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Multilateral Instrument

a new world order for availing tax treaty benefits

The Multilateral Instrument (MLI)[1] has brought about far reaching and significant changes in the application and grant of tax treaty benefits amongst several countries[2] globally.

With effect from 1 April 2020, several of India's tax treaties have been impacted as a consequence of the MLI coming into force, including treaties with the U.K., Singapore, Australia, the Netherlands, Canada, U.A.E., etc. Going forward, claim of tax treaty benefits will require a detailed and careful evaluation of the impact of MLI on cross border payments.

Failure to appropriately apply tax treaties may result in default in withholding obligations, and the consequences of such a failure are quite onerous under the Indian tax law.

Some key provisions of tax treaties which have undergone change are provided below:

- Amendment to the preamble of the tax treaties
- Incorporation of Principal Purpose Test (PPT)
- Incorporation of anti-treaty abuse measures covering taxation of:
  - dividends
  - capital gains, etc.
- Expansion in the scope of Agency PE
- Restrictions on the scope of PE exceptions
- Restrictions on artificial splitting of contracts

Some of the illustrative transactions with non-residents, which should be evaluated from an MLI perspective, include the following

- Payment for purchase of software licences
- Payment towards services charges
- Payment towards management cross-charges
- Payment towards use of equipment
- Payment of dividend and interest
- Capital gains arising from transfer of investments
- Provision of marketing services by an Indian entity to its overseas parent/group entity
- Purchase of goods where negotiations are made by an Indian representative of the seller
- Construction and installation contracts, if carried out by closely held companies
- Transactions/arrangements entered into in the past, the benefit from which arises to the taxpayer after 31 March 2020

1. MLI is an outcome of the OECD Project to tackle Base Erosion and 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.
2. More than 135 countries and jurisdictions are collaborating on the implementation of the BEPS Project under the Inclusive Framework.

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What taxpayers should do?

- Identify cross border transactions/ arrangements where a treaty benefit is likely to be claimed
- Identify foreign payments where tax is not withheld or withheld as per treaty rates
- Check whether payment is to a related party or a third party
- Analyse nature of payment and whether the relevant article under a treaty has been modified by MLI
- Evaluate impact of MLI on tax positions taken in the past
- Evaluate if the declaration from payee (such as 'no PE' declaration) needs to be modified
- Evaluate contractual safeguards and documents to ring-fence risks.

Our value proposition

We could assist you in evaluating the impact of MLI on tax treaty positions and developing an appropriate approach to deal with MLI and help ensure compliance with various tax obligations. Listed below are some of the specific areas where we can be of assistance:

- Undertaking an impact analysis of PPT on existing structure/transactions
- Evaluation of PE risk under existing business models and suggest mitigation avenues
- Assist in maintaining appropriate documentation and demonstrating substance to mitigate risk
- Exploring alternative remedies for tax management
- Suggesting contractual safeguards and documents to ring-fence risks
- Establishing procedures for local teams along with dos and don'ts.

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