

## **Tax alert: Comprehensive amendments introduced in the India-China tax treaty**

Issued on: 30 July 2019



## Summary

India and China had signed a protocol for amending the existing tax treaty between the two countries on 26 November 2018. India has notified this protocol on 17 July 2019. Changes in the treaty shall have effect in India in respect of income derived on or after 1 April 2020.

The protocol incorporates limitation of benefit clause containing the principal purpose test. Further, it comprehensively amends the manner of determining permanent establishment. It also incorporates provisions for exchange of information between the two countries in line with latest international standards.

## Key amendments

### Persons covered

- **Fiscally transparent entity or arrangement**

It has been provided that income derived by or through a wholly fiscally transparent entity or arrangement established in either of the contracting states shall be considered as income of the resident of the contracting state to the extent that the income is treated, for the purposes of taxation by that state, as the income of a resident of that contracting state.

- **Treatment in case of dual-residency in cases other than individual**

In such cases, residential status shall be determined by mutual agreement between competent authorities of India and China. For the purpose of determination, due regard shall be given to 'place of effective management', place of incorporation, and any other relevant factors. In the absence of any mutual agreement, the person shall not be entitled to benefit, if any, under the tax treaty.

### Permanent establishment (PE)

The protocol replaces the entire article related to PE. Key changes in the article include:

- **Construction/ Supervisory/ Installation PE**

Under the earlier provisions for the purpose of determining 183-day threshold, cumulative days on

**other such sites/ projects/ activities** was to be considered. This has been amended as follows:

- **Other such sites:** The reference to 'other such sites/ projects/ activities' has been removed.
- **Activities undertaken by closely related enterprises:** Where activities carried on during one or more period in aggregate do not exceed 183 days, connected activities carried by any closely related enterprises during different periods of time, if exceeding 30 days, at the same building site<sup>1</sup> shall be added for determining 183 day threshold.
- **Service PE:** Under the earlier provisions in the treaty, a service PE was constituted when furnishing of services continued for more than 183 days. This has been amended to provide that a Service PE could be created even when activities continue for the **same or connected project**. Further, threshold of 183 days is required to be checked within any 12-month period commencing or ending in the fiscal year concerned.
- **Agency PE:** Under the revised provisions a person undertaking following activities on behalf of an enterprise in other contracting state shall be deemed to create a PE except when the work is limited to preparatory and auxiliary character:

---

<sup>1</sup> or construction, installation or assembly project

- **Habitually concludes contracts** or habitually plays the principal role leading to conclusion of contracts<sup>2</sup> and these contracts are:
  - (i) In the name of the enterprise, or
  - (ii) For the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
  - (iii) For the provision of services by that enterprise
- **Habitually maintains a stock of goods** or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise

- **Activities by an independent agent**

Agency PE shall not be created where activities are undertaken by an independent agent acting in the ordinary course of that business.

However, a person shall not be treated to be an independent agent if he is acting exclusively or almost exclusively on behalf of one or more closely related enterprises<sup>3</sup>.

- **Preparatory and auxiliary activities:**

Under the earlier provisions, a PE was not constituted where an enterprise maintained goods or merchandise solely for the purpose of **delivery**. This exclusion for delivery has now been removed.

## Business profits

- **Attribution of profits**

Under the earlier provisions, no profit attribution was required if it was proved that the activities were either not performed by the PE or were not related to the PE. This provision has been removed. Also, the term 'directly or indirectly' attributable to PE has also been removed.

## Principal purpose test

- **Entitlement to benefits**

A new article on 'entitlement to benefits' has been added which incorporates<sup>4</sup> a principal purpose test (PPT). Accordingly, benefit under the treaty shall not be granted if it is proved that obtaining treaty benefit was one of the principal purposes of the arrangement or transaction. This would however not apply in cases where it is established that granting the treaty benefit would be in accordance with the object and purpose of the treaty.

## Preamble of the treaty

- **Elimination of treaty shopping**

The preamble to the treaty has been replaced and inter-alia reflects the intent to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements)

---

<sup>2</sup> that are routinely concluded without material modification by the enterprise

<sup>3</sup> A person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a

company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

<sup>4</sup> Article 27A has been inserted

---

## Our comments

The treaty has been amended in line with international standards emanating out of Organisation of Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) action plans. Taxpayers would now have to relook at their existing arrangements and structures and align them with these changes so as to ensure that they continue to avail the treaty benefits.

## Contact us

To know more, please visit [www.grantthornton.in](http://www.grantthornton.in) or contact any of our offices as mentioned below:

<b>NEW DELHI</b> National Office Outer Circle L 41 Connaught Circus, New Delhi 110001 T +91 11 4278 7070	<b>NEW DELHI</b> 6th floor, Worldmark 2, Aerocity, New Delhi – 110037 T +91 11 4952 7400	<b>AHMEDABAD</b> 7th Floor, Heritage Chambers, Nr. Azad Society, Nehru Nagar, Ahmedabad - 380015	<b>BENGALURU</b> 5th Floor, 65/2, Block A, Bagmane Tridib, Bagmane Tech Park, C V Raman Nagar, Bengaluru – 560093 T+91 80 4243 0700	<b>CHANDIGARH</b> B-406A, 4th Floor, L&T Elante office Industrial area, Phase-I, Chandigarh 160002 T +91 172 4338 000
<b>CHENNAI</b> 7th Floor, Prestige Polygon 471, Anna Salai, Teynampet Chennai - 600 018 T +91 44 4294 0000	<b>DEHRADUN</b> Suite 2211, Michigan Avenue, Doon Express Business Park, Saharanpur Road, Dehradun – 248002 T +91 135 264 6500	<b>GURGAON</b> 21st Floor DLF Square, Jacaranda Marg, DLF Phase II, Gurgaon 122002 T +91 124 462 8000	<b>HYDERABAD</b> 7th Floor, Block III White House, Kundan Bagh, Begumpet Hyderabad 500016 T +91 40 6630 8200	<b>KOCHI</b> 7th Floor, Modayil Centre Point, Warriam road junction, M.G. Road, Kochi 682016 T +91 484 406 4541
<b>KOLKATA</b> 10C Hungerford Street, 5th Floor, Kolkata 700017 T +91 33 4050 8000	<b>MUMBAI</b> 16th Floor, Tower III, Indiabulls Finance Centre, SB Marg, Elphinstone (W) Mumbai 400013 T +91 22 6626 2600	<b>MUMBAI</b> 9th Floor, Classic Pentagon, Nr Bisleri, Western Express Highway, Andheri (E) Mumbai 400099 T +91 22 6176 7800	<b>NOIDA</b> Plot No. 19A, 7th Floor Sector – 16A, Noida 201301 T +91 120 4855 901	<b>PUNE</b> 3rd Floor, Unit No 309 to 312, West Wing, Nyati Unitree Nagar Road, Yerwada Pune- 411006 T +91 20 6744 8800

For more information or for any queries, write to us at [contact@in.gt.com](mailto:contact@in.gt.com)



Follow us @GrantThorntonIN



**Grant Thornton**

An instinct for growth™

© 2019 Grant Thornton India LLP. All rights reserved.

"Grant Thornton in India" means Grant Thornton India LLP, a member firm within Grant Thornton International Ltd, and those legal entities which are its related parties as defined by the Companies Act, 2013.

Grant Thornton India LLP is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001.

References to Grant Thornton are to Grant Thornton International Ltd (Grant Thornton International) or its member firms. Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.