

Multilateral Instruments – Is It a Game Changer for India

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1. Introduction

It has been almost 4 years since OECD came out with set of 15 action plans² to limit Base Erosion and Profit Shifting (BEPS). The BEPS package has been designed to ensure that profits of a Multinational Corporation (MNC) are taxed where the economic activity leading to the generation of profits is performed, ie, where the value is created. India has been an active participant in this ambitious project and has made its presence felt as some of the adopted measures are on principles that India has always been emphasising upon.

BEPS being a global issue deserved global solution and the implementation of the measures listed in action plans required amendment in thousands of bilateral tax treaties. To facilitate swift and efficient revision of tax treaties, the adhoc group established by OECD released the 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting', referred to as the Multilateral Instrument (MLI). Since the first signing ceremony of the MLI on 7 June 2017, as of 09 April 2019, 87 jurisdictions have signed the MLI and from those, 25 jurisdictions have deposited the instrument of ratification³ as well.

The MLI covers three minimum standards (Article 6, Article 7 and Article 16 of the MLI) which the signatory countries are committed to implement. Another key area extensively covered by MLI is on avoidance of permanent establishment which has been a contentious issue globally for the MNCs. MLI modifies the Covered Tax Agreements (CTAs) where both parties have notified that they wish to modify the agreement. Also, signatories to the MLI

1 The views expressed are personal views of the authors

2 <http://www.oecd.org/ctp/beps-actions.htm>

3 <http://www.oecd.org/tax/treaties/beps-ml-signatories-and-parties.pdf>

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are offered the flexibility (other than for minimum standards) to opt-out and opt-in of the MLI provisions and this is done through reservations and notifications, respectively.

At the time of signing of MLI, India has indicated that it proposes to cover all 93 tax treaties under the MLI and has provided a provisional list of reservations and notifications in this regard.

The signing of MLI marks the dawn of a new era with respect to taxation of cross-border transactions. Its implementation will have significant impact on businesses with existing cross-border operations as well as foreign investors keen on investing in different countries.

The article focuses on the impact that MLI may create in the times to come, once India ratifies it, on the trade and investments of India.

2. Bird's eye view of India's MLI position¹

MLI is a complex instrument running into 39 Articles. Articles 1 and 2 give the general scope and definition, Articles 3 to 17 contain the substantive rules and should be interpreted in accordance with the general principles of treaty interpretation, and Articles 18 to 26 are intended to operate as a single cohesive arbitration provision.

Various provisions of MLI and India's position with respect to the same are mentioned below:

Article of MLI	Provision in brief²	Existing Indian Treaty provisions	India's Reservations and Notifications³
Article 1 – Scope of the Convention	Article 1 provides the scope of the MLI	-	-
Article 2 – Interpretation of the Terms	Article 2 defines the following terms CTA, Party, Contracting	-	India has notified 93 tax treaties as CTAs to be

1 Relevant to note that the provision of the MLI would get adopted in an Indian tax treaty only when matching action happens, ie, both the parties to MLI must adopt so as to the same provision in the Indian tax treaty with that country

2 <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>

3 <http://www.oecd.org/tax/treaties/beps-ml-position-india.pdf>

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	Jurisdiction and Signatory		covered by the MLI
Article 3 – Transparent Entities	This Article is based on the new Article 1(2) of the OECD Model convention MC and addresses income earned through transparent entities Income derived by or through an entity that is treated as wholly or partly fiscally transparent under the tax law of either Contracting Jurisdiction shall be regarded as income of a resident of a Contracting Jurisdiction only to the extent that such income is treated, for purposes of taxation by that Contracting Jurisdiction as the income of a resident of that Contracting Jurisdiction	Some of the existing tax treaties (like USA, UK, Norway and Sweden) provide that the term 'resident of a Contracting Jurisdiction' shall apply only to the extent income derived by partnership, estate or trust is subject to tax in that state as income of a resident, either in its hands or in the hands of partners or beneficiaries	India has opted not to adopt this provision in its tax treaties
Article 4 – Dual Resident Entities	This Article is based on Article 4(3) of the OECD MC and provides	Existing India tax treaty (like Finland, Japan, USA, Cyprus, Korea, Thailand, Macedonia	India has chosen to apply this provision

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	that the issue of dual residency for non-individuals is to be addressed by mutual agreement between CA, having regard to place of effective management (POEM), place of incorporation and other factors	and Indonesia) already provide that the CA can determine residential status of a person other than an individual through Mutual Agreement Procedures (MAP)	with respect of 91 CTAs (Greece and Libya are excluded)
Article 5 - Methods for Elimination of Double Taxation	The Article provides three options for elimination of double taxation which the parties may opt to follow - Option A – The per this country of residence would not give exemption for the income earned by its resident from the treaty partner country, if such income is exempt from tax or subjected to tax at lower rate in such country. The country of residence should grant deduction for the taxes paid by its resident in the treaty partner	India generally follows ordinary credit method for relieving from double taxation	India has opted not to adopt this provision in its tax treaties

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	<p>country, which cannot exceed the tax payable in the country of resident on such income</p> <p>Option B – As per this, where the income paid on an instrument is tax deductible in the source country but in the country of residence such income is treated as dividend and not subject to tax in country of residence, in such cases, the country of residence should not treat such income as exempt dividend but tax it and give credit for the taxes paid on such income in the country of source</p> <p>Option C – This is similar to credit method existing in OECD MC</p>		
<p>Article 6 – Purpose of a CTA (Minimum Standard)</p>	<p>Article 6 primarily seeks to insert a statement in the preamble of the tax treaties to the effect that the purpose of the treaty is not to create</p>	<p>The language presently found in most of India's tax treaties currently is 'for the avoidance of double taxation and the prevention of fiscal evasion'</p>	<p>India has not made any reservation / notification in this regard. Being a minimum standard, this</p>

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	<p>opportunities for double non-taxation or reduced taxation through tax avoidance or evasion including treaty shopping</p> <p>Additionally, the countries may also make reference to the intention of developing economic relationship and enhancement of cooperation in tax matters</p>		<p>preamble would be incorporated in all of India's CTAs</p>
<p>Article 7 – Prevention of treaty abuse</p>	<p>This Article provides three approaches for preventing treaty abuse:</p> <p>(1) Principal Purpose Test (PPT) - (Minimum Standard)</p> <p>(2) Simplified Limitation of Benefit (SLOB)</p> <p>(3) Combination of detailed LOB and anti-conduit measures</p> <p>By virtue of Article 7(4) of MLI, the person to whom</p>	<p>Some existing treaties already provide for denying treaty benefit where the main purpose of the transaction/arrangement is to avail treaty benefit (like Korea, Luxembourg, Singapore, Mauritius, Indonesia UK, Poland, Norway etc)</p>	<p>India has chosen to apply the SLOB provisions in addition to PPT approach. However, its applicability to India's tax treaties will depend on whether its treaty partners have also chosen to adopt the SLOB clause- India has made reservation to</p>

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	the benefit was denied can make a request to CA for treaty benefit		Article 7(4) of the MLI; therefore, the CA cannot grant discretionary relief
Article 8 – Dividend Transfer Transactions	<p>This Article addresses the abuse of beneficial tax treatment (say 5% rate) given under the tax treaties for dividend income in case of minimum 25% shareholding in the company distributing dividend</p> <p>Also, it requires a minimum holding period of 365 days to avail the beneficial rate provided in the tax treaties</p>	<p>Minimum shareholding threshold varies from treaty to treaty – some have 10% (US, Mauritius), while some others have 25% (Singapore, Denmark), and some do not provide any threshold at all (Germany, Japan, South Africa, Sweden, Netherlands).</p> <p>The minimum holding period criteria existing in some of the present tax treaties are:</p> <ul style="list-style-type: none"> • India-Portugal treaty provides for a minimum holding period of 2 years • India-Zambia treaty provides for a minimum holding period of 6 months 	<p>India has notified that the Article would not apply to Portugal treaty</p> <p>It has further notified 21 treaties which currently provide for a concessional rate of dividend without providing a shareholding period</p>
Article 9 - Capital Gains from Alienation of Shares or Interests of Entities	<p>The Article provides two alternatives:</p> <p>(1) Source country will get taxing</p>	Existing treaty with Malaysia and Netherlands has minimum threshold criteria	India has opted for Alternative 2

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
<p>Deriving Their Value Principally from Immovable Property</p>	<p>right if the value threshold is met at any time during the period of 365 days preceding the date of transfer</p> <p>(2) In addition to value threshold of 365 days, a value threshold of more than 50% is prescribed for trigger of source taxation</p> <p>The Article shall also apply to partnership or trust</p>	<p>Also, provision similar to Alternative 2 have been recently introduced in Israel tax treaty</p>	
<p>Article 10 - Anti-Abuse Rule for Permanent Establishments (PE) Situated in Third Jurisdictions</p>	<p>Benefit of the treaty not to apply to any item of income on which the tax rate in the third jurisdiction in which an exempt PE is located is less than 60% of the tax that will be imposed in residence jurisdiction of the enterprise</p>	<p>None of India's tax treaty has this rule</p>	<p>India has not made any reservations in respect of this Article Hence, this would get adopted in its tax treaties, subject to matching</p>

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
<p>Article 11 - Application of Tax Agreements to restrict a party's right to tax its own residents</p>	<p>The Article is a 'savings clause' which provides that a treaty does not impair right of the jurisdiction to tax its own residents</p>	<p>Presently, Article 1(3) of India-USA contains similar clause</p>	<p>India has not made any reservations or notified any CTA in respect of this article</p> <p>Hence, this would get adopted in its tax treaties, subject to matching</p>
<p>Article 12 - Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies</p>	<p>The Article suggests changes to PE article in the following manner:</p> <p>a. Dependent agent PE has been extended to include a person who habitually plays a principal role in the conclusion of contracts that are routinely concluded without material modification by the enterprise</p> <p>b. Person cannot be considered an</p>	<p>India-Italy tax treaty provides that an agent will not be regarded as an independent agent if the activities of such an agent are devoted wholly or almost wholly on behalf of closely related enterprise</p> <p>Under India-Switzerland tax treaty, an authority to negotiate and enter into contracts for and on behalf of the foreign enterprises could result in a PE for the foreign enterprise</p>	<p>India has not made any reservations in respect of this Article and has notified all 93 CTAs to adopt this article</p>

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	independent agent if he acts exclusively or almost exclusively on behalf of closely related enterprises		
<p>Article 13 - Artificial Avoidance of permanent Establishment Status through the Specific Activity Exemptions</p>	<p>This Article provides two options for modifying preparatory and auxiliary PE exemption in tax treaties:</p> <p>Option A: Exemption should only be available if the specific activity listed in the CTA is of a preparatory or auxiliary character on standalone or overall basis</p> <p>Option B: Allows countries to retain the automatic exemption to listed activities, irrespective of the same being preparatory or auxiliary in nature</p> <p>Independent of the above, this Article, further, contains a provision for</p>	<p>Certain India's tax treaties (like Finland, France, Germany, UK, Hong Kong) operate in a manner similar to Option A, ie, a specific clause is included to cover the combination of activities and such activity is of preparatory or auxiliary in nature</p>	<p>India has chosen Option A in respect of all of its 93 CTAs. However, India has not expressed any position with respect to Anti-fragmentation rule; hence, this shall be applicable subject to matching</p>

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	adopting an anti-fragmentation rule		
Article 14 - Splitting-up of Contracts	<p>This Article seeks to avoid situation where contracts are split between related parties to avoid PE provisions</p> <p>The Article provides that the period of time spent by the enterprise carrying on the activities in the other contracting state will be aggregated with the period of time spent by the closely related enterprises in relation to connected activities carried out by such closely related enterprises in the other contracting state</p>	<p>Certain India tax treaties (like Australia, Canada, Spain, Denmark, Italy, Bulgaria, USA, Mexico, Colombia, etc) specifically provides that time spent on other sites or projects is also to be considered while determining the threshold for PE</p>	<p>India has neither made any reservation nor notified any countries in respect of this Article</p>
Article 15 – Person Closely Related to an Enterprise	<p>This Article provides the meaning of the term 'person closely related' in context of Articles 12, 13 and 14</p>	<p>Presently, none of India's tax treaty contains this clause</p>	<p>Definition of Article 15 would be relevant only where Articles 12, 13 and 14 are adopted</p>
Article 16 – Mutual	<p>This Article provides for</p>	<p>Currently, none of India's tax treaties</p>	<p>India has opted not to</p>

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
Agreement Procedure (Minimum Standard)	mandatory inclusion of MAP provisions in CTAs. Some of the salient features of this article are: <ul style="list-style-type: none"> - Taxpayers can approach the CA of either contracting jurisdiction - Taxpayers needs to present his case to the CA within 3 years of the first notification of the action resulting in taxation, not in accordance with the provisions of the treaty - Agreement reached among the CA shall be implemented irrespective of the time limits in the domestic laws 	provide that case is to be presented to the CA of either contracting jurisdiction	adopt a provision according to which the taxpayer can approach CA of either of the contracting jurisdiction. However, as this is a minimum standard, India has opted to implement minimum standard through a bilateral notification or consultation process under the MLI
Article 17 – Corresponding Adjustments	This is based on Article 9(2) of the OECD MC and requires compensatory or	Most of India's tax treaties already contain this language. However some of the treaties which do not contain	India would adopt this provision except where such

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	corresponding adjustment if there is double taxation arising out of transfer pricing adjustments	similar provisions are Belgium, France, Germany, Mauritius, Italy, Sweden, UAE Also, the Government has notified to accept Transfer Pricing MAP/ APA applications regardless of presence of Article 9(2) in the tax treaties	provision already exists in the tax treaty Adoption of this article in the Indian tax treaties would facilitate settlement of transfer pricing disputes through MAP and bilateral Advance Pricing Agreements (APA) negotiations
Articles 18-26 - Mandatory Arbitration	Articles 18 to 26 deal with mandatory arbitration and issues such as appointment of arbitrators, confidentiality of arbitration proceedings, and resolution of a case prior to the conclusion of arbitration, type of arbitration process, etc	India does not have mandatory arbitration clause in any of its tax treaties	India has opted not to adopt this provision in its tax treaties
Articles 27-39 - Final Provisions	This part deals with procedural		India has currently

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Article of MLI	Provision in brief ²	Existing Indian Treaty provisions	India's Reservations and Notifications ³
	provisions such as signature, ratification, reservations, notifications, date of entry into force, date of effect, etc, to make the MLI provisions operational		notified 93 existing tax treaties and also given provisional list of reservations and notifications

3. Articles of MLI having impact¹ on Indian tax treaties with its major trading partners

MLI Provision	Impact of the MLI on India's Tax Treaties			
	Japan	Australia	France	UAE
Article 2 – Covered Tax Agreement	Both India and Japan have covered each other in its CTA	Both India and Australia have covered each other in its CTA	Both India and France have covered each other in its CTA	Both India and UAE have covered each other in its CTA
Article 4 – Dual Resident Entities	MLI provision to be implemented. However, discretionary relief cannot be provided by CA because of express provision		Does not apply	
Article 6 – Purpose of a CTA	Existing treaty language to co-exist along with MLI text (creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance)			
Article 7 – Prevention of Treaty Abuse	PPT test to be applied to the extent of incompatibility			
Article 9 - Capital	Threshold in terms of days	Source country will	Threshold in terms of days	Does not apply

¹ Reference in this regard has been made to India MLI position and the other jurisdictions MLI position

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MLI Provision	Impact of the MLI on India's Tax Treaties			
	Japan	Australia	France	UAE
Gains from Alienation of Shares or Interests of Entities Deriving Their Value Principally from Immovable Property	and percentage shareholding to be introduced	get taxing right if the value threshold is met any time during the period of 365 days preceding the date of transfer	and percentage shareholding to be introduced	
Article 10 - Anti-abuse Rule for Permanent Establishments (PE) Situated in Third Jurisdictions	MLI provisions supersedes	Does not apply		
Article 11 - Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents	Does not apply	This would apply and supersede the provisions of the agreements to the extent of incompatibility	Does not apply	
Article 12 - Artificial Avoidance of Permanent Establishment Status through Commissionaire	Extended definition of DAPE applicable Further, independent agent definition as	Does not apply	Extended definition of DAPE applicable Further, independent agent definition as per MLI to apply	Does not apply

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MLI Provision	Impact of the MLI on India's Tax Treaties			
	Japan	Australia	France	UAE
Arrangements and Similar Strategies	per MLI to apply			
Article 13 - Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Activities, carried on either individually or collectively, are preparatory or auxiliary in nature. Also, anti-fragmentation provision shall apply		Anti-fragmentation provision shall apply	Does not apply
Article 14 - Splitting-up of Contracts	Does not apply	This would apply and supersede to the extent of incompatibility	Does not apply	
Article 15 – Person Closely Related to an Enterprise	Applicable			Does not apply
Article 16 – Mutual Agreement Procedure	Do not apply			In addition to existing treaty language, now 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

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MLI Provision	Impact of the MLI on India's Tax Treaties			
	Japan	Australia	France	UAE
				the Covered Tax Agreement
Article 17 – Corresponding Adjustments	Do not apply		This would apply and supersede the existing provision to the extent of incompatibility	This would apply and supersede the existing provision to the extent of incompatibility

*** For some of the other major trading partners:**

- United States is not party to MLI.
- China – MLI should not apply as China has not included India as in its CTAs.
- Germany – MLI should not apply as Germany has not included the treaty with India as its CTAs.
- Hong Kong – The agreement would not be a CTA because neither jurisdictions have included it in the notification.

4. Articles of MLI having Impact on India's treaties with its major investment jurisdictions**

MLI Provision	Impact of the MLI of India's Tax Treaties			
	Singapore	Cyprus	Netherlands	Luxemburg
Article 2 – Covered Tax Agreement	Both India and Singapore have covered each other in its Covered Tax Agreement	Both India and Cyprus have covered each other in its Covered Tax Agreement	Both India and Netherlands have covered each other in its Covered Tax Agreement	Both India and Luxemburg have covered each other in its Covered Tax Agreement
Article 4 – Dual Resident Entities	Does not apply		Exists in existing tax treaty	Does not apply

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MLI Provision	Impact of the MLI of India's Tax Treaties			
	Singapore	Cyprus	Netherlands	Luxemburg
Article 6 – Purpose of a CTA	Existing treaty language to co-exist along with MLI text (creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance)			
Article 7 – Prevention of Treaty Abuse	PPT to apply and supersede the provisions to the extent of incompatibility			PPT to apply
Article 9 - Capital gains from Alienation of Shares or Interests of Entities Deriving Their Value Principally from Immovable Property	Does not apply		Source country will get taxing right if the value threshold is met any time during the period of 365 days preceding the date of transfer	Does not apply
Article 10 - Anti-Abuse Rule for Permanent Establishments (PE) Situated in Third Jurisdictions	Does not apply		MLI provision supersedes	Does not apply
Article 13 - Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Does not apply		Activities, carried on either individually or collectively, are preparatory or auxiliary in nature. Also, anti-fragmentation provision shall apply	Does not apply

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MLI Provision	Impact of the MLI of India's Tax Treaties			
	Singapore	Cyprus	Netherlands	Luxemburg
Article 14 - Splitting-up of Contracts	Does not apply		MLI provision to supersede the provisions of the existing treaty	Does not apply

**** For some of the other major investment partners:**

- Mauritius - MLI should not apply as Mauritius has not included the treaty with India as its 'CTA'.

5. Concluding remarks

The MLI is a big step in the implementation of BEPS initiatives and the reservations and notifications made by India and its major trading/investment partners provides an insight on how Indian tax treaties will shape up in the BEPS world. The MLI modifies bilateral tax treaties (the covered agreements) in a number of ways and one will have to read the tax treaty/the accompanying protocol alongside the changes made by MLI.

As per the provisional list submitted in June 2017, India has notified all its comprehensive tax treaties except Taipei as its CTAs; however, the key trading/investing countries such as China, Germany and Mauritius have correspondingly not notified their Indian treaties as CTAs and US is not party to MLI. Thus, in order to effectively implement some of the BEPS measures, India will have to renegotiate the tax treaties with these countries. Additionally, there are some gaps in implementing the anti-abuse rules under the bilateral tax treaties as India has opted for the PPT plus a simplified limitation on benefits rule, while most of India's treaty partners have opted only for the PPT rule and thus where India wants to include the LOB rule, it can only be implemented once it has been agreed with the treaty partner.

India has introduced General Anti Avoidance rules effective 1 April 2017 which require fulfilment of the Main Purpose Test as well as one of the Tainted Element Tests, while the MLI seeks to deny tax treaty benefits if the main or even one of the principal purposes is to obtain the treaty benefit. While in most situations where GAAR is complied with, it is likely that PPT test under the MLI would also be met, yet conflicts cannot be ruled out and India would need to provide detailed guidance on the implementation of these rules to minimise litigation.

Another important area where Indian tax authorities have been aggressive is holding permanent establishment on account of presence of dependent agent in India. While the widened definition (covering agent who habitually plays the principal role leading to conclusion of contracts) under the MLI gives additional support to tax authorities contentions, some of the treaty partners such as Canada, Cyprus, Luxembourg, Singapore and the UK have opted for the modified agency PE article not to apply to its tax treaty with India. Accordingly, the debate around whether mere participation in negotiations with no authority on concluding terms may lead to PE in India continues to exist.

To conclude, the MLI is going to play a pivotal role in the negotiation or renegotiation of tax treaties across the globe and the effectiveness of the MLI will be tested over time. As aforesaid, there are various situations where tax treaties may need to be renegotiated bilaterally to have effectively deal with BEPS situations. Globally, there is an increased focus on BEPS, with many countries also making unilateral changes in their domestic laws to accelerate the process of implementing some of BEPS measures, eg, introduction of equalization levy, significant economic presence to tax certain digital transactions, or introduction of Diverted Profit tax or Multinational Anti avoidance law, etc. As more and more countries adopt unilateral measures for incorporating the BEPS Action Plan in domestic laws of the various jurisdictions, the effectiveness of the implementation of MLI may reduce.

Though MLI is a momentous step, however, given the reservations and notifications made by India on MLI for its various trading and investment partners, there may not be much significant impact of MLI on Indian tax treaties as envisaged earlier.