposit of the Instrument of Ratification.

\(^{108}\) Bulgarian and Hungarian MLI Positions at the time of signature, OECD, p.19.

\(^{109}\) See Status of List of Reservations and Notifications upon the Israeli Deposit of the Instrument of Ratification and the Cypriot, Turkish and Romanian MLI Position at the time of signature, OECD, 2019.

\(^{110}\) Referral response, p. 2.


\(^{112}\) For example: “desiring to conclude a Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income” from the treaty with Barbados and “desiring to avoid double taxation with respect to taxes on income and on capital” from the treaty with Hungary.
suggests that both wordings fall under the scope of Article 6 (2).\textsuperscript{113} Furthermore, it appears that the only reason for Article 6 (1) not using language which refers to an intention or desire etc. to conclude a convention for the elimination of double taxation, is that the MLI, in most cases will introduce the preamble to a treaty after the treaty has already been concluded. The conclusion in this case therefore seems to be that the four treaties that were not notified, should have been notified under 6 (5). Regarding the treaty with Barbados it seems to have been correctly left out by Sweden as the preamble contains language directly referencing a mutual will to prevent tax avoidance.

### 4.2.2 Notification mismatches under Article 7 (17) (a)

#### Treaties and provisions notified by Sweden under Article 7 (17) (a)

Sweden has notified 9 treaties under Article 7 (17) (a) in the MLI. These are the treaties concluded with Argentina, Chile, Ireland, Japan, Kazakhstan, Mexico, Nigeria, Ukraine and the United Kingdom.\textsuperscript{114}

The only mismatch with regard to these treaties are the treaty with Kazakhstan. The relevant article in the CTA with Kazakhstan is Article 27 (4), which consists of four paragraphs. Neither country has notified the first paragraph which specifies which type of company that is subject to the limitation on treaty benefits, while both countries notified the second and third paragraphs which lay out the basis for denying treaty benefits.\textsuperscript{115} The mismatch regards the fourth paragraph of Article 27 which has the following wording:

> It is agreed that when a Contracting State contemplates denying the benefits of the Convention to a resident of the other Contracting State in application of paragraph 1, 2 or 3 of this Article, the competent authority of such first Contracting State shall consult with the competent authority of the other Contracting State.

Kazakhstan has notified the fourth paragraph while Sweden has not done so. No official explanation as to why it was not notified has been given by Sweden in the draft act regarding the MLI.

Given the wording in Article 7 (17) (a) of the MLI, upon which such mismatched notifications are based, the consequence of this mismatch would appear to be that Article 27 (4) in the treaty with Kazakhstan would continue to apply after the MLI modifications. Whereas in the case with the other non-mismatched treaties notified under 7 (17) (a), which contain a clause requiring the competent authorities to consult with its counterpart in the other state before

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\textsuperscript{113} Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 2016, p. 20.

\textsuperscript{114} The Kingdom of Sweden, \textit{Status of List of Reservations and Notifications at the Time of Signature}, OECD, 2018.

\textsuperscript{115} Lag (1997:919) om dubbelbeskattningsavtal mellan Sverige och Kazakhstan.
contemplating denial of treaty benefits (Chile, Mexico and Nigeria), these clauses would appear to be replaced by the provision in Article 7 (1) i.e. the PPT and therefore not be applicable after the MLI modifications. Below this will be discussed in greater detail.

In Article 7 (17) (a) it says that the parties shall notify the Depositary of all CTAs that are not subject to a reservation described in 7 (17) (b) as well as notify whether the CTA contains a provision described in paragraph 7 (2) and if so the article and paragraph number of each such provision. From this it should be concluded that each article and paragraph that is listed in the countries’ notifications under Article 7 (17) (a) is held by the countries to be such a provision that is described in paragraph 2. For example, both Sweden and Chile have listed Articles 10, 11 and 12 in the protocol to their CTA in their notifications to the OECD. Those articles relate solely to an obligation for one contracting state to consult with the other states competent authority before contemplating the denial of treaty benefits.

Thus, it would stand to reason that both Sweden and Chile consider those articles to be provisions which are described in paragraph 2. The effect of both countries notifying the same provision is stated in 7 (17) (a) to be that that provision is replaced by the provisions of paragraph 2. As a consequence of this, the provisions in Articles 10, 11 and 12 in the protocol to the Swedish treaty with Chile would be replaced by Article 7 (2), i.e. after the modifications of the MLI, there would no longer be any obligation for one of the states to consult with the other states competent authority before contemplating the denial of treaty benefits. This seems to be supported by paragraph 96 of the Explanatory Statement116 which states that existing notification or consultation provisions in an existing PPT would be replaced by the compatibility clause in paragraph 2. Although it is not defined what constitutes a consultation provision, it would appear likely that the provisions in Articles 10, 11 and 12 in the protocol to the Swedish treaty with Chile as well as Article 27 (4) in the treaty with Kazakhstan can be considered to be such provisions. However, it should also be noted that both paragraph 96 and Article 7 (17) (a) states that the consultation provisions would be replaced by the compatibility clause in paragraph 2. Thus, it does not directly state that the PPT in Article 7 (1) will replace them. But, since Article 7 (2) states that Article 7 (1) shall apply this should in our view be interpreted as Article 7 (1) replacing the relevant provisions. Therefore, in the case with Article 27 (4), in the treaty with Kazakhstan, where the parties did not both notify the consultation provision, it would not be replaced by Article 7 (1) through the reference in 7 (2) and continue to be applicable after the MLI modifications. This should follow from the wording in Article 7 (17) (a) where it is stated that if the parties do not notify the same provisions, the MLI provisions will only supersede the existing provisions to the extent that the existing provisions are incompatible with the MLI. Article 27 (4) does not appear to be incompatible with Article 7 (1).

The next question pertains to the motive behind Sweden not notifying Article 27 (4) in the treaty with Kazakhstan, but doing so in relation to all the other consultation provisions. One way of determining the motive is examining the reason behind why Article 27 (4) was included in the treaty in the first place. However, the reason for that is not mentioned in the Swedish draft act for the legislation which implemented the treaty with Kazakhstan in Swedish domestic law. It is therefore unclear whether the original inclusion of the provision was the result of a concession to Kazakhstan or for example if Sweden wanted it included as a matter of policy. However, it should be noted that of the 9 CTAs listed under Article 7 (17) (a) only four of them, including the one with Kazakhstan, contain provisions which require the competent authorities to consult with each other before denying treaty benefits (the treaties with Chile, Mexico and Nigeria). All of them except the one with Kazakhstan have been notified by Sweden. This suggests that it is not part of the general Swedish treaty policy to have provisions of this kind apply. This of course assumes that the Swedish government anticipated that the consequence of both countries' listing the same consultation provision would be that they no longer apply after the MLI modifications. The case may also be that the countries' did not interpret the language in Article 7 (17) (a) to have the effect that we described above, in which case they may not be aware of this possible consequence thus rendering an analysis of why the Swedish government chose not to notify the Kazakhstani consultation clause moot.

A counterpoint to that view is that the treaty with the United States as well as the newly updated treaty with Brazil both contain language requiring that the competent authorities consult with each other before denying treaty benefits. In the case with the Brazilian treaty, the consultation clause is a novelty in the countries' bilateral tax treaty relationship. This could perhaps be taken to indicate that Sweden has a wish to include such clauses in its treaty negotiations. It should however be mentioned that the negotiations regarding the updated Brazilian treaty had been ongoing for ten years prior to the signing on March 19th. 2019. Thus, it does not necessarily reflect the current Swedish tax treaty policy. Since the amending protocol is so new, no draft act relating to the implementing legislation has, at the time of writing, been laid before the swedish parliament. As a consequence of this, no further clarity regarding the inclusion of the consultation clause in the Brazilian treaty can be provided.

One assumption which can be made based on the apparent incoherence regarding the existence of consultation clauses in the Swedish tax treaty network, is that Sweden simply does not have a firm policy on the matter and instead opts for flexibility in its position. This could perhaps be a way for Sweden to increase its leverage when it comes to negotiating other provisions which are held to be more important to its tax treaty policy goals.

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117 See the Swedish treaties with Chile, Nigeria and Mexico.


119 Article 17 (6) in the treaty with the United States and Articles 26-A 5 and 7 c) in the treaty with Brazil.
Treaties not listed by Sweden under Article 7 (17) (a)

There is one mismatch with regards to Saudi Arabia where Saudi Arabia has notified the CTA with Sweden and its Article 28 (1), while Sweden has not notified the CTA at all. The text of Article 28 (1) has the following wording:

Nothing in this convention shall affect the application of the domestic provisions to prevent tax evasion and tax avoidance concerning the limitation of expenses and any deductions arising from transactions between enterprises of a contracting state and enterprises of the other contracting state, if the main purpose or one of the main purposes of the creation of such enterprises or of the transactions undertaken between them, was to obtain the benefits under this convention, that would not otherwise be available.

The official explanation for this in the draft act is that the government considers the provision in 28 (1) to be a form of PPT provision but not of the kind that is described in Article 7 (2) of the MLI. The government’s opinion is that the paragraph only refers to the use of domestic provisions to deny treaty benefits and thus is not an anti-treaty abuse provision in the meaning of Article 7 of the MLI. In this case the government’s view is in conflict with the view of the Swedish tax authority which in its referral response to the draft act questioned why the Saudi Arabian CTA and Article 28 (1) were not notified.

4.2.3 Notification mismatches under Article 16 (6) (a)

There are 14 treaties notified by Sweden under Article 16 (6) where the other country has made a reservation under Article 16 (5) (a). These are the treaties with Canada, Chile, China, Hungary, India, Indonesia, Italy, Kazakhstan, Latvia, Mexico, Poland, Romania, Slovak Republic and South Africa. Of these countries only Mexico has notified the Swedish treaty under Article 16 (6) (a) despite their reservation.

Notification mismatches under Article 16 (6) (b) i

Sweden has only notified the treaty with Venezuela under Article 16.6 (b). However, Venezuela has not signed the MLI and therefore not made a reciprocal notification.

Notification mismatches under Article 16 (6) (b) ii

There is one mismatch with regards to Article 16 (6) b) ii out of 50 treaties listed. Indonesia has not notified the treaty with Sweden while Sweden has notified it. It is unclear why Indonesia did not notify the Swedish treaty since Article 25 (1) second sentence in the treaty has the wording: //..Within three years../>. This could perhaps be due to a clerical error or the fact that Indonesia has not notified Sweden as a CTA under Article 2 (1).
4.2.4 Notification mismatches under Article 17

Argentina has listed Article 9 (2) in the treaty with Sweden under Article 17 (4), whilst Sweden under Article 17 (3) (a) has not listed the treaty with Argentina as containing a provision described in Article 17 (2).

Of the 61 treaties notified by Sweden under Article 16 (6) (a) there are an additional 19 treaties where the other country has not signed the MLI. However, Thailand has expressed an intention to sign the MLI at a further date but their MLI positions are not public as of yet and it remains unclear whether or not the treaty with Sweden will be a CTA.

There are 15 countries who have notified the treaty with Sweden under Article 17 (4) but not made a reservation under Article 17 (3). These are: Armenia, Barbados, China, Cyprus, Japan, Kazakhstan, Lithuania, Luxembourg, Mauritius, Malta (Malta has written “reservation” in its position paper given to the OECD. However, it is not stated under which article this reservation is made but it is most likely 17 (3) (a)), the Netherlands, Pakistan, South Africa, Tunisia, and the United Kingdom.

There are 16 countries who have not signed the MLI, but whose treaties have been notified by Sweden under Article 17 (4). These are: Albania, Azerbaijan, Bangladesh, Belarus, Bolivia, Botswana, Gambia, Macedonia, Namibia, Philippines, Sri Lanka, Trinidad and Tobago, United States, Venezuela and Zimbabwe.

There is one country which has signed the MLI but not listed the treaty with Sweden as a CTA whereas the treaty has been notified by Sweden under Article 17 (4). That country is Indonesia. As already mentioned, we have not found any official reason for this.

Canada has made a reservation under Article 17 (3) (a) not to apply Article 17 to CTAs already containing a provision described in Article 17 (2). In this matter, Canada has notified Article 9 (2) in its treaty with Sweden, whilst Sweden has not made a corresponding notification. Further, Mexico has listed the treaty with Sweden under Article 17 (3) (a), whilst Sweden has not made a corresponding notification.

Jamaica has listed Article 9 (2) in the treaty with Sweden under Article 17 (4), whilst Sweden under Article 17 (3) (a) has not listed the treaty with Jamaica as containing a provision described in Article 17 (2).

4.3 Minimum standards of the MLI

Sweden has adopted all minimum standards with regards to the CTAs. The only reservation Sweden has made to a minimum standard is under Article 17 (3) (a), thereby exempting treaties already containing a provision for corresponding adjustments. Treaties which are not CTAs, have been excluded from the MLI due to the reasons described in section 2.2.2.
4.4 Other bilateral solutions complying with the MLI

One current example of bilateral MLI-compliant solutions is the newly updated treaty with Brazil. It should be noted that the treaty with Brazil was not notified under Article 2 (1), most likely due to the then-ongoing renegotiations. Below we will discuss the changes to the treaty with Brazil, with an emphasis on the minimum standards of the MLI.

**MLI minimum standards**

**Article 6 of the MLI**

Through Article 1 of the amending protocol the treaty now has a preamble with the following wording:

The Government of the Federative Republic of Brazil and The Government of the Kingdom of Sweden;

Desiring to conclude a convention for the avoidance of double taxation with respect to taxes on income;

Intending to eliminate double taxation with respect to taxes on income 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 convention for the indirect benefit of residents of third States); Have agreed as follows:

This is the exact wording of the preamble text in Article 6 of the MLI. Thus, it appears that Sweden and Brazil have simply included Article 6 of the MLI through bilateral negotiations and not opted for any tailor-made modifications to the preamble wording.

**Article 7 of the MLI**

Through Article 11 in the amending protocol a new article named Article 26 (a) has been added to the treaty. Article 26 (a) (9) is an anti-treaty abuse provision and has the following wording

Notwithstanding the other provisions of the Convention, a benefit under this convention shall not be granted in respect of an item of income 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
This provision is a PPT and uses the exact wording of the PPT provision in the MLI. Thus, it appears that the parties have once again not made use of the opportunity to make specific modifications in their bilateral negotiations and instead have simply incorporated the PPT in Article 7 of the MLI.

Article 16 of the MLI

Through Article 9 of the amending protocol the existing MAP provision of the treaty (Article 25) is replaced by a new Article 25 which has the following wording:

1. Where a person considers that the actions of one or both of the contracting states result or will result for him in taxation not in accordance with the provisions of this convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either contracting state. The case must be presented within 3 years from the first notification of the action resulting in taxation not in accordance with the provisions of the convention.

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 state, with a view to the avoidance of taxation which is not in accordance with the convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the contracting states.

3. The competent authorities of the contracting states shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the convention. They may also consult together for the elimination of double taxation in cases not provided for in the convention.

4. The competent authorities of the contracting states may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

Once again, the parties have opted to incorporate a provision from the MLI verbatim, with this article being Article 16 of the MLI. The only difference with regards to Article 16 in the MLI is the fourth paragraph which states that the contracting states can communicate directly with each other. This paragraph is not included in the MLI but is instead the fourth paragraph in the OECD model tax treaty. It should however be noted that the parties, in contrast with the preceding three paragraphs, have not chosen to incorporate the exact wording used in the OECD model tax treaty, but have omitted the phrase following: “//may communicate with each other directly..//” which is: “///including through a joint commission consisting of themselves or their representatives...///”

Article 17 of the MLI

Interestingly, the amending protocol does not contain a provision complying with Article 17 in the MLI regarding corresponding adjustments.
5. Effects and Potential Mismatches on Signed CTAs

The following sections discuss potential mismatches that may arise in situations where reservations have been made for specific provisions in relation to specific countries. Regarding Article 7 it should be noted that Sweden has a number of provisions in existing tax treaties which limit tax treaty benefits based on the PPT or similar tests. There is therefore little evidence supporting a deviation from the standard Swedish tax treaty policy with regard to the Swedish choice of the PPT under Article 7. In fact, it was mentioned in the draft act that the Swedish tax authorities and other domestic authorities already had some familiarity with PPT provisions which was upheld as an argument in favour of choosing the PPT in Article 7. Regarding the other articles they also largely follow the Swedish treaty policy, for example the existing arbitration provisions in the Swedish treaties all use the individual opinion method which Sweden chose by make a reservation under Article 23 (2) in the MLI.

5.1. Specific reservations made by Sweden or against Sweden

Sweden has made reservations against several of the Articles listed in Article 28 (1).

5.1.1 Swedish reservations under Article 28 (2) (a)

Sweden has made three reservations under Article 28 (2) (a) regarding the scope of arbitration. Sweden reserves the right not to apply Part VI on requests which the competent authorities in both jurisdictions agree is not suitable for arbitration. Such an agreement shall be made before the day when the arbitration would have begun and the person who presented the request shall be notified about the agreement. Sweden also reserves the right not to apply Part VI on matters regarding persons with dual residency in other cases than physical persons. Furthermore, Sweden reserves the right not to apply Part VI on matters regarding hard to value immaterial assets. In case the primary adjustments is made (1) to an open tax year, but concerns income relating to a closed tax year, or (2) through the application of domestic law which states a longer period of adjustment, specifically for hard to value immaterial assets which is different from the ordinary time limits for reconsideration of tax decisions.

5.1.2 Compatibility between the Swedish reservations under Articles 18-26 and Article 28 (2) (a) and the reservations of other jurisdictions

As mentioned above, Sweden has 43 CTAs, of which 13 have opted in for the arbitration provisions in Article 18. Below we will list those countries and treaties that contain reservations that could cause problems for the application of the MLI provisions.

120 Due to the limited length of the paper, for a comprehensive understanding of the results of the analysis, three Tables have been elaborated. Table 1 refers to ‘positions of Sweden’; Table 2 refers to ‘Implications of specific provisions and reservations adopted by Sweden on signed CTA’s’; Table 3 refers to ‘Implications of specific provisions and reservations adopted by other jurisdictions on signed CTA’s’. These documents are available at request. Please feel free to write to gttc@ibfd.org to request this information.

121 For further details regarding the Swedish notifications and reservations, please see the Swedish MLI Position in Table 1.
Italy has made a reservation under Article 23 (3). The effect of this will be that the arbitration provisions will not be applicable between Sweden and Italy until such time as the competent authorities of both countries agree on which type of arbitration process shall apply between them.

Japan has made a reservation under Article 26 (4) and listed the treaty with Sweden. The arbitration provisions in the MLI will therefore not be applicable between the two countries.

Canada has made a reservation under Article 23 (3) and Article 23 (7). The effect of this will be that the arbitration provisions will not be applicable between Sweden and Canada until such time as the competent authorities of both countries agree on which type of arbitration process shall apply between them.

5.2 Other countries reservations in relation to Sweden

Below follows a compilation of which jurisdictions have included a reservation that prevents the application of the MLI in any bilateral tax treaty signed by Sweden and to what extent any reservation mismatches prevent the application of these specific provisions in the CTAs appointed by Sweden. Since Sweden has only opted in for the minimum standards and the arbitration provisions, we only discuss the other jurisdictions reservations under articles 6, 7, 16 and 17 since they are the only ones which Sweden has not made a reservation against.

5.2.1 Reservations under Article 6

No reservations that prevent the application of a treaty have been found.

5.2.2 Reservations under Article 7

No reservations that prevent the application of a treaty haven been found. However, five countries have stated that they accept the PPT as an interim measure but that they intend to bilaterally adopt an LOB. Poland and Chile have stated that they intend to adopt the LOB in addition to the PPT. Canada and India have stated that they intend to adopt the LOB in addition or in replacement of the PPT. Finally, Mauritius has stated that it intends to adopt the LOB in replacement of the PPT.

These statements are significant due to the fact that they mean that these countries will likely engage in bilateral negotiations in spite of the MLI. Thus, Sweden could take that opportunity to make more thorough changes to those treaties as they will be renegotiated anyway.

5.2.3 Reservations under Article 16
No reservations that prevent the application of a treaty have been found.

5.2.4 Reservations under Article 17

No reservations that prevent the application of a treaty have been found.

6. Conclusions

In this report we have established that the Swedish government chose a cautious approach to the MLI by only opting in for the minimum standards in Articles 6, 7, 16 and 17 and the arbitration provisions in Articles 18-26. However, the cautious approach is understandable given the novelty of a multilateral agreement such as the MLI. But it must be mentioned that an important factor in the success of the MLI is surely the number of countries which participate in it and the degree to which their MLI positions align. A cautious approach where a country makes many reservations could therefore have the effect of lessening the overall effectiveness of the MLI and perhaps necessitate the use of bilateral renegotiations in spite of the MLI in order to implement the tax treaty related BEPS measures that are not included in the MLI minimum standard e.g. the provisions regarding hybrid mismatches. We found no convincing evidence that the MLI would give rise to any domestic legal issues.

We also found that the MLI does not provide a quick way for Sweden to implement the tax treaty related BEPS measures due to its dualistic legal system, which require amendments to the implementing legislation of each treaty that is to be modified by the MLI. The only other alternative would be to bilaterally change the treaty texts, but it seems likely that this would be an even slower process. Therefore, the MLI does not appear to cause Sweden to have to renegotiate its treaties bilaterally in this regard. Regarding whether any treaty should be renegotiated bilaterally for other reasons, we have however not found any evidence to suggest that a bilateral renegotiation should take place due to the MLI.

During the course of this report, we found a few different notification and reservation mismatches. However, the notification mismatch that we think is the most interesting is the Swedish omission of a consultation clause in Article 27 (4) of the treaty with Kazakhstan. We could not find a reason for why Sweden did not notify this consultation clause as Sweden has notified all other consultation clauses in its CTAs. This could indicate that Sweden wanted the clause to remain in effect specifically with regard to Kazakhstan. Apart from that, we found that four treaties probably should have had their preambles notified under 6 (5).

We would tentatively suggest that Sweden considers accepting the baseball arbitration provisions in Article 23 (1) of the MLI. This would most likely broaden the number of countries with which Sweden has arbitration provisions and may lead to more MAP cases being resolved, either through settlements during the MAP or as a result of the subsequent

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arbitration. Sweden could make use of the possibility to mutually agree on different rules in Article 23 (1) of the MLI and e.g. add language which requires the arbitration panel to follow international principles in making its decision. This way the concern that the use of baseball arbitration would lead to international principles not being followed that was expressed in the draft act, can be lessened.