BASE EROSION AND PROFIT SHIFTING (BEPS) PROJECT FINAL REPORTS AND AMENDMENTS IN THE INCOME TAX ACT, 1961

BEPS by the Multinational Enterprises (MNEs) globally through innovative and ingenioustax planning is of serious concern for the Governments of the countries, political leaders, medias & civil society.Hundreds of studies have been undertaken in this regard by the Government Authorities, International Organisations and researchers.

BEPS treads in the grey areas of tax avoidance and tax evasion.MNEsdo BEPS through aggressive tax planning. They availtheloopholes in the different tax laws & proceduresor in the bilateral Double Taxation Avoidance Agreements (DTAAs) between countries to artificially reduce their taxable income or by shifting profits to low-tax or no tax jurisdictions wherelittle or no economic activitiesare performed. In this way, a substantial amount of profits of MNEs disappear from tax net in any country of the world.

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This happens from the presence of tax haven countries offering tax benefits like low rates or even nil rates of taxation or tax deferral systems.

BEPS results in negative economic impacts,like significant Corporate Income Tax (CIT) losses, disadvantageous positions ofthe domestic enterprises in comparison to the tax-aggressive MNEs, excessive debtinclination by the corporates, foreign direct investments not on the consideration of efficiency of rate of return but on tax considerations etc.

To respond to this situation, at the request of the G20Governments,the Organisation for Economic Co-operation and Development (OECD) published an Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan, OECD, 2013) in July, 2013.

The principal goal of the BEPS Project was to ensure that profits of MNEs will be taxed only where economic activities are carried out &economic values are createdalong with the goal to eliminate the menace of double taxation.

Seven preliminary reports were published in September, 2014. Ultimately, on October 05, 2015 the 'OECD/G20 Base Erosion and Profit Shifting Project-2015 Final Reports' was

releasedcontaining 15 Actions.

BEPS Project Reports are not legally binding on the countries. However, all OECD and G20 countries agreed that BEPS Project recommendations will be implemented consistently.

Brief Descriptionsof each of the Actions recommended by the BEPS Project-2015 Final Reportsand their implementation status in Indiaare provided below.

1. ACTION 1: Addressing the Tax Challenges of the Digital Economy:

Digital economy is the outcome of thedevelopment of the Information and Communication Technology.

The business models of the digital economy include several types of e-commerce, app stores, online advertising, cloud computing, participative networked platforms, high speed trading, and online payment services.

Digital economy and its business models do not themselves culminated into BEPS issues, but some of its key features aggravated the risks of BEPS, like generation of stateless income.

Implementation Status in India

India introduced 'Equalisation Levy'under Sections 163 to 180 of Chapter VIII of the Finance Act, 2016 to address the tax challenges of the Digital Economy. Under this 'Equalisation Levy',barring three exceptions a person resident in India and carrying on business/profession or a non-resident having a Permanent Establishment (PE) inIndia while paying for 'specified services'to a non-residentshall deduct equalisation levy at the rate of six per cent from the amount paid or payable to a non-resident in respect of the 'specified service'.

Here 'specified service' means online advertisement, any provision for digital advertising space or any other facility or service for online advertisement and includes any other service as may be notified by the Central Government.

To take care of the menace of double taxation, Section 10(50)of the Income Tax Act, 1961 (Act)provides that if any income arising from any specified service suffers 'Equalisation Levy'then it will be treated as exempted income.

2. ACTION 2: Neutralising the Effects of Hybrid Mismatch Arrangements:

MNEs utilises differences in the tax treatment of an entity or instrument under the laws of two or more countries by arranging Hybrid Mismatches to avail the benefits of no tax in two tax jurisdictions or long-term deferment of the payment of taxes. For example, an instrument will be so constructed that it will be treated as debt instrument in one country and equity instrument in another country. In that case, when payment of interest on debt instrument will be deductible expenditure in one country, on the other hand the same payment will be treated as tax exempted dividend in another country.

To address this problem, the OECD/G20 BEPS Projectrecommended for designing of domestic taxation rules and development of model tax treaty provisions.

Implementation Status in India

India is yet to take any measure in this regard.

3. ACTION 3: Designing Effective Controlled Foreign Company Rules:

If a company (called parent company) of one country holds controlling shares in another company (called subsidiary company)located in a foreign country, thenthe second company will be called asControlled Foreign Company (CFC). MNEs often shift their income to a CFC and thereby erode the bases of their incomes in the countries of their residences and other countries.

BEPS report provides recommendations for CFC rules which are in the nature of blocking such shifting and base erosion of incomes.

Implementation Status in India

India is yet to make any rule on CFC.

4. ACTION 4:Limiting Base Erosion Involving Interest Deductions and Other Financial Payments:

The risks of BEPS arise in this respectthrough excessive debt financing (third party debt or intra-group loans) i. e. thin capitalisation of group entities in high tax countries and enjoying the benefit of consequential deduction of high interest payments.

To address this problem of BEPS, the recommended approach was to limit the deductibility ofnet interest payments (interest expense less interest income) and other payments equivalent to interest to a fixed ratio of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA). The report recommends a range of ratios between 10% and 30%.

However, in the case of high leveraging of a MNE group by third party debt due to non-tax reasons, the report proposes a group ratio rule (Net Interest/EBITDA ratio of the group) along with fixed ratio rule.

The report also allows replacement of fixed ratio rule by 'Equity Escape' rule which compares the quantum of equity and assets of an entity within a group to thequantum of equity and assets of the group.

The report admits the requirement of formulating suitable separate rules for the banking and insurance sectors considering their specific features.

Implementation Status in India

Section 94B (to be applicable from April 01,2018) of the Act provides that where an Indian company, or a PE of a foreign company in India, being the borrower, incurs any expenditure by way of deductible interest expenses or of similar nature of expenses exceeding one crore rupees in respect of any debt issued by thenon-resident associated enterprise of such borrower, the interest shall not be deductible in excess of thirty per cent of EBITDA of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

Even loan availed from third-party but guaranteed by an associated enterprise or against deposit of matching amount by an associated enterprise with that third-party lender,shall be deemed to have been loan availed from associated enterprise

The Section 94B excluded an Indian company or PE of a foreign company which is engaged in the business of banking or insurance.

Section 94B also provides for carry forward of interest expenses (which could not be deducted) for eight assessment years.

5. ACTION 5:Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance:

Presently, Intellectual Property (IP)occupies a pivotal position for the development of an economy. Because, a vibrant IP regime generates income and foster growth & employment. The BEPS Project agreed on the 'nexus approach'for providing preferential tax treatment in a country of the incomes from IP of a taxpayer.

This nexus approach requiresthat benefit of preferential tax treatment of income from IP can be availed by a taxpayer only to the extent it hasundertakensubstantial activity and itself incurred Research & Development (R & D) expenditures for development of the IP which leads to generation of income from that IP.

Implementation Status in India

The enacted Section 115BBF of the Act provides that income from patent developed and registered in India, by way of royalty shall be taxable @ 10%.However, no expenditure or allowance shall be allowed in computing the income from royalty.

6. ACTION 6:Preventing the Granting of Treaty Benefits in Inappropriate Circumstances:

BEPS Project identifies abuses of tax treaties (introduced to avoid double taxation)between countries i. e. treaty shopping one of the most important sources of BEPS.

Under the BEPS Project countries have agreed to counter this treaty shopping by including anti-abuse measures in their tax treaties and by enactment of General Anti Abuse Rule (GAAR). GAAR is based on the principal purposes of transactions or arrangements or Principal Purposes Test (PPT) which provides that if the principal objective of transactions or arrangements of an entity is to avail treaty benefit then the benefit will be denied.

Implementation Status in India

Indiaenacted Sections 95 to 102 and 144BA of the Act under GAARto combat the menace of treaty shopping.GAAR will be applicable,among other conditions,if main purpose of the arrangement is to obtain tax benefit by creating rights and obligations which are ordinarily not created between unrelated persons dealing in an uncontrolled environment or arrangements which either wholly or partly lac commercial sense.

7. ACTION 7:Preventing the Artificial Avoidance of PE Status:

According to tax treaties, profits from PE of a non-resident foreign enterprise located in a country are taxable in thatcountry.Other profits of that non-resident foreign enterprise are not taxable.Therefore, the definition of PE provided in the tax treaties is crucial in determining whether any profit of a non-resident foreign enterprise will be taxable in a country or not.

One of the common tactics employed by the MNEs to circumvent attraction of PE status in a county is commission agent arrangement. Here, commission earned by the person

from selling the products will be taxable in that country, while in fact, the foreign enterprise (which is the owner of the products and performing substantive functions in that country for marketing its products)will end up by paying no tax on the profits earned by it from selling the products in that country as the foreign enterprise has no PE in that country technically.

To curb these practices, changes are recommended to modify the definition of PE in the OECD Model Tax Convention.

Implementation Status in India

Clause (a) of Explanation 2 to Section 9(1)(i) of the Act amended(to be effective from April 01, 2019)the definition of 'business connection' to curb such practices. Henceforth, a person habitually exercising authority in India to conclude contracts or habitually concluding contracts on behalf of non-residents and also a person habitually playing a principal role leading to conclusion of contracts bynon-residents shall constitute 'business connection'in India.Consequently,incomesaccruing or arising directly or indirectly from such 'business connection'will be treated as incomes deemed to accrue or arise in India.

The Finance Act, 2018 also introduced Explanation 2A to Section 9(1)(i) of the Act (to be effective from April 01, 2019) to clarify the definition of 'business connection' in India. It has been clarified that 'significant economic presence' of a non-resident in India shall constitute 'business connection' in India. The term 'significant economic presence'has also been defined in the Explanation 2A.

It has also been provided in the said Explanation 2A that only so much of income as is attributable to the transactions or activities from such 'significant economic presence' shall be deemed to accrue or arise in India.

8. ACTIONS 8–10:Aligning Transfer Pricing Outcomes with Value Creation:

The BEPS Project Report identified that the allocation of profits from the intragroup transactions to individual members of the group following the existing international transfer pricing rules using the arm's length principle are not aligned to the economic activities undertaken in a particular country by a group member generating the profits.

Actions 8- 10 of the BEPS ProjectReport has tried to ensure that transfer pricing results are aligned with economic activities and value creationin a particular country.

Implementation Status in India

Several aspects of the international transfer pricing guidelinesrecommended by the BEPS Project Report are already practised and covered by the guidelines issued by the Indian tax authorities.

There is yet no further communication in this regard from the Indian tax authorities.

9. ACTION 11: Measuring and Monitoring BEPS:

It is very much difficult to measure the global impact of BEPS activities due to its complex nature and the absence of requisite data. However, it has been estimated that due to BEPS, loss of revenue from CIT was between 4% and 10% of the global CIT revenues annually i. e. equivalent to USD 100 to 240 billion.

This report made several recommendations which will improve the accessibility to and analysis of the available data.

10. ACTION 12:Mandatory Disclosure Rules:

Tax authorities of the countries confront a challenge of getting timely, comprehensive and relevant information on theaggressive tax planning arrangements of the MNEs. This restricts theabilities of the tax authorities to response to those threats through risk assessments, audits or changes of the laws and rules.

To combat this, BEPSACTION 12 recommendsmandatory disclosures by MNEs of their aggressive or abusive transactions, arrangements, or structures with respect to taxation.

The recommendations also prescribedformulation of rules by countries for addressing aggressive international tax planning and development of effective mechanism for exchange of information and cooperation between tax jurisdictions.

Implementation Status in India

India is yet to make any rule in this regard.

11. ACTION 13:Transfer Pricing Documentation and Country-by-Country Reporting:

Here,recommendations have been made for formulation of transfer pricing documentation rules so that information about the transfer price transactions of the MNEs in different tax jurisdictions are disclosed in a moretransparent manner. The rules will require the MNEs to provide all relevant tax jurisdictions with information on their global allocation of income, economic activity and taxes paid in a generic format.

Accordingly, three tier standardised approach has been recommended.Under the three tier standardised approach, MNEs have to submit with their relevant tax jurisdictionsa 'Master File', a 'Local File'anda 'Country-by-Country (CBC) Report'(by large MNEs only)annually containing prescribed information

These three documents will provide useful information on transfer price transactions and enable tax authorities to assess BEPS risks and will assist on decisions for effective transfer price audits.

Implementation Status in India

India has comprehensive legislative measures for keeping, maintaining and furnishing of 'Local File'with the tax authorities under Section 92D of the Act and Rule 10D of the Income Tax Rules, 1962 (Rule).

With the objectiveof incorporating the concept of maintaining and filing with the tax authority of 'Master File' in the Act, Indiaintroduced a proviso to Section 92D (1) of the Act and Sub-Section (4) in Section 92D of the Actto be effective from the Assessment Year 2017-2018.

India also introduced the concept of CBC Reporting by enacting Section 286 of the Act to be effective from the Assessment Year 2017-2018.

The detailed requirements for furnishing the report to comply with Section 286 of the Act have been prescribed in Rule 10DB.

ThisCBC Reporting is applicable if the consolidated revenue of the international group exceeds a prescribed threshold limit.

On July 28, 2017 India notified Multilateral Competent Authority Agreement on the Exchange of CBC Reports. This agreement was signed by India,being a party to the Convention on Mutual Administrative Assistance in Tax Matters,on May 12, 2016 at Beijing, China. This will facilitate the exchange of CBC Reports by India with other countries.

Section 271GB was enacted under the Act to provide for severe penalty, if there is failure to comply with the requirements for filing the'CBC Report'.

12. ACTION 14:Making Dispute Resolution Mechanisms More Effective:

Article 25 of theOECD Model Tax Convention, 2014 (OECD, 2014) provides a mechanism through which tax authorities of contracting countries can resolve differences or difficulties in interpretation or application of the Convention on a mutually agreed basis. This mechanism is known asMutual Agreement Procedure (MAP).

Objectives of the measures recommended under BEPS Action Plan 14 are to enhance the effectiveness and efficacy of the MAP.

Under the BEPS FinalReport countries have agreed to implement a minimum standard to resolve tax treaty related disputes.

Implementation Status in India

India is yet to make any rule under these guidelines.

13. ACTION 15:Developing a Multilateral Instrument to Modify Bilateral Tax Treaties:

Tax treaties are entered by the countries to avoid the menace of double taxation. This has resulted into thousands of bilateral tax treaties between countrieswhich are based on different models of Double Taxation Avoidance Agreements (DTAAs).

Incorporating changes in the thousands of bilateral tax treaties to plug the loopholes requires considerable time and resources.

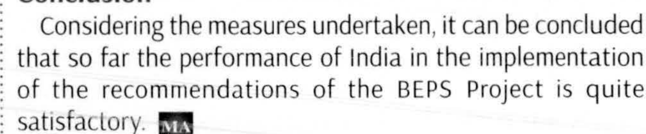
To address these problems, leaders of the G20 countries agreed to explore the feasibility of a Multilateral Instrument (MLI) for entering tax treaty among countries.

The MLIis a turning point in tax treaty history.On June 07, 2017 in Paris Ministers and other high-level representatives of 70 jurisdictions attended the first signing ceremony of MLI. In this ceremony, MLI was signed by 67 countries covering 68 jurisdictions.At the signing ceremony, 09 countries and jurisdictions expressed their intentions of becoming a signatory to the MLI by signing a letter.

Implementation Status in India

Indiasigned MLI onJune 07, 2017.

Conclusion



Considering the measures undertaken, it can be concluded that so far the performance of India in the implementation of the recommendations of the BEPS Project is quite satisfactory. MA

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