

INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

Volume 2 | Issue 2

2020

© 2020 *International Journal of Legal Science and Innovation*

Follow this and additional works at: <https://www.ijlsi.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com>)

This Article is brought to you for “free” and “open access” by the International Journal of Legal Science and Innovation at VidhiAagaz. It has been accepted for inclusion in International Journal of Legal Science and Innovation after due review.

In case of **any suggestion or complaint**, please contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication at **International Journal of Legal Science and Innovation**, kindly email your Manuscript at editor.ijlsi@gmail.com.

BEPS in India Impact on Indian Tax Policies and Objectives

PAVAN KUMAR.R¹

ABSTRACT

The Organization for Economic Co-operation and Development (OECD, Originated as Organization for European Economic Co-operation: OEEC in 1948) was founded in the year 1961 with an intention to encourage economic progress and world trade by way of putting an end to the strategy planning of several multinational companies who have implemented meticulous tax planning methods to shift profits to lower tax jurisdictions, destroying the tax base of the higher tax jurisdictions, by exploiting the gaps in tax rules and avoid paying taxes. This process is termed as Base Erosion and Profit Shifting (BEPS). This is an alarming issue because of the reason that there are several countries that have designed their tax policies in such a way that they look lucrative to foreign investors. Even though on the first instance, they appear to profit the investors, but on the long run are highly dangerous as they impact the economy of countries in a very bad way.

Recently, India has also made several amendments in its domestic laws and treaties to bring them in line with the BEPS recommendations. Further, in a developing country like India, it is also vital to balance the implementation of BEPS recommendations, while continuing to be an attractive investment destination for foreign investors as well. The relevance of BEPS is from an India outbound as well as India inbound perspective. The BEPS project is extremely relevant for India, especially the action plans dealing with treaty abuse and transfer pricing. The main objective of this paper is to critically evaluate the OECD tax model with regard to Base Erosion Profit Shifting in India and its impact on tax policies in India. The BEPS project is extremely relevant for India, especially the action plans dealing with treaty abuse, permanent establishment, and transfer pricing documentation and country-by-country reporting. The relevance of BEPS is from an India outbound as well as India inbound perspective.

¹ Author is Pursuing MBL from NLSIU, Bengaluru, India.

I. INTRODUCTION

The Harmful tax practices have been an ever-growing trend that is not limited to one part of the world. It has been a global issue, putting trade and investment patterns out of their place and as well as destroying tax bases gradually. In the year 1961, with the noble intention to encourage economic progress globally and as well as improvise world trade by way of putting an end to the clever strategy planning of the several multinational establishments who have implemented meticulous tax planning methods to shift profits to lower tax jurisdictions, destroying the tax base of the higher tax jurisdictions, by exploiting the gaps in tax rules and avoid paying taxes, the Organization for Economic Co-operation and Development (OECD), which actually originated as the Organization for European Economic Co-operation (OEEC) in the year 1948, was founded.

II. OECD BEPS

The process, which is termed as (BEPS Base Erosion and Profit Shifting) is an alarming issue because of the reason that there are several countries that have designed their tax policies in such a way that they look lucrative to foreign investors. Even though on the first instance, they appear to profit the investors, but on the long run are highly dangerous as they impact the economy of countries in a very bad way.

OECD commenced working on the BEPS project to address concerns that existing principles of domestic and international taxation were failing to keep pace with the global nature of modern business models. Governments, revenue authorities and social organizations are of the belief that existing rules give businesses excessive opportunity for arbitraging tax rates and regimes. In the recent years, even India is taking up the situation very seriously and trying to do its best and putting in a lot of effort to counter such harmful practices and provide a safe and secured trading environment that has clear transparent aspects to it. Along with the co-operation of the several nations that are signatories and parties to the Multilateral Convention to Implement Tax Treaty related measures to prevent BEPS and the directions provided by the OECD on a regular basis, it can be seen that the countries that are providing tax havens might not remain the same in the near future.

III. TAX EVASION

Tax evasion is not a new phenomenon, but an old menace from the past that is growing in the present and is surely going to cast a threat to the future. It is necessary that the case of Al Capone in 1931 which led to the foundation for methods needs to be adopted by tax

authorities to counter and convict tax offenders. Along with that, it is also necessary to collect data from all the nations and formulate principles after due research in the field of tax evasion with specific focus on the psychological decision-making process.

Coming to the case of our country which is an active participant and contributor in the BEPS project since initiation, it is always committed to the implementation of the minimum standards to tackle the BEPS issues. Recently, India has also made several amendments in its domestic laws and treaties to bring them in line with the BEPS recommendations. Further, in a developing country like India which is also the second largest populated country in the world resulting into a huge consumer base, it is also vital to balance the implementation of BEPS recommendations, while continuing to be an attractive investment destination for foreign investors as well.

BEPS ACTION PLAN

The Action Plan on BEPS released by the OECD in 2013 identified 15 actions based on three fundamental pillars:

- Introducing coherence in domestic tax rules that affect cross-border activities
- Reinforcing substance requirements in the existing international standards
- Improving transparency as well as certainty for businesses and governments

IV. INDIAN PERSPECTIVE

The problems associated with BEPS are exacerbated in an Indian context due to India's heavy reliance on revenues from corporations (including multinationals), which are dependent upon international tax rules. Among the various aspects addressed by BEPS, India has identified major challenges posed by the digital economy, artificial avoidance of PE status, treaty abuse and transfer pricing as being particularly relevant in the Indian context.

The relevance of BEPS is from an India outbound as well as India inbound perspective. The BEPS project is extremely relevant for India, especially the action plans dealing with treaty abuse and transfer pricing. The BEPS project is extremely relevant for India, especially the action plans dealing with treaty abuse, permanent establishment, and transfer pricing documentation and country-by-country reporting. The relevance of BEPS is from an India outbound as well as India inbound perspective.

The process to become one of the members is very long and complicated as it would be reviewed by up to 20 OECD Committees to make sure that it meets all the required criteria's and are up to OECD standards. Along with that, the countries should also be ready and

willing to make necessary changes in the areas of corporate governance, anti-corruption, and environmental protection. Once a member, they are bound to share complete data which helps OECD to analyze and make necessary plans to help in the growth of their economy and even OECD can plan its policies accordingly. One of the things that OECD is very much concerned is the global trade war, as it weakens the growth of economy and affects global trade.

India has ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) in 2017 on the 7th of June. The Instrument of Ratification to OECD was deposited in 2019 on 25th of June. MLI will enter into force in India from the 1st of October 2019 and as hence, its provisions will have effect on India's DTAA's from the Financial Year of 2020-21.

As MLI applies alongside with the Covered Tax Agreements (CTAs), if any of the provisions are found to overlap with the provisions of one another, compatibility clauses would help in addressing those conflicts. Because of the reason that MLI does not modify all the tax treaties in the same manner, it creates some doubts in the minds of the taxpayers and in such a scenario, they can look into the synthesized treaty texts that have been released by the Central Board of Direct Taxation (CBDT).

When MLI takes effect from the 1st of April 2020, the tax environment would be much stricter for the multinationals as they would have to modify their preamble text of the tax treaties laying out the purpose and object of the MLI. There are also several other things that needs to be investigated but the most important of them all would be documentation if the companies want to defend their treaty claims.

A good number of Tax treaties entered by India with other nations would certainly be impacted on account of MLI, especially in the areas such as dispute resolution, prevention of treaty abuse, avoidance of permanent establishment status and so on. As India has treaties with several nations who are already a signatory to the MLI, the treaties would be impacted as soon as the MLI takes effect.

One most important change that is anticipated is the satisfaction of the PPT to qualify for the treaty benefits and according to the test, if it is found that if one of the principal purpose of an arrangement or transaction was to obtain treaty benefit, then in that case, the benefit of the tax treaty would be denied. On the contrary it may also lead to increased litigation, because as of now, there is no clarity on how the test would be applied by the tax authorities.

AIM

The main aim of modifying the Indian Tax Treaties through the MLI is to curb the revenue loss that is happening due to the treaty abuse and BEPS strategies employed by the multinational establishments. It is also aimed that the profits are taxed at the place, from where they are generated. The DTAAAs with the countries that have already ratified the MLI will be modified by the MLI and for the remaining CTAs, the effect of MLI would be from the time of when the countries ratify the MLI and the position taken under MLI by them.

IMPACT ON INDIAN TAX TREATIES:

The key areas of impact on Indian Tax Treaties are as follows:

1. Preventing tax treaty abuse
 - Minimum standard under BEPS AP 6 to tackle treaty abuse, i.e., insertion of new preamble and principal purpose test (PPT) in all Indian CTAs to be achieved
 - PPT to replace/supersede existing general anti-abuse provisions in CTA, or to be added in the absence of such provisions
 - Additionally, India has chosen to apply simplified limitation on benefits (SLOB), which will generally apply to CTAs if other party has also opted for its application
2. Widening Permanent establishment (PE) scope
 - Broader agency PE rule to apply to address artificial avoidance of PE status through commissionaire arrangements and similar strategies
 - Address avoidance of PE formation through specific activity exemptions and splitting up of contracts
3. Improving dispute resolution
 - MAP request to be implemented through bilateral negotiation or consultation process
 - Provisions on mandatory binding arbitration (in the event competent authorities are unable to reach a decision under MAP) to not apply to all CTAs
4. Other key modifications
 - Tie breaker test in case of dual residency of person (other than an individual)

to be now decided by competent authority (CA) of the CTA parties

- Taxation of capital gains from alienation of shares /interests deriving value principally from immovable property may also be amended

V. IMPACT ON TAX TREATIES OF INDIA WITH OTHER NATIONS:

The manner in which the tax treaties of India with other nations will be impacted is:

1. India-France:

- Only PPT to be added since France has not opted for SLOB
- Broader agency PE rule applicable since France has notified India tax treaty
- Avoidance of PE status through specific activity exemptions related provision not applicable since France has not chosen same option
- Splitting up of contracts related provision not applicable since France has made a reservation

2. India-UK:

- Only PPT to apply since UK has not opted for SLOB
- Broader agency PE rule not applicable since UK has made a reservation
- Avoidance of PE status through specific activity exemptions related provision not applicable since UK has not chosen any option
- Splitting up of contracts related provision not applicable since UK has made a reservation

3. India-Singapore:

- Only PPT to apply since Singapore has not opted for SLOB
- Broader agency PE rule not applicable since Singapore has made a reservation
- Avoidance of PE status through specific activity exemptions related provision not applicable since Singapore has not chosen same option
- Splitting up of contracts related provision not applicable since Singapore has made a reservation

4. India-Netherlands:

- Only PPT to be added since Netherlands has not opted for SLOB

- Broader agency PE rule not applicable since Netherlands has made a reservation
- Avoidance of PE status through specific activity exemptions related provision applicable since Netherlands has chosen same option
- Splitting up of contracts related provision applicable

UK was one of the countries at the forefront in adopting the BEPS recommendations including the MLI. India and UK have notified that the MLI shall be applicable to the Double Tax Avoidance Agreements (DTAAs) and as such, the India-UK DTAAs will be read along with the MLI. It is also to be noted that except in the case when it is a minimum standard as it would apply even though it is not notified, both the countries need to have notified the particular articles of the MLI to be applied. In the case when one of the countries do not opt for article, it cannot be applied to the treaty. As Article 4 of the MLI i.e. the dual resident entity is opted by both the nations, it provides for application of the Mutual Agreement Procedure to resolve cases of dual residency.

Some of the notable impacts are in respect of:

Article 4: Dual resident entities- Dual residency in case of a person other than an individual to be determined by MAP

Article 5 - Elimination of double taxation - Relief from double taxation by way of credit method of exemption

Article 6 - Purpose of a CTA - Intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements

Article 7 - Principal Purpose Test - Anti-abusive tests provided which limit treaty benefits for specific items of income such as dividend, interest, royalty and FTS.

Article 13 - Artificial avoidance of PE status through the specific activity exemptions - Activities (including those of closely related persons) covered under the specific activities list deemed not to constitute PE, to be tested on combined basis

Article 15 - Definition of a person closely related to an enterprise - Definition as per MLI applicable

Article 16 – MAP - MAP applicable with certain modifications. Mandatory arbitration not agreed by India.

The CBDT has also released synthesized text for several tax treaties of India with several nations, representing the shared understanding of the made to the agreements by the MLI.

VI. DTAA'S

In accordance with the adoption of the provisions under the MLI by contracting parties, the respective Double Taxation Avoidance Agreements (DTAAs) between such parties shall be modified to the extent of the provisions adopted and in order to provide a clear insight into the impact of the MLI on existing treaties, the OECD recently published the new "Guidance for the Development of Synthesized Texts". According to the same, the CBDT has released the synthesized text of several Indian tax treaties with other nations like the India-Singapore DTAA, the India-UK DTAA, the India-Poland DTAA, the India-Brazil DTAA, the India-Australia DTAA, the India-Finland DTAA and the India-Slovak Republic DTAA, in such a way that it represents their shared understanding of the modifications made to the Agreement by MLI.

Here is a brief overview of the same:

INDIA AND SINGAPORE

The synthesized text for the application of the DTAA between India and Singapore was prepared based on instruments of ratification deposited by Singapore and India on 21 December 2018, and 25 December 2019, respectively. The MLI entered into force for Singapore and India on 1 April 2019, and 1 October 2019, respectively.

Unless stated otherwise in the synthesized text, the provisions of the MLI will come into effect with respect to the India-Singapore DTAA as follows:

India:

In respect of withholding taxes – 1 April 2020

In respect of other taxes – 1 April 2020.

Singapore:

In respect of withholding taxes – 1 January 2020

In respect of other taxes – 1 April 2020.

The articles from the MLI as incorporated in the synthesized text of the India-Singapore DTAA are paragraph 1 of article 6 (Purpose of a Covered Tax Agreement) of the MLI, and paragraph 1 of article 7 (Prevention of Treaty Abuse) of the MLI, with applicable modifications as outlined in the synthesized text.

INDIA AND UK:

The synthesized text for the application of DTAA between India and the UK was prepared based on the instruments of ratification deposited by India and the UK on 25 June 2019, and 29 June 2018, respectively. The MLI entered into force for India and the UK on 1 October 2019, and 1 October 2018, respectively.

Unless stated otherwise in the synthesized text, the provisions of the MLI will come into effect with respect to India–UK DTAA as follows:

India:

In respect of withholding and other taxes – 1 April 2020.

UK:

In respect of withholding taxes – 1 January 2020

In respect of corporation taxes in the UK – 1 April 2020

In respect of income and capital gains taxes in the UK – 6 April 2020.

The articles from the MLI as incorporated in the synthesized text of the India-UK DTAA are: Paragraph 1 of article 6 (Purpose of a Covered Tax Agreement) of the MLI; paragraph 1 of article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its own Residents); paragraph 1 of article 4 (Dual Resident Entities) of the MLI; paragraph 4 of article 13 (Artificial Avoidance of Permanent Establishment Status through Specific Activity Exemptions); paragraph 1 of article 15 (Definition of a Person Closely Related to an Enterprise); second sentence of paragraph 1 of article 16 (Mutual Agreement Procedure); second sentence of paragraph 3 of article 16 (Mutual Agreement Procedure); and paragraph 1 of article 7 (Prevention of Treaty Abuse) of the MLI with applicable modifications as outlined in the synthesized text.

DIGITALIZATION

Currently there has been a lot of developments in the digital world and even though it is true that things have been more convenient happening at the click of a button, enabling the development of trade and commerce through technology, that is not confined to any region or territory, the rapid growth that has erased geographical boundaries, has brought along with its several challenges to the economic aspects of a country. As there is no physical place of operation, the countries are looking for new methods to monitor such transactions. Even after working on the issue for a long time, even the OECD was not successful in arriving at a

permanent dependable solution till date. As such, it has been causing huge losses to the revenues of the countries.

VII. INDIAN FINANCE ACT 2020 AND INTERNATIONAL TAX

Aligning Tax Treaties with Multilateral Instrument (MLI).

India has entered into Double Taxation Avoidance Agreements (DTAA) with about 100 countries over the years. India has since also signed and ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) which is the outcome of G-20-OECD initiative on international taxation. As a result, MLI has come into force for India on 1st October 2019 and its provisions will be applicable on India's DTAAs from FY 2020-21 onwards.

Article 6 of MLI contains the Preamble to be incorporated to all the Covered tax agreements which also specify about minimum standards and it shall apply invariably to all the signatories of MLI. To incorporate such preamble in the statute itself, it is proposed to amend clause (b) of sub-section (1) of section 90 of the Act so as to provide that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for, inter alia, the avoidance of double taxation of income under the Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of any other country or territory).

Finance Bill 2020 proposes to empower the Central Government to enter into agreements with governments of other countries to give effect to MLI for avoidance of double taxation of income but without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty-shopping arrangements aimed at obtaining reliefs for the indirect benefit of residents of any other country or territory.

Profit attribution rules for Permanent Establishments of non-residents

Safe harbour rules were presented in 2009 by means of Section 92CB of the Act to give conditions on fulfilment of which move cost proclaimed for universal exchanges between Associated Enterprises will be acknowledged. Correspondingly, arrangements were presented in the Act in 2012 enabling the Board to go into Advance Pricing Agreements (APA) for deciding Arm's Length Price of worldwide exchange entered by an individual with its

Associated Enterprises.

Finance Bill 2020 proposes to empower Board to frame rules for determination of profits attributable to the Permanent Establishment of a non-resident in India.

VIII. COVID-19:

As nothing is fixed in this ever-changing universe the sudden arrival of the pandemic COVID-19 has raised several questions. The sudden outbreak has impacted the entire world and the policy makers in India and as well as the whole world are looking for answers on how to counter its effects on the economy as they are aware that its effects have long term effect and has brought up new challenges as the lockdown has impacted the businesses significantly. The ever-optimistic OECD has been seeing such hurdles several times. OECD BEPS action items was triggered because of the financial crisis in 2008 and again after a decade, this pandemic crisis, which has also resulted in financial crisis is weakening the economies globally.

There has been a lot of criticism that OECD works in favor of the developed nations. But as a matter of fact, it is actually doing a commendable job in coming to a uniformed solution globally, which by itself a herculean task. It was expected that in the year end during the G20 Summit at Saudi Arabia a final report of the technical details of the consensus-based solution shall be released, but the global pandemic has shifted things further uncertainly and even in the event if the meeting happens, it is . As a result, it is certain that the nations would give priority in restoring their economy than focusing on the multilateralism. There is a lot of uncertainty looming around, because of the pandemic, as there will be major changes in the working policies and as well as international relations, as there will be a lot of political discussions in the future steps to be taken.

To implement the BEPS measures in an effective manner to achieve the projected goals, it would take a high level of commitment between the member nations. Even though it is true that there are flexible options provided, the same freedom should not lead to further exploitations. As of now it would be premature to depict the future outcome of how MLI will transform the text of the tax treaties in the era of challenges.

A lot of pressure would lie on the tax experts as they would have to work along with the new changes that come with the implementation of MLI as there is still certain ambiguity in the interpretation of the clauses. But the positive aspect is that there would be a lot of learning with respect to international law. If the MLI proves to be a successful accomplishment, the trend in internationalization of tax law is surely going to continue and as a result, in the future

may be much better international instruments would be developed by the OECD to address the other unconventional interactions that are bound to arise in the global tax treaty network.

Taxes have been in existence from a long time and play a major role in the economy of a country. It has always been reminded that there is a lot of care and caution to be taken while addressing issues related to taxation or else it might yield undesired results. Similarly, there would be a lot of challenges to be faced while implementing the MLI as it needs to cater the needs of taxation of several nations. Due to the highly competitive market and a decreased profit margin, multinationals are trying all possible options to make profits by evading taxes. The earlier tax treaties were easily exploitable for their benefits, but MLI is looking promising to curb all tax evasive practices especially by countering BEPS.

It would take a lot of time to make changes to the tax policies, as the global economy is fragile, and the challenges are astronomical. It sometimes appears that the OECD is over predictive about the results, but it is too soon to conclude anything. The world is changing day in and out and the pandemic COVID-19 has made huge impact on the nations and as well as their economies. Lockdowns has resulted in production and movement of goods resulting in huge losses to multinationals. There was no plan to counter such hard times and as such the nations are by themselves fighting against the pandemic along with plans on how to bring back the economy to its previous stable form.

IX. CONCLUSION

Weakened economy would certainly take a long time to return to its initial glory and in the mean time when the nations are looking towards the after effects of the pandemic, it is highly unpredictable what the future holds and in what way the implementation of OECD BEPS holds its ground. The future cannot be predicted and in such unsure circumstances, a lot of rethinking needs to be done in arranging the priorities. In short time, there has been noticeable improvements in the implementation of BEPS actions and the results have been certainly felt. But for a fuller achievement of the projected goals, all the member nations need to work together aggressively towards equality and once the pandemic subsides, we would all need to start together afresh in building the economy of the country, one step at a time and only after things return to normal, we would be able to see the positive outcome of the OECD BEPS Action Plan.
