Multilateral Instrument: The new dilemma of foreign investors

By *Palak Shah*, ET Bureau | Updated: Jan 22, 2017, 09.11 PM IST

Post a Comment

MUMBAI: The Multilateral Instrument (MLI), a new global tax avoidance agreement, that is in the process of being signed by 100 countries, is now causing a lot of anxiety among foreign portfolio investors (FPIs).

Budget 2017:
Can Arun Jaitley make you & economy happy?
Click for our special Budget 2017 coverage

Stay up to date on market action, follow ETMarkets@Twitter

MLI is an agreement put out by OECD, the intergovernmental economic organisation, to stop Base Erosion and Profit Shifting (BEPS), a practice referring to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. MLI is thus a framework through which over 100 countries and jurisdictions are collaborating to tackle BEPS or anti-treaty shopping provisions. The agreement has to be signed by India before the first week of June.

“Once adopted, MLI will replace certain portions of existing bilateral treaties that India has with several countries, including the US. It is also likely to impact new protocols signed with Mauritius, Singapore and Cyprus. The mandatory minimum standard threshold under MLI, as it stands today, appears to be far higher than the Indian GAAR (General Anti Avoidance Rules), something which was feared until now,” said Suresh Swamy, partner, tax and regulatory services, PwC. “The present understanding is that GAAR will override all treaties where it is applied. But what needs to be clarified is what will happen when MLI is implemented.”

GAAR was framed to check tax avoidance by foreign investors mainly in tax havens. Under it, FPIs have to convince tax authorities that the sole purpose of locating in a particular jurisdiction was not tax avoidance.

Tax experts say under MLI, foreign investors would have to pass a ‘principal purpose test’ to satisfy all countries that tax avoidance was not the chief purpose. What complicates matters is that participating countries have a right to specify, at MLI’s ratification, as to which provisions of the MLI they would opt in to and out of, leaving the field open for different interpretations.

“Circumstances under which the collective investment vehicles can potentially be entitled to treaty benefits and whether they will meet various conditions under the limitation of benefit (LOB) becomes a concern or an issue,” said Rajesh Simhan, partner, Nishith Desai Associates.

Tax experts say FPIs, private equity and all other foreign investors will have to pass through two key LOB tests, which are principal purpose and ownership criteria. More important is the answer to this conundrum: Whether MIL will supersede all existing bilateral treaties to enhance its effectiveness or that a country will wish to override all its bilateral treaties to achieve an uncertain result beyond the scope of its control?

“The fear is more of unknown as both MLI as well as GAAR are yet to be implemented,” said Daksha Baxi, ED, Khaitan & Co. “But MLI is just an improvised version of a treaty and GAAR is a domestic tax law that may override the treaty. Yet once both are put in practice, a further clarification by CBDT would help.”

An optional provision is included in MLI to provide some relief by allowing the competent authority to grant treaty benefits that would otherwise be denied under a principal purpose test rule if it is determined that such benefits would have been granted in the absence of the arrangement or transaction. However, even if this rule is followed it would generally not provide investors with the certainty that they require prior to making investments, say experts.

 Copyright © 2017 Bennett, Coleman & Co. Ltd. All rights reserved.