**CAHIERS MAGELLANES-NS**
Volume 06 Issue 2
2024

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

# THE ROLE OF MULTILATERAL INSTRUMENTS AND ITS IMPACT ON WITHHOLDING TAX UNDER INDIAN TAXATION LAWS: A CRITICAL ANALYSIS OF INDIAN TAXATION TREATIES UNDER ECONOMIC GLOBAL SUSTAINABLE GROWTH

**Kankana Ghosh**
PhD Scholar (law)
Amity Law School Jaipur,
Amity University Rajasthan

**Prof. Dr. Saroj Sharma,**
Dean, School of Law,
Presidency University,
Bangalore, Karnataka.

**ABSTRACT:**

***"Better business conduct leads to thriving global economy".***

*Multilateral Instruments are the Multilateral treaties that enable jurisdictions to swiftly modify their bilateral ta treaties to implement measures designed to better address multinational tax avoidance. These measures were developed as part of OECD/G20 Base Erosion and Profit Shifting (BEPS) project. India has manifested the role of Multinational agencies which aims to spur the economic development through alleviating poverty along with preserving the environment by reducing carbon emissions and generating electric transmitting gadgets which accelerates high scale of Capital investment even in the foreign entities dealing with the gadgets of economic sustainability.*

*Though Multilateral Development Bank (MDB) provides grant to fund projects that provides both social and economic development but still Indian MLIs face utmost challenges in hearing the bilateral tax treaties signed under OECD Model convention.*

*Hence, this Article seeks to analyse how MLI overrides the global treaties that are treated as the throny problem for escorting the amount of tax from the global arena and highlighting the loopholes of the taxation treaties leading Tax evasion and Tax avoidance within the territory of India.*

**KEYWORDS:** Base Erosion Profit Shifting, General Anti-Avoidance Rules, Specific Anti-Avoidance Rules, Multilateral Instruments, Economic Sustainability, Multinational Enterprises.

## INTRODUCTION:

Multilateral Instruments are the pile of multilateral treaty which enables the territorial jurisdictions or the nations entering into an agreement modifying their bilateral tax treaties for third party tax avoidance. Though India is not a member country to OECD but India became a signatory to the OECD's MLI treaty along with 67 other jurisdictions in the year 2017, June 7. The Multilateral Instruments (MLI) has got a way forward by an intergovernmental organization. OECD has implemented the Multilateral

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

Convention to implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting as Action 15.

OECD (Organization for Economic Co-operation and Development) has been stimulated in relation to Economic growth and fostering advancing world trade. It has provided a platform for seeking answers to the problems arising among its member countries. It has worked for better coordination in good domestic practices and moreover adopting and executing international policies among its members.

MLI came into force on 1st July 2018. The framework for G20 millennium has dragged to involve 125 countries to collaborate with India involving them to put end on tax avoidance strategies by introducing the scheme of Base Erosion and Profit Shifting (BEPS) action plan that aims in exploiting gaps in paying aggressive taxes and eliminating double taxation by combating opportunities over the various mismatches in tax rules between the countries.

Structure of MLI:

MLI consists of 39 Articles:

- *Article 1 and 2 set out the scope of MLI;*
- *Article 3 – 17 deal with BEPS tax treaty measures;*
- *Article 18 – 26 cover provisions related to mandatory binding arbitration;*
- *Article 27 – 39 contain procedural provisions such as provisions relevant to adoption and implementation of the MLI including ratification, entry into force and entry into effect dates, withdrawal etc.*[1]

Multilateral trade agreements have indeed focused on strengthening the economy to be competitive among the developed countries. It has standardized both the import and export procedures and enriched India with giving various economic benefits from and to all other member nations.

India has proved to be the signatory to MLI along with other developed countries who have expressly desired to do so. Such as – UK, Canada, Germany, India, Italy and Russia.

BEPS measures involves time to time amendments to Double Taxation Avoidance (DTA), domestic laws, exchange of information about tax payers, exchange of advance rulings/tax reliefs given by other countries, peer review of countries who provide tax reliefs which erode other countries tax base etc when requires.

The objective is that profits are taxed where economic activities generating profits are performed and where value is added.

MLI modifies the operation of the DTA to the extent of BEPS measures only.

Article 3 to 15 (in part II to IV) are the operative parts of the MLI. These will directly modify the DTAs (if agreed by countries who have signed the DTA). These articles cover following BEPS Action reports:

a. Hybrid Mismatches (Action 2);
b. Preventing Treaty Abuse including treaty shopping (Action 6);

[1]OECD & MLI SIGNATORIES, http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (last visited April 20, 2024).

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

c. Artificial Avoidance of PE (Action 7).

The person(s) qualified for DTA application are such as, an individual residing in the member nation of the treaty, political divisions etc. Moreover, it includes the company or entity where the principal class of shares is regularly traded on one or more recognized stock exchanges. It even involves the Non-profit organizations of the member countries that has been agreed for DTA.
Examples:

a. India - Mauritius DTA;
b. India – Singapore DTA;
c. Indirect Transfer.

Each party to the MLI must notify tax treaties to which the MLI provisions would apply. MLI provisions would apply to a tax treaty only if both parties to the tax treaty notify it as Covered Tax Agreement (CTA).[2]

**GENERAL ANTI-AVOIDANCE RULES:**

Mostly the mature economies like USA, UK, Canada, Austria, France and Germany. Currently, India is even have adopted a cautious approach towards introducing the 'General Anti-Avoidance Rules' in Indian taxation economyafter the Indian Supreme Court pronounced a long-awaited decision in the landmark Vodafone Case. The highest authority of the Indian Judiciary even found it evident to enact the concept of GAAR in the Indian economy which aims to empower the Revenue Authority for not allowing any tax benefits to the arrangements who do not have the commercial substance for any transactions.

The inappropriate planning in taxation system often creates uncertainty, abuse and difficulties for the taxpayers for both domestic as well as foreign inward investments.

From the judgement of Supreme Court, it has been analyzed that a sound business has to be always demonstrated in a particular structure and the taxpayer should presume the GAAR transparently.

The Judgement of Indian Judiciary has undergone in favour of Vodafone group which had a battle of around 2.2 billion of taxing amount which required clarity from the foreign investment taxation system through offshore investment vehicles.

As Vodafone has acquired the India operations of Hong-Kong Hutchison Whampea Ltd for around 10 billion.

Therefore, it has been argued by the Indian government that the assets based in India requires to have tax transacted to Indian Government.[3]

**IMPACT OF MULTILATERAL INSTRUMENTS OVER TAX TREATY NETWORK:**

In the era of Globalization, the economic impact has increased the gap in taxation system in between the different countries. For facilitating effective cross border investments, the work-stream of OECD put emphasis on reducing the double taxation system which resulted to design double tax treaties to

---

[2]Multilateral Instrument (MLI) Ratification. *Impact on Indian tax treaties.* August 2019, *available on:* www.in-tax-multilateral-instrument-ratification-noexp.pdfDeloitte. pg 1 - 14 (last visited at: May 02, 2024).
[3]Tax Policy, www.Pwc.cz/taxpolicy (last visited at: May 04, 2024).

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

strike a balance on the taxation amount on bilateral treaties or trade.
GAAR has led to negative sentiments in the environment. Foreign Institutional Investors, for example, who were net buyers in the initial months in 2012, turned into sellers as there is still uncertainty about their investments.
In the era of Globalization, the economic impact has increased the gap in taxation system in between the different countries. For facilitating effective cross-border investments, the work stream of OECD put emphasis on reducing the double taxation system which resulted to design double tax treaties to strike a balance on the taxation amount on bilateral treaties or trade.
The OECD Model Tax Convention is based to introduce taxation rules into multiple bilateral tax treaties. And hence the MLI has to be designed flexibly to reflect the following minimum standards –

- Allowing the jurisdictions to specify the tax treaties to which the MLI applies;
- Creating flexibility with the provisions that relate to a minimum standard in order to allow countries to choose the option that fits them the best;
- Including the possibility to opt in or out of provisions in case the provisions do not relate to a minimum standard;
- Including the possibility for a country to opt out of provisions for treaties that have existing provisions with specific and objectively defined characteristics;
- Providing a choice to apply optional or alternative provisions, for example the optional provision on mandatory and binding arbitration.[4]

The concept of 'Multilateralism' has been found evident in bringing global changes even in Indian taxation arena during cross-border transactions. "Mr. Akhilesh Ranjan, a former member of Central Board of Direct Taxes" has considered the epitome of developing a single instrument which may change at least 3000 existing tax treaties. Even 90 MLI signatories on Indian Board has shown successful results in the Global Consensus.
India has completed the process of ratification to include the MLI provisions with the OECD on 25th June 2019.
The two components that has been adopted to test the eligibility of the income recipient of the other country to enter into cross-border transactions are as follows:

A. PPT (Principal Purpose Test): It contains both RPT (Reasonable Purpose Test) and Object & Purpose Test Carve Out.

RPT seeks to obtain the tax benefits, either directly or indirectly.
And Object & Purpose Test Carve Out provides to allow the grant of benefits despite of obtaining tax benefits to the MLI holder if the objective and purpose of the MLI is relevant of the treaty.

[4]How Multilateral Instruments are impacting tax treaty network? https://www.ey.com>en-in>how-multilateral-instruments-are-impacting-tax-treaty? (last visited at: May 06, 2024).

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

B. SLOB (Simplified Limitation of Benefits).

The Indian MLI and treaties are patterned in the following forms:

I. OECD (Organization for Economic Cooperation and Development): It is an organization formed by 37 democratic countries in order to develop the policies among them that is related to sustainable economic growth.

II. DAPE (Dependent Agent Permanent Establishment): In comparison to OECD patterned treaties, the DAPE definition in many Indian treaties are boarder even before MLI were launched and organized. For instances, many treaties signed by India with Japan, Russia, Singapore, Australia and the UK contain a scope for covering persons who habitually secure orders which converges with the MLI proposal.

III. PoA exemption, anti-fragmentation rule and anti-splitting rule: MLI provisions related to the aforesaid mentioned is currently not a part of the existing treaties of Indian signatories. The Indian tax treaties that require modification in MLI signatories are with Australia, Ireland, Japan, Netherlands, Russia and UK.

**BASE EROSION AND PROFIT SHIFTING(BEPS):**

BEPS is the project undertaken by the mostly OECD and G20 countries which refers to the tax strategies that prose the gaps and other mismatches found in the taxation rules involving cross-border transactions. It is an action plan that involves to make the taxation profit disappear and reduce taxation abuse even to the jurisdictions where there is very less or no real activity of business transactions are found.

The BEPS action plans are structured around three fundamental pillars:

A. Introducing Coherence:

The Indian taxation rules are staked together that affect the cross-border activities. It works over the following grounds -

a. Limiting interest deductions as instances there had a time when a taxpayer or business enterprise pay interest in certain cases then the interest get deducted from the income that is subjected to pay tax which is abundantly applicable in recent time;

b. Countering hybrid mismatch arrangements and countering tax avoidance or abuse;

c. Countering harmful tax practices.

B. Improving Transparency:

It relates to transfer pricing documentation which works for providing information regarding the global operations (various business units providing goods and services to international market by allowing exposures and enacting regulations) and the financial information of the various companies to the revenue authorities. It ensures the setting of prices to the revenue authorities transactions occur during

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

the transfer of property or services between associated MNC group under common control.

C. Reinforcing Substance:

It strengthens the international standards with alignment of taxation by preventing treaty shopping, enhancing rules related to creation of permanent establishment for taxation in the source country.
Limiting for enjoying the treaty benefits negotiated only between the parties, rather than any third party.
In addition to the aforesaid mentioned components, there are other forms of treaty abuse. Such as:

a. Dividend transfer transaction that artificially lowers withholding tax on dividends;

b. Transaction that circumvent the rule that prevents source taxation of sale of shares deriving value primarily from immovable property;

c. Taxes has to be paid for the entities having dual residencies;

d. To address the treaty abuse through transfer of property and assets to a permanent establishment where the company establishes its operations in a foreign country to generate local income.

When a person sell its holding prior of receiving the return from the income, then it stands the same holding gets reinvested. As, the person selling the holdings no longer involves with receiving any investment.
Therefore, the income shall move into capital account and the transaction shall refer as 'Dividend Transfer'.
Here, it refers that the Dividend transfer cannot lower the tax withholding on Dividend (tax deducted at source from payments by an employer made to non-residents).
According to section 195 of Income Tax Act 1961, the tax shall be withheld @20% (plus applicable surcharge and less) on the amount of final Dividend payable.[5]
The OECD Model Convention 1963 has been followed by the second Regional tax Conference in Mexico and the Fiscal Committee organized in London during the year 1943.
The OECD Model Convention has been drafted in-order to avoid the Double Taxation Avoidance Agreement (DTAA) by its member countries. It worked to avoid the double taxation on income and capital gains. It worked for eliminating tax evasion, set a platform for conflict resolution and fostering economic trade and cross-border investments.
It avoids the double taxation payment when the source overlaps to the residence rule simultaneously or when a business holder becomes a resident of two or more countries at a time then the treaty comes to the picture.

[5]Geeta Jani, *How can businesses assess Multilateral instruments led changes in India's tax treaties?* EY INDIA. May 27 2024, 12:52 AM) https://www.ey.com>en-in>tax>how-can-businesses.

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

**INTERPLAY BETWEEN INDIAN TAXATION TREATIES & INDIAN INCOME TAX ACT, 1961 :**

India's tax treaty regulatory framework is provided under section 90, section 90A and section 91 in the Income Tax Act 1961.

Under Section 6 of the Income Tax Act, a resident of India is taxable for its global income. And in case of non-resident of India, the person is liable to pay tax if it originates any of its income within the jurisdiction of India.

In *Deputy Commissioner of Income Tax V. ITC Ltd.,* it has been held that a taxpayer is either opt to pay its tax upon the DTAA agreement or as per the normal rates and the provisions of the Income Tax Act, which ever amount is more favourable for the taxpayer.

Section 90 of the Income Tax Act empowers the Central Government of India to enter into an agreement with any foreign government and provides relief for paying taxes twice in both the countries. The business entity is subjected to pay the tax either only under the Indian Income Tax Act or under the Income Tax Act prevailing in the foreign country. It provides relief measures in the situation of exchanging information on the tax avoidance or tax evasion or investigation of cases on tax evasion.

Under section 90, only the resident assesses can claim double tax relief. In case of non-resident assesses, they requires to obtain a Tax Residence Certificate (TRC) from their respective countries.

Under Section 90(4) of the Act, in the case of a Non-Resident Assesses, the benefit of tax treaty should been entertained by the Assessing officer will be only after submission of the TRC. The same applies even under section 90A of the Act, where Central Government of India is empowered to enter into agreement with any specified association that is established outside the territory of India.[6]

DTAA (Double Taxation Avoidance Agreement) prevents an individual to pay tax to both the Indian and Foreign Government where he/she is working as expatriate. It prevents both the Indian and foreign governments from levying taxes simultaneously. Through the DTAA agreement, both the country parties allow relief to the individual working in foreign country through a foreign tax credit or exemption method under the bilateral agreement to ensure a one-time tax deduction.

Under Section 90A and Section 91 of the Act, if an individual earns income from foreign entity associated in foreign country than the individual is liable to pay a levied percentage of tax to both the countries as per the DTAA agreement. Whereas, under section 91 of the Income Tax Act, an individual is eligible to claim tax relief if the DTAA agreement is absent between the two countries (India and another country). India has DTAA with more than 94 countries, however, double taxation relief is granted even on income from other countries Section 91 of the Income Tax Act, 1961.

The unilateral relief method is applicable in this case due to the absence of DTAA.

Since, the individual is paying taxes in two different countries, the lowest payable tax rate can be claimed as tax relief.[7]

**Treaty Shopping:**

Treaty shopping has been common in the context of Corporate restructuring. However, natural persons

[6] DELOITTE, Base Erosion and Profit Shifting (BEPS) Analysis and India Outbound Perspective 2017, https://www2.deloitte.com>dam>tax-2016pdf. (last visited June 06, 2024).

[7]Prabhakar KS, *Indian Tax Treaties and Most Favoured nation Clause,* TAXMANN (June 07, 2024, 10:09 AM), https://www.taxmann.com>international-tax>top-story.

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

can also resort to treaty shopping by changing their nationality or acquiring another one.
Treaty shopping is a phenomenon of International tax matters. It is not a phenomenon introduced to take benefits of a favourable tax jurisdiction and even practising tax evasion between both the countries. According to Action 6 of BEPS was conceptualized to cater to the three broad objectives of treaty abuse and treaty shopping:

A. To clarify that tax treaties are not intended to be used to generate double non-taxation;

B. To identify the tax policy considerations that in general countries should consider before deciding to enter into a tax treaty with another country;

C. To develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

To include treaty benefits, following are the elements that countries would implement in their tax treaties:

A. The combined approach of a LOB and PPT rule;

B. The PPT rule alone;

C. The LOB plus a mechanism to deal with conduit financing arrangements.

Countries like India, US and Japan essentially avail the LOB rule which limits the availability of tax treaty benefits that meet certain conditions based on legal nature ownership and general activities of the entity and is objective in nature.
On the other hand, the PPT rule seeks to deny tax treaty benefits if one of the principal purposes of the transaction or arrangement was to obtain treaty benefits.
In addition to the above, there are targeted rules to address other forms of treaty abuse:

A. Dividend transfer transaction that artificially lowers withholding tax on dividends;

B. Transaction that circumvent the rule that prevents source taxation of sale of shares deriving value primarily from immovable property;

C. Dual residency of entities;

D. Transfer of property and assets to a permanent establishment.

A new rule is proposed to provide that tax treaties do not generally restrict the tax-ability in the state of residence. It is also proposed to clarify that departure or exit taxes and are not in conflict with tax treaties.
Historically, the Indian Jurisprudence has respected the form of the transaction, unless the form itself is sham and thus have rejected the approach of the tax authorities to deny treaty benefits on the ground of treaty shopping.
The Supreme Court in the landmark judgement of Azadi Bachao Andolan has held that in absence of

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

LOB clause in the tax treaty, treaty benefit would prevail.
Various treaty negotiations such as ‘India-Singapore tax treaty’, ‘India-US tax treaty’, ‘India-Armenia tax treaty’, ‘India-Iceland tax treaty’, ‘India-Mexico tax treaty’ and ‘India-Finland tax treaty’ were arranged in such a manner where the main purpose was to avoid taxes, i.e., the PPT rule.
Hence, the tax payers have to convince the tax authorities that the transactions have not been carried out with the primary purpose of tax avoidance.
For instances, ‘The India-Luxembourg tax treaty’ contains a provision for supremacy of domestic anti-abuse provisions apart from the PPT rule.
Tax treaties such as ‘India-Singapore tax treaty’, ‘India-Mauritius tax treaty’ and ‘India-Cyprus tax treaty’ has been amended to provide anti abuse rules on taxation of capital gains.
On the legislative front, the Indian Government has recognized that treaty shopping results in tax leakages. Therefore, over the past few years, the Indian Government has been working to tighten the rules in the Indian tax law for granting tax treaty benefits. India has included various clauses in its domestic law, some of which are as follows:

A. Mandating requirements to furnish a tax residency certificate along with a self-declaration confirming certain basic information, as a minimum threshold to claim tax treaty benefits;

B. The provision of levying higher withholding tax in the absence of Indian PAN/specified documents;

C. Reporting and taxing of indirect transfers materially modifying the ownership structure or control of an Indian entity;

D. Adoption of place of effective management as a threshold for determining residency; and

E. Limiting interest deduction on borrowings from non-resident associated enterprises.

Hence, in the year 2012, Indian Government codified the General Anti-Avoidance Rule (GAAR) and made it effective from 1st April 2017.
Action 6 of BEPS recommended the PPT rule in the purview as the Indian GAAR has empower the revenue authorities to go deeper into the transactions and/or arrangements (eg. Looking at ownership structures, beneficial ownership, voting rights etc) and would enable them to draw inference whether a particular entity is a conduit entity without any real economic substance/activity with the main purpose being obtaining a preferential tax benefit.
The Indian GAAR also overrides tax treaties, which is consistent with the OECD commentary on anti-avoidance rules which is specifically included in various bilateral treaties that India has entered into ‘India - Luxmenbourg tax treaty’, ‘India - Malaysia tax treaty’, ‘India - Singapore tax treaty’, ‘India - Israel tax treaty’ ‘India - Indonesia tax treaty’ ‘India - Korea tax treaty’, ‘India - Macedonia tax treaty’, ‘India - Thailand tax treaty’.
Many countries around the world have enacted or are in the process of enacting anti-avoidance provisions in their domestic tax laws. Similarly, many countries are also proposing to re-negotiate tax treaties to incorporate PPT/LOB clause in their tax treaties. This process of re-negotiating tax treaties will be eased with the signing of Multilateral Instruments.

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

To conclude the LOB/PPT rule and anti-avoidance rules that may impact intermediate holding companies for investing outside India, which lacks substance and have been interposed only to avail tax treaty benefits.
Indian MNEs that have made investments or are doing business outside India need to review their existing operational structure, arrangements, agreements and investment modes to consider whether they are sufficiently robust to withstand a potential challenge under the LOB/PPT rule and anti-avoidance rules.
The signing of MLI under BEPS Action 15 has been updated that India has signed on the minimum standard for tax treaty abuse applicable to all Indian tax treaties by adopting the PPT and simplified LOB.
Moreover, it has introduced the express statement in the preamble of the treaties that common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

**Dispute Resolution and Implementation of Multilateral Instrument:**
Countries participating in BEPS agree that the introduction of the measures developed to address BEPS should not lead to uncertainty for taxpayers and unintended double taxation.
Therefore, refining dispute resolution mechanism is a vital and integral component of the work on BEPS issues.
With the above in view, the guidance in Action14 of the BEPS Action provides for implementing "minimum standards" and "best practices" to enhance the effectiveness/efficiency of the Mutual Agreement Procedure (MAP) process. The minimum standards require countries to ensure that -

A. Treaty obligations related to the MAP are fully implemented in good faith and the MAP cases are resolved in a timely manner;

B. Implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and

C. Taxpayers can access the MAP when eligible.

In addition to above minimum standards, a set of best practices have been provided for such best practices includes implementation of bilateral advanced pricing arrangements, suspension of collection during pend-ency of MAP cases, training for tax examiners, access to MAPs for taxpayer - initiated adjustments etc.
Along with Action 14 of the BEPS Action the MLI provides a separate Chapter V on "Improving Dispute Resolution", which inter alias provides for inclusion of Articles of OECD model convention on MAP [Art. 25 (1) to 25 (3) in all tax treaties]. If a tax treaty related case qualifies to be considered under the MAP, upon the request of a tax payer, who can approach competent authority of either of the contracting jurisdiction, the contracting authorities should endeavour to agree between themselves how

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

double tax agreements should apply and implement any agreement.[8]
In the purview of Indian Government, BEPS is a negative phenomenon as it reduces the revenues for countries that levy high taxation rate.
According to Anti-base erosion profit shifting (BEPS) measures, it limits the maximum net interest deduction to 30% of Earnings Before Interest, Taxes, Depreciation, Amortization (EBITDA).
BEPS 2.0 has two parts or pillars, namely Pillar one and Pillar two.
Pillar one is focused on the reallocation of (a portion of) the consolidated profit of a MNCs to jurisdictions where sale arise as well as the standardization of the remuneration of routine marketing and distribution activities.
As a result, India may need to revise or defer the SEP concept or seek to incorporate it into the pillar one agreement.
Therefore, BEPS 2.0 will have a significant impact on India's taxation of the digital economy and may require some adjustments to the existing or proposed unilateral measures.
BEPS due to multinational enterprises exploiting gaps and mismatches between different countries tax system affects developing countries disproportionately due to their higher reliance on corporate income tax.
The view of Government across the world is that the current international tax standards have not kept pace with the changes in Global Business Practices. Many Countries have perceived the relevance of adopting BEPS as these reports include recommendations for significant changes in key element of the international tax architecture.

**India's support towards the BEPS project -**

Since the BEPS project aims to link tax with value creation, developing countries stand to gain from it. India has been one of the front-runners in the BEPS initiative. It is said that the Indian tax authorities position on certain tax matters for which they were criticized in the past (for being narrow-minded and revenue-focused) and then now find place under the BEPS Action plan.

**The effect of BEPS on the Indian tax environment -**

At the outset, India has already introduced certain provisions in its domestic law to deal with concerns highlighted under the BEPS Action plan. The imposition of Equalization Levy, Country - by - Country reporting and Master File requirements under the transfer pricing provisions have their origins in the BEPS project.
The Finance Bill 2017 proposes special provisions to restrict deduction of interest paid by an Indian Company to its associated enterprises where the interests pay-out exceeds INR 10 million a year. The interest deduction in which cases will be restricted to 30% of the EBITDA of the borrower. A significant impact of the MLI could be felt in the areas of tax treaty abuse and artificial avoidance of Permanent Establishment (PE) status.
India has been witnessed many such circumstances, where the tax treaties has been amended between the countries with India, even after the MLIs were signed.
So, the Indian government went with the purview that once the MLI is signed, a substantial number of the treaties signed by India would be covered under the principles of BEPS project.

[8] *Id.* at 06.

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

Any aggressive tax planning by using loopholes/gaps in the existing tax treaty provisions could be thwarted by the Indian tax authorities. This would significantly affect intermediate/holding company structures and cash box companies.

Foreign entities operating in India under "Commissionaire" models could also witness a significant impact. A commissionaire model involves an Indian entity securing orders in India for a foreign entity such that the ultimate contract of sale is concluded outside India between the foreign entity and the Indian customer.

In such cases, under the existing regulations, the Indian entity pays tax on a small margin attributable to the marketing/sales function, commonly on a cost plus margin basis, even though virtually all efforts for securing the contract were carried out in India.

The MLI now provides, as an option that where the Indian entity plays a principal role in securing the contract, it can be considered as a PE of the foreign entity in India. This would require a higher attribution of profits to the Indian entity and increase the tax liability in India. The tax exposure here would also be linked to the transfer pricing policies of the Indian enterprise.

The MLI also contains provisions to deal with situations of artificially splitting contracts between different entities to avoid a PE status in India. The MLI provides for the aggregation of the contract in such cases to examine the constitution of the PE. This will significantly affect enterprises undertaking Engineering Procurement and Commissioning (EPC) contracts or dealing with specialized installations/works.

**Preparing for life under BEPS:**

Adherence to BEPS requirements would necessitate the evaluation of the functions performed by the Indian enterprise, the value added by it and its comparison to the overall functions performed by the group entities. Based on this evaluation, the PE exposure could be evaluated and the profit to be attributed to Indian operations could be determined based on transfer pricing principles. This activity could also involve amending the business model of the Indian entity to ensure tax optimization and risk mitigation.

India is actively following the BEPS recommendations and has been bringing amendments in the domestic law to be in line with BEPS regulations. A number of proposals in Indian Finance Act 2016, are influenced from the recommendations emanating from the final reports of the OECD under its Action plan on BEPS. These include implementation of Master File and Country - by - Country (Cbc) Reporting (in compliance with Action 13), introduction of equalization levy which requires withholding on gross basis for all payments in relation to certain specified digital services (Action1) and a 'Patent Box' tax regime for royalty income (Action 5).

Response to BEPS will have to be managed in a phased manner and will require proactive and timely planning.

Companies will have to build consideration of potential BEPS impact into current tax planning and prepare different scenarios for its application.[9]

When an Indian company enters into agreement with a foreign entity for joining ventures in an agreed

[9]Volume Number 9, CMA MRITYUNJAY ACHARJEE, CROSS BORDER TAXATION BASE EROSION AND PROFIT SHIFTING (BEPS) 8 - 10 (Tax Bulletin 2018). https://icmail.in>Article>8.pdf (last visited at June 09 2024, 11:09 AM).

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

price of composite contract. The payment thus gets spitted into the following parts:

A. Design of the plant outside India (payment for which is taxable at 10% on gross basis);

B. Offshore supplies of equipment etc (not taxable as no role is played by any PE in India. There are not subject to import duty);

C. Local supplies and Installation charges (taxable on net income basis);

Therefore, it is found that the value of fair market may get under invoiced. On the other hand, the offshore supplies may get over invoiced.

**PPT RULE VS. GAAR:**

A. The PPT rule is broader in its ambit than GAAR. Under the PPT, benefits originating from tax treaties can be denied if one of the principal purposes of the arrangement is to obtain a benefit.

However, GAAR requires fulfillment of the main purpose test as well as one of the tainted element tests. It is likely that if the structure satisfies PPT, it shall likely to pass GAAR test;

B. Also, with respect to the scope of operation of the PPT rule, the PPT rule applies only in cases of tax treaty abuse, i.e., where granting treaty benefit is against the object and purpose of the tax treaty,

Whereas, GAAR applies to all kinds of abuse of tax provisions e.g. use of structure to obtain benefit under domestic tax legislation.

Hence, one of the purpose of GAAR and PPT is prevention of granting treaty benefits being granted in an inappropriate circumstances.

Therefore, the application of these rules may pose a conflict between them i.e., which provision is supreme when it comes to application. A possible argument to avoid conflict is to the extent treaty provisions prevail over domestic law if the application f domestic law is not in accordance with the provisions of tax treaty. Further, some of the treaties allow application of domestic law over tax treaty.

The provisions of the PPT is transaction or arrangement specific and not an entity specific. When it comes to GAAR, its application is wider.

Therefore, to the extent GAAR applies, the purpose of PPT would become redundant i.e., in GAAR transactions can be re-characterized which might not be situation in PPT. For eg, the residence of entity is shifted to India by invoking GAAR.

Burden of proof is on the taxpayers in case of GAAR whereas in case of PPT, it is on tax authorities.

However, under both the provisions, the responsibility of providing primary facts and evidences will be on the taxpayers. Compared to GAAR, the test of PPT is very subjective and no discretionary relief can be granted by competent Authorities, therefore it would lead to more confusion than the clarity.

Further, unlike the Approving panel in GAAR, there is no separate panel or authority to decide whether PPT has passed the test required by MLI.

Hence, it is likely that the Income tax officer will refuse to provide treaty related benefits on the ground that the requirements of the PPT under the treaty were not met.

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

Section 90 of the domestic tax law provides that the provisions of the domestic tax law would apply to the taxpayer to the extent more beneficial than a tax treaty.
Grandfathering provisions are available in GAAR which prohibit the application of GAAR for income arising from transfer of past investments made before 1st April 2017. However, no grandfathering provisions are available in PPT.
Hence, one MLI is effective for India, then even transfer of past investments made before 1st April 2017 which are grandfathered under the GAAR provisions may be subject to PPT test. This in effect makes the application of PPT provisions re attractive.
Anti-abuse provisions thus if used in right spirit would serve the intended purpose provided that they are applied only in cases of truly abusive, contrived and artificial arrangements. Both the anti-avoidance rules, shall definitely increase the substance requirement in the tax treaties. MNCs may have to re look at the structures of their operation.
Hence, maintaining proper documentation to justify the commercial rationale of the transaction becomes important. It is to be seen how with the implementation of these anti-abuse rules, the difference between tax evasion and tax avoidance will fade away in coming years.[10]

**A NEW ERA DAWNS IN INTERNATIONAL TAXATION: CURRENT SCENARIO -**

India joined hands with 68 countries in signing the MLI at a recently conference in Paris on June 2023. India joined hands with 68 countries in signing the MLI at a recently concluded ceremony. India witness to avoid the BEPS implementation which refers to artificial shifting of profits by MNCs to low or no tax locations.
Such shifting of profits are achieved through gaps in tax rules of different countries along with the governing tax treaties. Such actions erode the tax base of the country where the value was created and is therefore considered to be an abuse of the tax framework.
To address the BEPS concerns, the BEPS project was developed by the OECD committee on Fiscal Affairs (CFA) and endorsed by the G20 leaders in September 2013. It identified 15 Action plans to deal with BEPS.
Implementation of certain BEPS Action plans required amendments to the tax treaties across the world, which was a herculean task as there exist more than 3000 tax treaties. To address this, the OECD constituted an ad hoc group of member countries to prepare the text of MLI which, once signed will simultaneously amend a large number of tax treaties.
The MLI provides for insertion of PPT as a minimum standard. The PPT seeks to expressly state in the preamble of tax treaties that the purpose of the treaty is not to create opportunities for tax evasion, tax avoidance or double non-taxation. As per PPT, the benefit of the tax treaty shall not be granted if obtaining such benefit was one of the principal purposes of any arrangement or transaction.
Since this is a minimum standard, the PPT shall be imposed in all the tax treaties entered into by India

[10]Nupur Jalan, *Anti-abuse rules- GAAR and PPT,* TAXMANN (June 19, 2024, 09:29 PM), https://www.taxmann.com>top.story.

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

with the countries participating in the MLI.
In addition to the PPT rule, India has agreed to a SLOB which seeks to create supplementary conditions to be satisfied to avail, the benefit of a tax treaty. However, India's prominent treaty partners have not agreed to the SLOB clause and as such, the practical applicability of the SLOB clause could be limited.
India has not accepted the MLI provisions relating to arbitration proceedings for dispute resolution and methods for elimination of double taxation. The double taxation relief will continue to apply as per the existing bilateral tax treaties.
India has accepted the provisions for prevention of artificial avoidance of PE under commissionaire structures, specific activity exemptions and artificial, splitting of contracts. Some of India's treaty partners have accepted these provisions but some have not.
Hence, the expanded PE exposure for Indian marketing operations of a MNC could vary from country to country.[11]

A. Treaty obligations related to the MAP (Mutually Agreement Procedures) are fully implemented in good faith and the MAP cases are resolved in a timely manner;

B. Administrative processes are implemented that promote the prevention and timely resolution of treaty related disputes;

C. Taxpayers can access the MAP when eligible as MAP is the mechanism that contracting states use to resolve any disputes or difficulties that arise in the course of implementing and applying the treaty. The MAP thereby ensures that these disputes will not frustrate the treaty's goal of preventing international double taxation.

MAP is an alternative available to taxpayers for resolving disputes giving rise to double taxation whether judicial or economic in nature.
The agreement for avoidance of double taxation between the countries would give authorization for assistance of competent Authorities in the respective jurisdiction under MAP.
In addition to above minimum standards a set of best practices have been provided for such best practices includes implementation of bilateral advanced pricing arrangements, suspension of collection during pend-ency of MAP cases, training for tax examiners, access to MAPs for taxpayer-initiated adjustments etc.
Action 14 of the BEPS Action the MLI provides a separate Chapter V on "Improving Dispute Resolution", which inter alias provides for inclusion of Articles of OECD model convention on MAP [Art. 25 (1) to 25 (3)] in all tax treaties.
Double tax agreements should apply and implement in agreement.

## ROLE OF MLI ON ECONOMIC SUSTAINABILITY IN INDIA:

Economic sustainability refers to practices designed to create the long-term economic development of a company or nation while also managing the environmental, social and cultural aspects of its activities.

[11] A NEW ERA DAWNS IN INTERNATIONAL TAXATION: CURRENT SCENARIO, https://www.mondaq.com>india. (last visited at July 01, 2024).

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

It is about balancing economic growth and generating profit with the impact on the environment and people.
It is about making business decisions by safeguarding the natural resources for future generations and still promoting the economy to grow.
It is a long term game which aims to prevent the emissions to be reaching its peak by 2025.
Competition can mean a race to the bottom but it also drives betterment. The more businesses that are received well due to their green credentials, the more other businesses will adopt this approach.
New businesses will more likely set themselves up for putting sustainable practices into every aspect of their new venture, instead of as an afterthought. In return, Success shall breed Success.
Economic sustainability shall positively boost the profits, efficiency and customer satisfaction.
Economic sustainability needs upgrade infrastructure at high scale which leads to the cost of high capital investment and that in return is the main barrier preventing businesses from switching their practices.
Apart from adopting Cleaner air, Cleaner water, reducing carbon emissions, the lowest hanging fruit in terms of energy efficiency is the lighting system. It alone can drastically cut the carbon emissions.
LED is the most efficient lighting technology available making it more environmental friendly than the old alternatives. The technology can reduce our energy consumption by 80% when combined with control systems like motion sensors, the savings are still greater.
Capital investment remains a barrier, but innovative companies like LUMENSTREAM are disrupting the market via LED lighting as a service.
After lighting, we would look at our heating and the running of any electrical equipment. Making improvements on how the heating and cooling of the premises is run can be costly.
It may even involve investing in insulating the building but it could significantly cut outgoings on our energy bills when done right. The Carbon Trust has a fantastic guide for energy saving which would help us identify areas where we need to make changes.
Use of renewable energy sources like no fossil fuel investment being made in UK and EU from August 2023 and all electricity generation to be fossil fuel free by 2035.
India have choose 'green tariff' where the electricity used by our business comes from renewable energy sources. The UKWA put together an investment case for rooftop solar panels for warehousing.
The statistics are very convincing for the benefits for the business and for the UK's Net Zero goals. UK warehousing alone could even prevent 2 million tonnes of carbon dioxide a year from entering the atmosphere while reducing electricity bills by 40 - 80%.[12]

## MLI & FOREIGN INVESTORS:

The MLI, a new global tax avoidance agreement is now causing a lot of anxiety among FPI (Foreign Portfolio Investors). MLI is an agreement put out by OECD, the intergovernmental economic organization implements it to stop 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.
The MLI tends to tackle BEPS collaborating anti-treaty provisions framing over 100 countries, among one of those in India which has signed the agreement before the first week of June.

[12] "The Importance of Economic Sustainability for Your Business", *Published* - Jan 11, 2023.

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

"The present understanding through the Research is that GAAR will override all treaties where it is applied. But it is still required to be classified that what shall 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 as it has been found evident that foreign investors have took a huge privilege to avoid the taxation pressure up to an incredible percent in terms of avoiding the growth of PE in the jurisdiction and thus paved the way for tax avoidance.
Under Section 94 (8) of the Income Tax Act 1961, since SAAR (Specific Anti Avoidance Rules) as well as GAAR tackle tax avoidance, there are certainly an overlap in both concepts. However, considerably that SAARs are specific provisions, one could say that transactions covered by SAAR would not be examined under GAAR since 'specific prevails over general'. On the other hand, if a transaction doesnot pass the parameters for invoking SAAR but gets covered under the ambit of GAAR, one can question the underlying intent and bring such a transaction to tax by invoking GAAR.
In this regard, recently the Telangana High Court had an occasion to examine whether a transaction could be termed as IAA thereby invoking GAAR when SAAR under Section 94 (8) of the IT Act is also relevant to the said transaction.
Tax experts found under MLI, that foreign investors would have to pass a 'PPT' to satisfy all countries that tax avoidance was not the chief purpose what complicates the matter is that participating countries have a right to specify, a 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 shall meet various conditions under the LOB becomes a concern or an issue".*
Tax experts stated that FPIs, private equity and all other foreign investors will have to pass through two key LOB tests, which are principal purpose and ownership criteria.
The fear is more of unknown as both MLI as well as GAAR were yet to be implemented.
"MLI is just an improvised version of a treaty and GAAR is a domestic tax law that may override the treaty. When both are put in practice the clarification can be further proceed by CBDT and that would help".
An optimal 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 PPT 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 not generally provide investors with the certainty that they require prior to make investments.[13]
"Assessing the financial benefits of sustainability best practices requires a consideration of both their fiscal and economic impacts".

[13]Palak Shah, *Multilateral Instrument: The New Dilemma of Foreign Investors,* THE ECONOMIC TIMES (July 26, 2024, 08:50 AM), https://search.app/vrMCP65EQYt08Msh8.

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

A. Fiscal benefits consist of reduced agency expenditures and increased revenues. Investments in a variety of sustainability strategies can start having immediate and long term impacts on a jurisdiction's fiscal condition such as -

I. Budget savings through reduced agency expenditures, including the costs of water, energy and infrastructure development and maintenance;

II. Boosting tax and free revenues through increased economic activity and property values;

III. Reducing long term liabilities through cost savings and lowered operating costs;

IV. Improving fiscal stability in times of uncertainty such as potential rises in energy and water costs;

V. Using these savings to make targeted investments that spur additional savings, revenues and economic development.

B. Economic development consists of improvements in the economic growth, competitiveness and vitality of a community. Sustainability strategies can improve a business bottom line enhance the built environment and attract new economic activity into more walk able and revitalized areas:

I. Sustainability best practices generate savings to residents and businesses through reduced expenditures on water, energy, gas and other resources. These local savings are then available to support additional local investments and economic activity;

II. Communities that are well planned with a variety of housing options, commercial developments and efficient and convenient transportation choices attract investments in new and expended businesses. These investments can increase local economic activity and employment, saving time and money for employees and employers alike;

Well designed communities and efficient transportation are especially important for retaining and supporting the competitiveness of small to medium sized businesses, which are the source of most employment growth;

III. Communities that create opportunities for residents through sustainability practices to engage in physical activity and make healthy food choices generally have healthier residents. The economic benefits include lower health care costs for business, employees and public agencies more productive employees and students are better prepared to learn.[14]

Tax treaties typically stipulate that the business profits of a foreign enterprise are subject to taxation in a jurisdiction only if the enterprise has a permanent establishment there to which the profits can be

[14]THE FISCAL AND ECONOMIC BENEFITS OF SUSTAINABILITY, https://search.app/bicjvFwWoc3b9Rvk6 (last visited at July 26, 06:09 PM).

ISSN:1624-1940
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

attributed. The precise definition of permanent establishment in these treaties is pivotal in determining whether a non-resident enterprise is liable to pay income tax in another jurisdiction.

In response to common tax avoidance strategies, as highlighted in the BEPS Action Plan, a review of the permanent establishment definition was deemed necessary. This was aimed at preventing tactics like replacing traditional distributors with commissionnaire arrangements, allowing for a shift of profits out of the jurisdiction where sales occurred without a substantial change in the functions performed in that jurisdiction.

## CONCLUSIVE OBSERVATIONS:

The nature of rural economies and the challenges and opportunities rural communities face leads to new ways of thinking about land use, resource management and economic development.
This practice also improves social equity, bringing greater participation from residents that cannot come to a typical community meeting due to work and care obligations, transportation limitations or disabilities.
Rural communities can benefit from a variety of sustainability practices that support their unique economic circumstances. By supporting and enhancing the economic vitality of existing town centers and neighbourhood and protecting open space and working landscapes, communities are able to build upon and preserve their unique character to better market themselves to both businesses and residents.
Coupled with targeted investment in new, vibrant neighbourhood, rural communities are able to create places that attract and retain residents, while promoting positive environmental, social and financial impacts.

## SUGGESTIONS:

I. Carbon emissions should not be desirably reduced by shutting down all the economic activities;

II. India should mobilize investment with collective actions from all stakeholder groups to achieve its path to net-zero;

III. GAAR should more focus on introducing anti-abuse rules relating to the taxability of dividends and capital gains in tax treaties;

IV. Indian MLIs should focus to adopt the MLI taxation treaties more in accordance to the rules of GAAR and PPT as the taxation treaties serves to prevail over GAAR, in according to OECD Model Convention;

## RECOMMENDATIONS:

I. The PPT rule within the MLI framework along with the GAAR will significantly increase the threshold of substance required by holding companies to avail treaty benefits;

**CAHIERS MAGELLANES-NS**
Volume 06 Issue 2
2024

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

II. Taxpayers shall need to be more conscious and cautious while setting up such structures as well as while exiting from existing structures given the subjective PPT rule.

## BIBLIOGRAPHY:

**A. Websites -**

1. OECD & MLI SIGNATORIES, http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf;

2. Multilateral Instrument (MLI) Ratification. *Impact on Indian tax treaties.* August 2019, www.in-tax-multilateral-instrument-ratification-noexp.pdfDeloitte. pg 1 - 14;
3. Tax Policy, www.Pwc.cz/taxpolicy;

4. How Multilateral Instruments are impacting tax treaty network? https://www.ey.com>en-in>how-multilateral-instruments-are-impacting-tax-treaty?;

5. DELOITTE, Base Erosion and Profit Shifting (BEPS) Analysis and India Outbound Perspective 2017, https://www2.deloitte.com>dam>tax-2016pdf.;

6. THE FISCAL AND ECONOMIC BENEFITS OF SUSTAINABILITY, https://search.app/bicjvFwWoc3b9Rvk6.

**B. Blogs -**

1. Geeta Jani, *How can businesses assess Multilateral instruments led changes in India's tax treaties?* EY INDIA. (May 27 2024, 12:52 AM) https://www.ey.com>en-in>tax>how-can-businesses.
2. Prabhakar KS, *Indian Tax Treaties and Most Favoured nation Clause,* TAXMANN (June 07, 2024, 10:09 AM), https://www.taxmann.com>international-tax>top-story. ;
3. Nupur Jalan, *Anti-abuse rules- GAAR and PPT,* TAXMANN (June 19, 2024, 09:29 PM), https://www.taxmann.com>top.story.

**C. Books -**

1. Volume Number 9, CMA MRITYUNJAY ACHARJEE, CROSS BORDER TAXATION BASE EROSION AND PROFIT SHIFTING (BEPS) 8 - 10 (Tax Bulletin 2018). https://icmail.in>Article>8.pdf (last visited at June 09 2024, 11:09 AM).

*ISSN:1624-1940*
DOI 10.6084/m9.figshare.2631062
http://magellanes.com/

**D. Magazines -**

1. A NEW ERA DAWNS IN INTERNATIONAL TAXATION: CURRENT SCENARIO, https://www.mondaq.com>india.;

2. "The Importance of Economic Sustainability for Your Business", *Published* - Jan 11, 2023.

**E. NEWSPAPER -**

Palak Shah, *Multilateral Instrument: The New Dilemma of Foreign Investors,* THE ECONOMIC TIMES (July 26, 2024, 08:50 AM), https://search.app/vrMCP65EQYt08Msh8.