



# A Brief on Multilateral Instrument

12 April 2021



## Background information

In 2015, encouraged by the G20, the Organization for Economic Cooperation and Development (OECD) finalized the BEPS action plan, which includes the 15 action points listed below:

Action Point	Action Description
1	Address the tax challenges of digital economy.
2	Neutralize the effects of hybrid mismatch arrangements.
3	Strengthen the Controlled Foreign Company (CFC) rules.
4	Limit base erosion via interest deductions and other financial payments.
5	Counter harmful tax practices more effectively taking into account transparency and substance.
6	Prevent treaty abuse.
7	Prevent the artificial avoidance of Permanent Establishment (PE) status.
8	Aligning transfer pricing outcomes with value creation (intangibles).
9	Aligning transfer pricing outcomes with value creation (risks and capital).
10	Aligning transfer pricing outcomes with value creation (other high-risk transactions).
11	Measuring and monitoring BEPS.
12	Require taxpayers to disclose their aggressive tax planning arrangements.
13	Re-examine transfer pricing documentation.
14	Make dispute resolution mechanisms more effective.
15	Develop a multilateral instrument.

This alert focuses on Action 15 on multilateral instrument (MLI) which is a medium for updating bilateral double tax avoidance agreements ('DTAAs') swiftly (currently covering nearly 1,500 of them). It was devised under BEPS project of the OECD commissioned to assist governments to reduce opportunities for tax avoidance by multinational enterprises ('MNEs').

The measures specifically target:

- Hybrid mismatches (BEPS action point 2)
- Treaty abuse (BEPS action point 6)
- Avoidance of permanent establishment ('PE') status (BEPS action point 7)
- Improving dispute resolution (BEPS action point 14)

Each of the MLI signatories is required to provide a list of DTAAs wished to be covered and its positions and reservations in respect of each provision covered under the MLI. The signatories can amend their MLI positions until ratification through their domestic legislations. Even after ratification, countries can choose to opt in with respect to optional provisions or to withdraw reservations. The modified DTAA comprises the original DTAA provisions and the modified/ newly added provisions i.e. the commonly accepted features of the MLI by both the contracting parties.

Pakistan signed the "Multilateral Convention on Mutual Administrative Assistance in Tax Matters" on 07 June 2017 becoming the 104th jurisdiction to join the Convention. Thereafter, some of these action points were addressed by the insertion of relevant section/rules in the domestic direct tax statute in the following sections/rule and more actions are likely to follow:



# A Brief on Multilateral Instrument



## Background information

Section/Rule Reference	Section/Rule Heading
101(3)e	Cohesive business arrangement inserted vide Finance Act, 2018.
101A	Gain on disposal of assets outside Pakistan inserted vide Finance Act, 2018.
106	Thin capitalization.
106A	Restriction on deduction of profit on debt payable to associated enterprise inserted vide Finance Act, 2020.
108	Transaction between associates.
Chapter VIA	Documentation and country by country reporting requirements inserted vide S.R.O. 1191(1)/2017 dated 16 November 2017.
109A	Controlled foreign company inserted vide Finance Act, 2018.

In addition to the domestic law changes, the MLI has also brought about far reaching and significant changes in the application and grant of tax treaty benefits amongst several countries<sup>2</sup> globally.

With effect from 1 April 2021, several of Pakistan's tax treaties have been impacted as a consequence of the MLI coming into force vide S.R.O. 405(1)/2021 dated 01 April 2021.

Going forward, the claiming of tax treaty benefits will require a detailed and careful evaluation of the impact of the MLI on cross border payments.

Failure to appropriately apply tax treaties may result in withholding obligations and the consequences of such a failure may be onerous.

Some key provisions of the tax treaties which have undergone change as a result of the MLI 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.

To really understand the impact of the MLI to one's business and tax charge, the transaction type will need to be considered. The following section sets out the typical transactions that will be most impacted by the MLI changes for Pakistani Groups.

1. More than 135 countries and jurisdictions are collaborating on the implementation of the BEPS Project under the Inclusive Framework.



# A Brief on Multilateral Instrument



## Who will be impacted and key impact areas?

From a transactional perspective, some of the illustrative transactions with non-residents which should be evaluated from an MLI perspective for Pakistani Groups 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 a Pakistan entity to its overseas parent/ group entity

Purchase of goods where negotiations are made by a Pakistan 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 2021



# A Brief on Multilateral Instrument



## 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 to a third party.

Analyze 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.



## Value proposition to our clients

We can assist in evaluating the impact of the 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 suggesting 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 in house along with dos and don'ts.



KPMG Taseer Hadi & Co.,  
Chartered Accountants

# Contact Us

## **Karachi Office**

Sheikh Sultan Trust Building No. 2  
Beaumont Road  
Karachi – 75530  
Telephone 92 (21) 3568 5847  
Telefax 92 (21) 3568 5095  
e-Mail [karachi@kpmg.com](mailto:karachi@kpmg.com)

## **Lahore Office**

351, Shadman-1  
Main Jail Road  
Lahore 54000  
Phone +92 (42) 111 576 484  
Fax +92 (42) 3742 9907  
e-Mail [lahore@kpmg.com](mailto:lahore@kpmg.com)

## **Islamabad Office**

Sixth Floor, State Life Building  
Blue Area  
Islamabad  
Telephone 92 (51) 282 3558  
Telefax 92 (51) 282 2671  
e-Mail [islamabad@kpmg.com](mailto:islamabad@kpmg.com)

[www.kpmg.com.pk](http://www.kpmg.com.pk)

This document is solely for the benefit of our clients and can also be found on <http://kpmg.com.pk>

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2021 KPMG Taseer Hadi & Co., a Partnership firm registered in Pakistan and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.