CHAPTER 25

FUNDAMENTALS OF BEPS



LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **gain** a broad understanding of the concept of Base Erosion and Profit Shifting (BEPS);
- **appreciate** the significance of action plans of BEPS;
- **comprehend and appreciate** the provisions incorporated in the Indian tax laws in line with the different Action Plans of BEPS.

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25.1 BACKGROUND

Impact of Globalisation

Globalisation has benefited our domestic economies, boosted trade and increased foreign direct investments in many countries. The unrestricted movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. In this way, it accelerated growth, created jobs and fostered innovation. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country's corporate income tax regimes.

Growth of Multi-national Enterprises and consequent tax abuse

Way back in 1920s, pursuant to the first world war, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Globally, countries concur on the need to eliminate double taxation and the need to achieve this on the basis of accepted international laws that are clear and predictable, giving certainty to both governments and businesses. International tax law is, therefore, a pillar in facilitating the development of the global economy. With the economy, the enterprises also became more globally integrated. Multi-national enterprises (MNE) now represent a significant proportion of global GDP.

Also, the increasing significance of the service component of the economy, and of digital products which are deliverable over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been accompanied by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus, encouraging MNEs to minimise their tax burden by resorting to aggressive tax planning.

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Adverse Effects of BEPS

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid. This has become a critical issue since governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth. Further, when tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden. Also, enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Need for international collaboration to protect tax sovereignty of its countries

Taxation is at the core of countries' sovereignty, but the interaction of domestic tax laws with the tax laws of other countries in certain cases leads to gaps and frictions. While developing their domestic tax laws, sovereign states may not adequately take into consideration the effect of other countries' laws. The interaction of separate sets of domestic laws enforced by sovereign countries causes frictions, including potential double taxation for corporations operating in many countries. It also causes gaps, in cases where corporate income is untaxed, both in the country of source and in the country of residence, or is taxed only at nominal rates. In the domestic context, coherence is generally achieved through a principle of matching – a payment that is deductible by the payer is usually taxable in the hands of the recipient, unless explicitly exempted. There is no

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similar principle of coherence at the international level, which leaves considerable scope for arbitrage by taxpayers, though sovereign states have united to ensure coherence in a narrow field, namely, to prevent double taxation. BEPS relates primarily to instances where the interaction of different tax rules & tax systems leads to double non-taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. International standards have tried to reduce these frictions in a manner that respects tax sovereignty; however, gaps still remain. Therefore, there is a need for countries to collaborate on tax matters so that they are able to get their due share of taxes.

25.2 OVERVIEW OF BEPS

In the background of the above repercussions and the global financial crisis in 2009, the G-20 countries shifted their focus to strengthen the international financial system. The G-20 mandated the OECD to address the issue of tax avoidance, in light of which during February 2013, the OECD published a report on "Addressing Base Erosion and Profit Shifting" iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing draft Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013 which came to final fruition in October 2015. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

The Action Plans were structured around three fundamental pillars viz.:

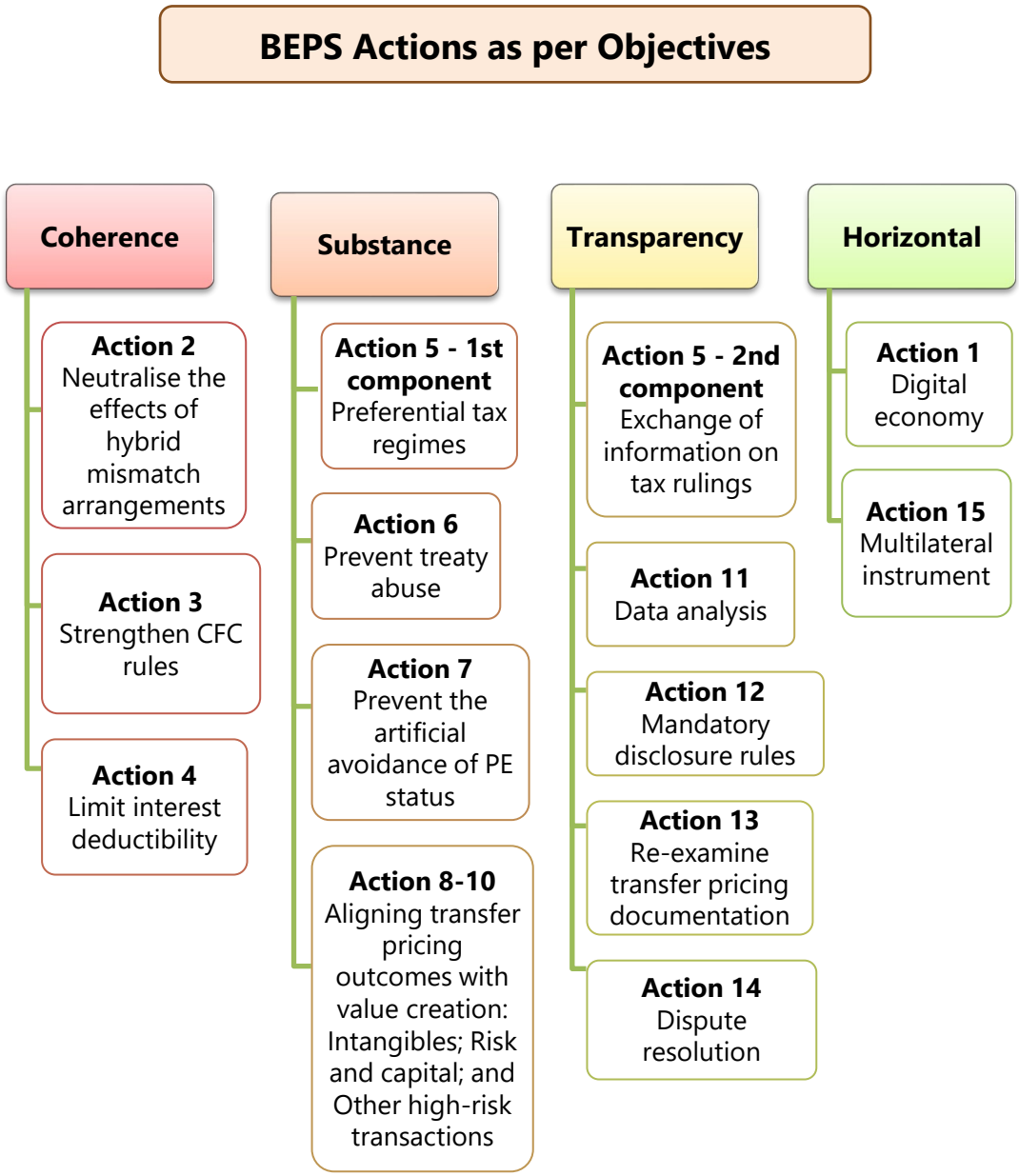
(i) Introducing **coherence** in the domestic rules that affect cross-border activities.

(ii) Reinforcing of **'substance'** requirements in existing international standards; Alignment of taxation with location of value creation and economic activity; and

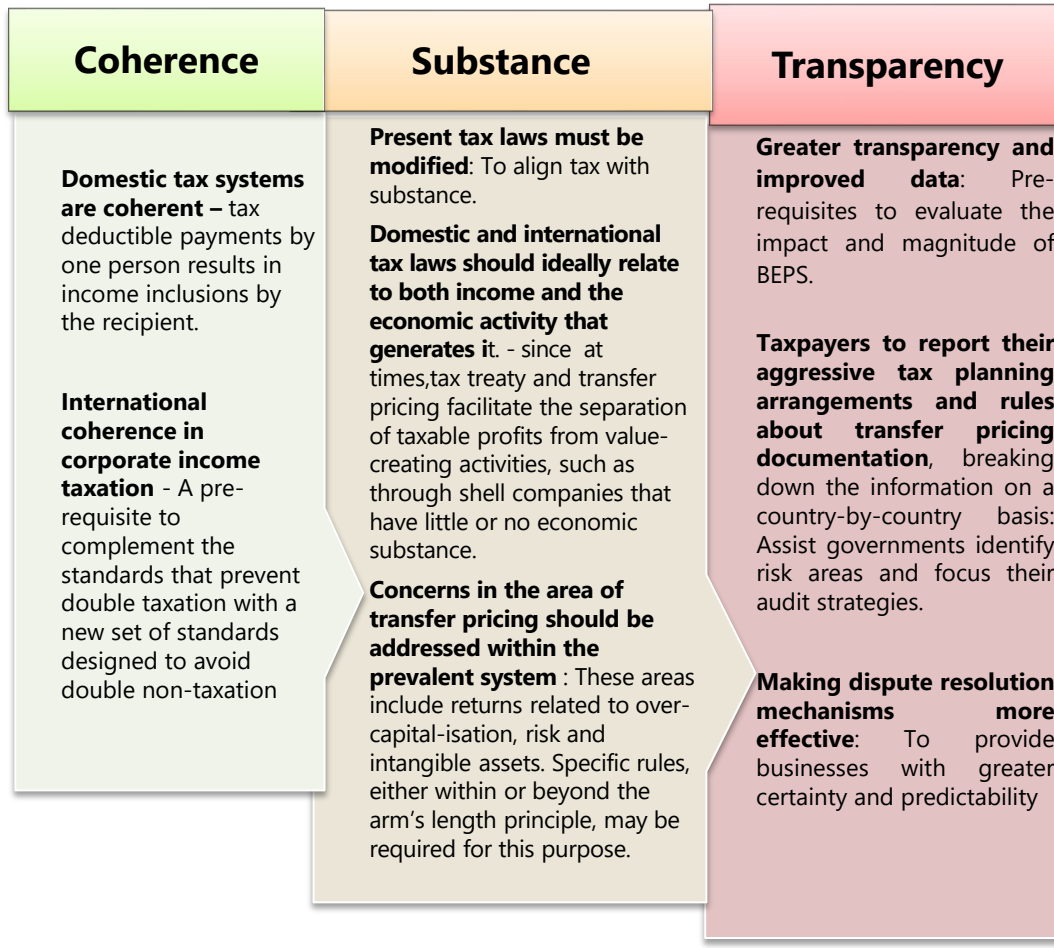
(iii) Improving **transparency** and **tax certainty**.

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A brief classification of the various action plans based on the fundamental pillars is as under:



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The BEPS measures range from new minimum standards to a revision of pre-existing international standards, and to common approaches which will facilitate the convergence of national rules and guidance drawing on best practices.

An unprecedented level of participation has been witnessed, with 148 jurisdictions (including OECD and non-OECD members) participating in the OECD/G20 Inclusive Framework on BEPS.

The Inclusive Framework seeks to ensure that the international tax framework for multinational enterprises (MNEs) remains relevant in an evolving global economy by addressing base erosion and profit shifting, including the tax challenges arising from the digitalisation of the economy.

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It also promotes international cooperation to enable governments to protect their tax bases and raise revenues efficiently through a fair, transparent, and consistent international tax system.

The summary explanatory statement indicates the level of political commitment by OECD, G20 and other States involved in the 2015 work to the various reports. The OECD has iterated the following terms to indicate the commitment by various participant countries:

Minimum Standards

Minimum Standards are those BEPS measures that every member of the Inclusive Framework has committed to implement consistently. Unlike the other BEPS Actions, which are recommendations or best practices, these standards are mandatory commitments for participating jurisdictions and are subject to peer review.

Minimum standards require the implementation of specific BEPS measures by all members of the Inclusive Framework, as failure to implement them may result in negative spillover effects, including adverse impacts on the competitiveness and tax base of other jurisdictions.

The four BEPS minimum standards –

- Action 5 (Countering Harmful Tax Practices)
- Action 6 (Preventing Treaty Abuse)
- Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting), and
- Action 14 (Making Dispute Resolution Mechanisms More Effective)

are subject to a peer review process to ensure their timely, consistent, and effective implementation and to maintain a level playing field.

Accordingly, all members of the Inclusive Framework on BEPS commit to implementing these minimum standards and participating in the peer review process.

Revision of a standard which already exists

Existing standards have been updated and will be implemented but with the caveat that all BEPS participants have not endorsed the underlying standards on tax treaties or transfer pricing; and

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Best practice

A best practice is not a standard but optional recommendation for states to follow. Guidance based on best practices will support those countries proposing to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation.

(1) Action plan 1 – addressing the challenges of the digital economy

Digital economy: Dissolving link between income-producing activity and physical location

In the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

Given the rise of e-commerce, an entire digital economy has emerged in the last decade. Since there is a concept of 'intangibility' attached to the digital model of business, tax authorities often faced challenges rightly bringing to tax the profits earned from a digital business. To address the same, the first action plan of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par. Before the same, physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. It was observed that servers were, therefore, placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

Taxation issues in E-Commerce

These new business models under the industrial revolution 4.0 have created new tax challenges. Since the existing international tax system was designed during

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early 20th century, they remain archaic and are incompatible with the modern-day business dynamics:

The typical taxation issues relating to digitalisation are:

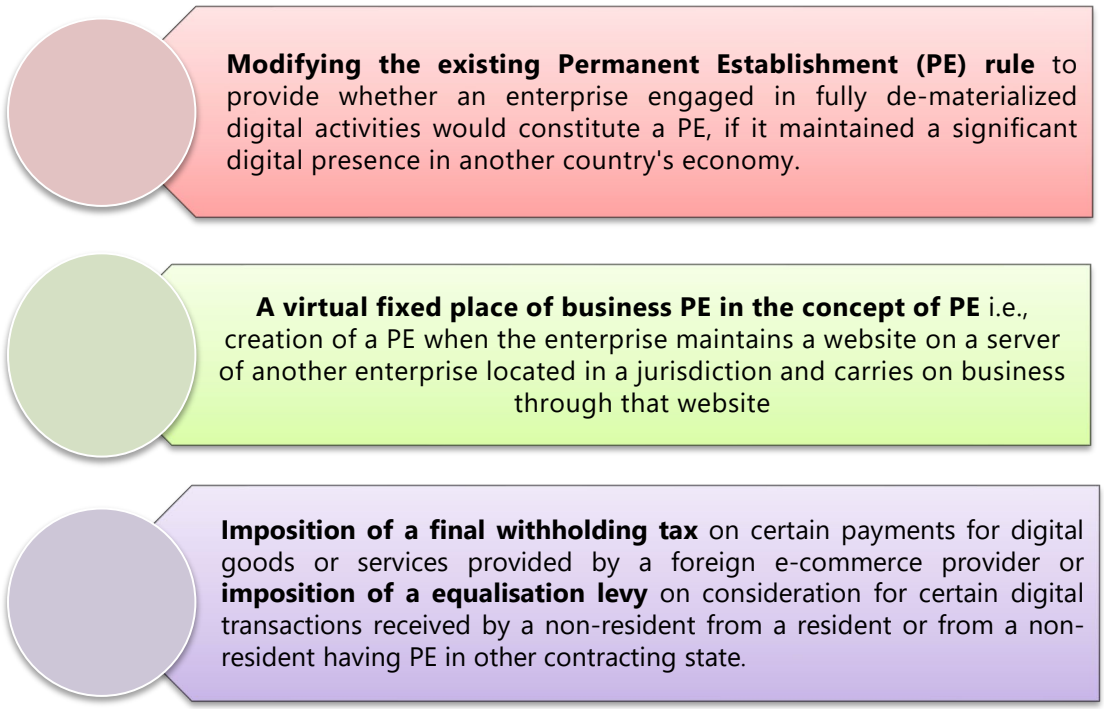
(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e., place of business, location, and permanency must be reconciled with the new digital reality.

OECD Recommendations under Action Plan 1 of the BEPS project

The OECD has recommended several options to tackle the direct tax challenges which include:



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Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

OECD - BEPS 2.0 – Consensus based solution for tax challenges arising out of digitalisation

The 2015 Action 1 report provided for options to safeguard against BEPS on account of digitalisation, however it did not provide for any recommendations and left it to the discretion of the countries to resort to these measures as part of their domestic law. The report also indicated that it was agreed between the members to continue to monitor developments in respect of the digital economy, with a further report to be delivered by October, 2021.

After the delivery of the Interim Report in March 2018, the Inclusive Framework has released details of an agreement on 8th October 2021, titled "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy".

Pillar 1 – Re-allocation of profit and revised nexus rules: This pillar explores potential solutions for determining where tax should be paid for new business models and on what basis ("nexus"), as well as what portion of profits could or should be taxed in the jurisdictions where clients or users are located ("profit allocation").

Pillar 2 – Global anti-base erosion mechanism (Minimum Tax): This pillar explores the design of a system to ensure that multinational enterprises pay a minimum level of tax. This pillar is intended to address remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to protect their tax base from profit shifting to jurisdictions which tax these profits at below the minimum rate.

The Pillar Two Model Rules have been designed to make sure they accommodate a diverse range of tax systems, including different tax consolidation rules, income allocation, entity classification rules etc., as well rules for specific business structures such as joint ventures and minority interests. As such, many of the specific provisions of the Pillar Two Model Rules will not apply to all jurisdictions or each individual in scope MNE.

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Taxpayers that either have no foreign presence or that have less than EUR 750 million in consolidated revenues are not in scope of the Model Rules. In addition, the Pillar Two Model Rules do not apply to government entities, international organisations and non-profit organisations (preserving domestic tax exemptions for sovereign, non-profit and charitable entities), nor do they apply to entities that meet the definition of a pension, investment or real estate fund (preserving the widely shared tax policy of not wishing to add an additional layer of taxation between the investment and the investor). These entities are excluded even if the MNE group they control remains subject to the rules. Taxpayers in scope of the rules calculate their effective tax rate for each jurisdiction where they operate, and pay top-up tax for the difference between their effective tax rate per jurisdiction and the 15% minimum rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the MNE. A de minimis exclusion applies where there is a relatively small amount of revenue and income in a jurisdiction. The Pillar Two Model Rules also contemplate the possibility that jurisdictions introduce their own domestic minimum top-up tax based on the GloBE mechanics, which eliminates (or is at least fully creditable against) any liability under GloBE, thereby preserving a jurisdiction's primary right of taxation over its own income.

Indian Taxation Regime

The concept of 'Significant Economic Presence' (SEP) which is similar to the virtual fixed place PE as recommended in the 2015 BEPS Action Plan 1 report is contained under section 9(9) of the Income-tax Act, 2025

Section 9(9)(a)(ii) provides that business connection in India shall include Significant economic presence in India. As per section 9(9)(d), a non-resident shall have Significant economic presence where there is -

	Nature of transaction	Condition
(a)	Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India or	Aggregate of payments arising from such transaction or transactions during the tax year should exceed **₹ 2 crores.**
(b)	Systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

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Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,-

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, significant economic presence will not be constituted for the transactions or activities are confined to the purchase of goods in India for the purpose of export.

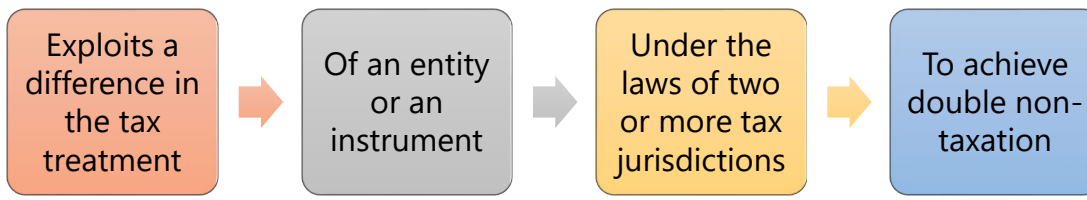
It may be noted where a business connection is established by reason of significant economic presence in India, only so much of income as is reasonably attributable to the transactions or activities referred to in section 9(9)(d) above shall be deemed to accrue or arise in India.

(2) Action plan 2 - Neutralise the Effects of Hybrid Mismatch Arrangements

Before understanding what Action Plan 2 recommends, we must understand what a hybrid mismatch is.

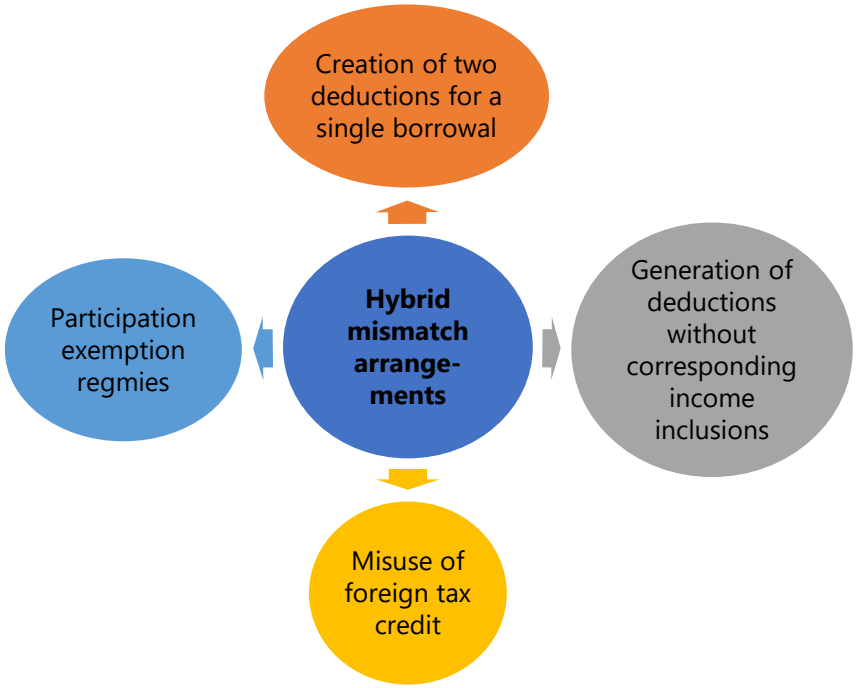
Hybrid Mismatch Arrangement: Meaning

A hybrid mismatch is an arrangement that:



Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

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Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches. It may not be easy to find out which country has in fact lost tax revenue, since the laws of each country involved have been complied with; however, there is a reduction of the overall tax paid by all parties involved as a whole, which ultimately has an adverse effect on competition, economic efficiency, transparency and fairness.

Recommended general amendments are as follows:

- **A rule denying transparency to entities where the non-resident investors' resident country treats the entity as opaque.**



Let us say, X Co., a parent company in country X indirectly holds Y Co., an operating company in country Y. Between X Co. and Y Co. is a hybrid entity that is treated as transparent or disregarded for country X tax purposes and as non-transparent for country Y tax purposes. X Co. holds all or almost all equity interest in the hybrid entity which in turn holds all or almost all equity interests in Y Co.

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The hybrid entity borrows money from a third party and the loan is used to invest equity into Y Co (or to buy the shares in Y Co from either another company of the same group or from an unrelated third party). The hybrid entity pays interest on the loan. Except for the interest, the hybrid entity does not claim any other significant deduction and does not have any significant income.

With respect to Country Y, for tax purposes, Hybrid Entity is subject to corporate income tax. Its interest expenses can be used to offset other country Y group companies' income under the country Y group tax relief regime.

On the other hand, country X treats the hybrid entity as transparent or disregarded, with the result that its interest expenses are allocated to X Co, which deducts the interest expense to offset unrelated income. The net effect is that there are two deductions for the same contractual obligation in two different countries.

Therefore, by virtue of rule denying transparency to an entity which is treated as opaque in the subsidiary company's country, the double deduction can be avoided.

- **A rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer;**



N Co, a company resident in country N is funded by M Co., a company resident in country M with an instrument that qualifies as equity in country M but as debt in country N. A payment made under the instrument would be deductible as interest expense for N Co under country N tax law. The corresponding receipts are treated as exempt dividends under the tax laws of country M. Consequently, deduction is available under the tax laws of country N without a corresponding income inclusion in country M.

Therefore, by virtue of rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer, exemption of such income in country M would not be possible.

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- **A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity**; **and**
- **Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.**

Treaty changes - Action Plan 2 recommends a provision in the case of income earned by a transparent entity. As per this provision, treaty benefits will only be afforded to so much of the income of the entity as the income of a resident of that State. A specific or general saving rule is proposed so that a State can tax a resident entity generally unrestricted by treaty.

Anti-hybrid rules - The report further issued a series of dedicated domestic anti-hybrid rules which would work in two stages. The primary rules would deny deductions to payers in situations where either

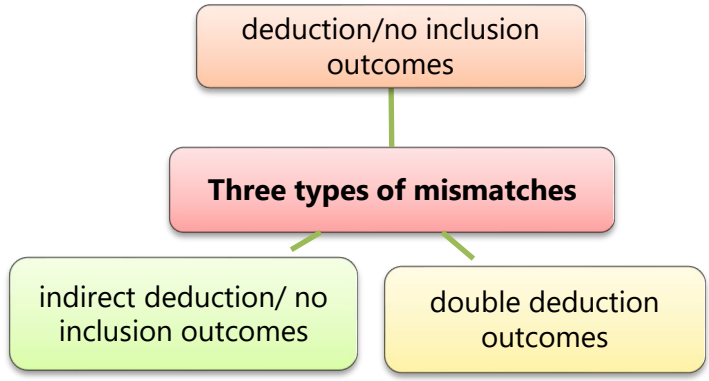
(i) Those payments will not be included in the recipient's ordinary income, or

(ii) The same amount is being simultaneously deducted by another entity.

Treatment of Branch mismatches: 2017 Report

Branch mismatches arise where differences in the tax rules governing the allocation of income and expenditure between a **head office** and its **foreign branch (permanent establishment)** result in all or part of the taxpayer's net income escaping taxation in both the branch jurisdiction and the residence jurisdiction. Unlike **hybrid mismatch arrangements**, which arise due to differences in the legal characterisation of entities or financial instruments, **branch mismatch arrangements** arise because of differences in the recognition or allocation of income, expenditure or payments between the head office and the branch under the tax laws of the two jurisdictions. The **OECD's 2017 Report on Neutralising the Effects of Branch Mismatch Arrangements** identifies **five basic types of branch mismatch arrangements**, which give rise to **three categories of tax mismatches**, and recommends domestic rules to neutralise their tax effects:

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The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

(3) Action plan 3 – Strengthen Controlled Foreign Company (CFC) Rules

Shifting investment income and passive income to subsidiaries in low tax or no tax jurisdictions: Deferral of home country taxation

Under the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until the income is distributed as a dividend. Therefore, it was common for publicly traded companies to form foreign subsidiaries in tax havens and shift "portable" income to those subsidiaries. Generally, income shifted were mainly investment income (interest and dividends) and passive income (rents and royalties), as well as sales and services income involving related parties. Tax in parent country on this income was avoided until the tax haven country paid a dividend to the shareholding company. This dividend could be avoided indefinitely by loaning the earnings to the shareholder without actually declaring a dividend.

Many countries (where global multi-nationals are based) have high tax rates as compared to certain other countries, which used their low tax rates as a means of attracting inward investment. As a result, when dividends were repatriated from these lower tax countries, the recipient generally suffered additional tax on those

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profits. Therefore, many companies have a tendency to leave the profits from these low-taxed subsidiaries offshore, with the objective of deferring home country taxation.

Obviously, Governments were disturbed that multinationals based in their countries kept large amounts of profits offshore. In order to address this issue, governments in various countries have introduced legislation aimed at eliminating the benefits of deferral, by currently taxing income in the parent country even when the income has not been repatriated or remitted to that country. These rules are generally referred to as Controlled Foreign Corporation (CFC) rules.

CFC Rules: Addressing BEPS

Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

The OECD Final Report does not propose a minimum standard for controlled foreign company (CFC) regimes. However, OECD regards CFC rules as being important in tackling BEPS and has made a series of **best practice recommendations** in relation to the 'building blocks' of an effective CFC regime. The major reason why the OECD was unable to provide more than best practice was fundamental disagreement over the policy of CFC regimes, in particular whether states should use the regime to protect other states' tax bases from earnings stripping.

(4) ACTION PLAN 4 – INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

The OECD is concerned that multinational groups are able to erode their tax base (i.e., reduce their taxable profits) with interest expense, for example by:

- Locating third party debt in high tax countries;
- Using intra-group loans to achieve interest deductions in excess of the group's actual third party interest expense;

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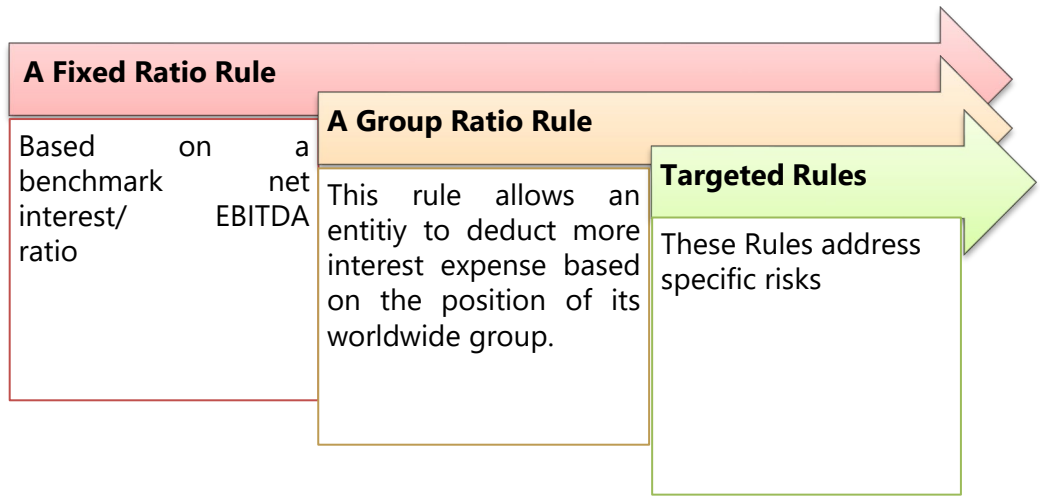
- Using related party or third party debt to finance the production of exempt or deferred income.

The use of third party and related party interest is perhaps one of the most simple of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity.

In particular, the deductibility of interest expense can give rise to double non-taxation in both inbound and outbound investment scenarios. The interest payments are deducted against the taxable profits of the operating companies while the interest income is taxed at comparatively low tax rates or not at all at the level of the recipient.

BEPS Action Plan 4 calls for the development of recommendations for the design of domestic rules to prevent tax base erosion through the use of interest expense and other financial payments that are economically equivalent to interest.

Common Approach: Linking an entity's net interest deduction to its level of economic activity: The mobility and fungibility of money enables multinational groups to achieve favourable tax results by adjusting the amount of debt in a group entity. The 2015 Report established a common approach which directly links an entity's net interest deductions to its level of economic activity, based on taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). This approach includes three elements:



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Indian Taxation Regime

Section 177 of the Income-tax Act, 2025: Addressing Thin Capitalization

Debt financing of cross-border transactions is often favorable than equity financing for taxpayer. In view of the above, in line with the recommendations of OECD BEPS Action Plan 4, Section 177 of the Income-tax Act, 2025 provides a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that tax year, whichever is less, shall not be deductible.

Applicability

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

Carry forward of disallowed interest expenditure

The provision allows for carry forward of disallowed interest expense for 8 tax years immediately succeeding the tax year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

Threshold limit

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable.

Section 177 does not apply to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance, a Finance Company located in an International Financial Services Centre, or such class of non-banking financial companies as may be notified by the Central Government.

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Also, section 177 would not be attracted on interest paid in respect of debt issued by a lender which is a permanent establishment in India of a non-resident engaged in the business of banking.

(5) ACTION PLAN 5 – COUNTER HARMFUL TAX PRACTICES

The Action 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action 5 Report consists of two parts.

One part relates to Countering harmful tax practices through the requirement of substantial economic activity (nexus approach), where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The 'nexus approach' requires that preferential tax regimes, particularly for intellectual property income, should be linked to the extent of substantial economic activity (i.e., research and development) undertaken in the jurisdiction.

The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns.

Indian Taxation Regime

In India, section 194(1) (Table Sl. No. 2) of the Income Tax Act, 2025 contains a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

Section 194(1) (Table Sl. No. 2) of the Income Tax Act, 2025 in line with nexus approach of BEPS Action 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial

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research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership.

Accordingly, section 194(1) (Table Sl. No. 2) of the Income Tax Act, 2025 provides that where the total income of the eligible assessee, being a person resident in India and who is a patentee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess).

For this purpose, "developed" means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(6) ACTION PLAN 6 – PREVENTING TREATY ABUSE

Protection against treaty shopping: Minimum Standard

Bilateral tax treaties concluded by jurisdictions in the world have served to prevent harmful double taxation and remove obstacles to cross-border trade in goods and services, and movements of capital, technology and persons. This extensive network of tax treaties has, however, also given rise to treaty abuse and "treaty-shopping" arrangements.

Treaty shopping typically involves the attempt by a person to indirectly access the benefits of a tax treaty between two jurisdictions without being a resident of one of those jurisdictions. There are a wide number of arrangements through which a person who is not a resident of a jurisdiction that is a party to a tax agreement may attempt to obtain benefits that a tax agreement grants to a resident of that jurisdiction.

Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving jurisdictions of tax revenues.

Treaty abuse is one of the most important sources of BEPS concerns. It is undesirable for several reasons, including:

- Treaty benefits negotiated between the parties to a treaty are economically extended to residents of a third jurisdiction in a way the parties did not

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intend. The principle of reciprocity is therefore breached and the balance of concessions that the parties make is altered;

- Income may escape taxation altogether or be subject to inadequate taxation in a way the parties did not intend; and
- The jurisdiction of residence of the ultimate income beneficiary has less incentive to enter into a tax treaty with the jurisdiction of source, because residents of the jurisdiction of residence can indirectly receive treaty benefits from the jurisdiction of source without the need for the jurisdiction of residence to provide reciprocal benefits.

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their 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.

Countries will implement this common intention by including in their treaties:

(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,

(ii) the PPT rule alone, or

(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

The CBDT vide Circular No. 1/2025 dated 21 January 2025 provides guidance on applying the Principal Purpose Test under India's DTAAs where a PPT provision exists. A CBDT clarification dated 15 March 2025 further states that the Circular applies only to the PPT and does not displace other treaty provisions or domestic anti-abuse rules such as GAAR and SAAR.

Implementation of Action 6 Minimum Standard

The latest peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have modified, or are in the process of modifying, their treaty network to implement the minimum standard and other BEPS treaty-related measures.

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As in previous editions, the latest peer review report continues to demonstrate the efficiency of the BEPS Multilateral Instrument (BEPS MLI) in implementing the minimum standard. It is by far the main tool of Inclusive Framework members for implementing the minimum standard. The majority of the jurisdictions that have signed the MLI have listed almost all their treaties under the MLI.

The provisions of the BEPS MLI have started to take effect with respect to treaties concluded by pairs of jurisdictions that have signed and ratified the BEPS MLI. For the treaties for which the MLI is effective, tax administrations can now use effective treaty provisions to put an end to treaty shopping.

Indian Tax Regime

LoB clause introduced in India-Mauritius Tax Treaty - On 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius.

In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India.

The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India.

A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax.

Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit.

A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian rupee 15,00,000 or Indian ₹ 27,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

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LoB clause in India-Singapore Tax Treaty - On similar lines, India and Singapore has signed a protocol amending the India-Singapore tax treaty.

Capital gains on sale of shares of an Indian company by a resident of Singapore was taxable only in Singapore, if such shares were acquired before 1.4.2017.

After amendment of the treaty, capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty.

In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.



The concessional tax of 50% of the applicable domestic tax rate was available only during the transitional period from 1 April 2017 to 31 March 2019.

(7) ACTION PLAN 7 – PREVENT THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

Tax treaties generally provide that the business profits of a foreign enterprise are taxable in a jurisdiction only to the extent that the enterprise has in that jurisdiction a permanent establishment to which the profits are attributable. The definition of permanent establishment included in tax treaties is therefore crucial in determining whether a non-resident enterprise must pay income tax in another jurisdiction.

Strategies used to avoid having a taxable presence in a jurisdiction under tax treaties may cause cross-border income to go untaxed or be taxed at low rates. The BEPS Action Plan called for a review of that definition to prevent the use of certain common tax avoidance strategies used to circumvent the former Model permanent establishment definition, such as arrangements through which taxpayers replace subsidiaries that traditionally acted as distributors by commissionnaire arrangements, with a resulting shift of profits out of the jurisdiction where the sales took place without a substantive change in the functions performed in that jurisdiction.

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These changes will ensure that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

Thus, the following steps have been advocated:

- **Reworking exceptions to PE definition** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature. The above test can also be applied to understand whether the activities undertaken by an enterprise in a state are 'preparatory or auxiliary'.
- **Analyzing arrangements entered through contractual agreements** – A Commissionnaire arrangement may be broadly defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). Commissionnaire arrangements have been a major cause of concern for tax administrations in many countries.

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Progress in implementation of BEPS Action Plan 7

The changes to the PE definitions were integrated in the 2017 OECD Model Tax Convention and in Part IV of the MLI (Articles 12 to 15). The Multilateral Instrument (MLI) is a flexible instrument that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their treaty network.

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) has been signed by over 100 jurisdictions. Many MLI Signatories and Parties have adopted one or more provisions relating to permanent establishments, thereby modifying their Covered Tax Agreements to counter the artificial avoidance of permanent establishment status. [For a detailed discussion of the MLI, refer to Action 15].

The 2025 Update to the OECD Model Tax Convention revised the Commentary on Article 5 to clarify when cross-border home-office and remote-working arrangements may constitute a place of business. This is a later treaty-interpretation development and not part of the original 2015 Action 7 Final Report.

(8) ACTION PLAN 8-10 - TRANSFER PRICING OUTCOMES IN LINE WITH VALUE CREATION/INTANGIBLES/RISK AND CAPITAL AND OTHER HIGH-RISK TRANSACTIONS

Over the last decades and in step with the globalisation of the economy, worldwide intra-group trade has grown exponentially. Transfer pricing rules, which are used for tax purposes, are concerned with determining the conditions, including the price, for transactions within an MNE group resulting in the allocation of profits to companies within the group in different countries. In this regard, based on the arm's length principle, transactions between associated enterprises have to be priced as if the enterprises were independent, operating at arm's length and engaging in comparable transactions under similar conditions and economic circumstances.

The arm's length principle has proven useful as a practical and balanced standard for tax administrations and taxpayers to evaluate transfer prices between associated enterprises, and to prevent double taxation. However, with its

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perceived emphasis on contractual allocations of functions, assets and risks, the existing guidance on the application of the principle has also proven vulnerable to manipulation. This manipulation can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of an MNE group. The aforesaid Action plans represent the OECD's work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on Intangibles, Risks and capital and other high-risk transactions. These are the hard areas of transfer pricing and are summarized together in the Final Report 'Aligning Transfer Pricing Outcomes with Value Creation'.

Clarification and Strengthening of existing standards on transfer pricing: Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the ALP the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm's length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm's length principle. The work has focused on three key areas.

Action Plan	Details
8	Addresses transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are generally difficult-to-value. Misallocation of the profits generated by valuable intangibles is a significant cause of BEPS.
9	Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Moreover, Action 9 addresses the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity undertaken by the funding company.
10	This action focuses on other high-risk areas, which include: - the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational,

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	- the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and - the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

Progress in Implementation

- Additional guidance on the attribution of profits to permanent establishments resulting from the changes in the Action 7 Final Report to Article 5 of the OECD Model Tax Convention was published in March 2018.
- Revised guidance on transactional profit split method (Action 10) was published in June 2018 and has been incorporated into the next edition of the OECD Transfer Pricing Guidelines.
- Additional guidance addressed to tax administrations on the application of the hard-to-value intangibles (HTVI) approach (Action 8) was finalised in June 2018 and has been incorporated in the next edition of the OECD Transfer Pricing Guidelines.
- Transfer pricing guidance on financial transactions (Actions 4 and 8-10) was published in February 2020 and has been incorporated in the OECD Transfer Pricing Guidelines.

(9) ACTION PLAN 11 – MEASURING AND MONITORING BEPS

The adverse fiscal and economic impacts of BEPS have been the focus of the OECD/G20 BEPS Project since its inception. While anecdotal evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, The Addressing Base Erosion and Profit Shifting report (OECD, 2013) recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.

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Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, the fiscal effects of BEPS are significant. BEPS causes other adverse economic effects, including tilting the playing field in favour of tax aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Measuring the impact and scale of BEPS activities and the effect of the implementation of the BEPS measures are important components of the ongoing work of the OECD/G20 Inclusive Framework on BEPS. Such measurement and monitoring is necessary to inform both policymakers and taxpayers of the effectiveness of the BEPS measures and the extent to which BEPS issues continue to exist.

Indicators of BEPS activity

Six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.

(ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.

(iii) **Foreign direct investment (FDI) is increasingly concentrated -** FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly -** For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

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(v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries**. The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

(10) ACTION PLAN 12 – DISCLOSURE OF AGGRESSIVE TAX PLANNING ARRANGEMENTS

A significant challenge faced by tax authorities worldwide is the lack of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations. Action 12 contains recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes, taking into consideration the administrative and compliance costs for tax administrations and business and drawing on experiences of countries that have implemented such rules. It recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The Action 12 report also sets out specific recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

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(11) ACTION PLAN 13 – RE-EXAMINE TRANSFER PRICING DOCUMENTATION

The lack of quality data on corporate taxation has been a major limitation to measuring the fiscal and economic effects of tax avoidance, making it difficult for authorities to carry out transfer pricing assessments on transactions between linked companies and even more difficult to carry out audits.

Under BEPS Action 13, all large multinational enterprises (MNEs) are required to prepare a country-by-country (CbC) report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates. This CbC report is shared with tax administrations in these jurisdictions, for use in high level transfer pricing and BEPS risk assessments. This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. The revised standardised approach requires taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing and other BEPS risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism. The implementation package included in this report sets out guidance to ensure that the reports are provided in a timely manner, that confidentiality is preserved and that the information is used appropriately, by incorporating model legislation and model Competent Authority Agreements forming the basis for government-to-government exchanges of the reports.

Requirements as per OECD report on Action 13 of BEPS Action Plan

The OECD report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

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Three-tier structure mandated by BEPS.

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure: -

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members. Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.
(2)	Local file	Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.
(3)	Country-by-country report	The BEPS Action 13 report provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and

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		(ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the: a) Multilateral Convention on Administrative Assistance in Tax Matters; b) Bilateral tax conventions; and c) Tax Information Exchange Agreements (TIEAs). **Following information are required in the CbC report**: Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group. CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Advantages of the three-tier structure [As per BEPS Report]

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

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Indian Taxation Regime

Transfer Pricing provisions under the Income-tax Act, 2025

Chapter X of the Income-tax Act, 2025 comprising sections 161 to 173 contain provisions relating to transfer pricing.

Section 171 requires every person, who (a) has entered into an international transaction or specified domestic transaction; or (b) is a constituent entity of an international group, to keep and maintain prescribed information and document in respect thereof.

Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file is incorporated in the Income-tax Act, 2025. The essential elements are incorporated in the Income-tax Act, 2025 while the remaining aspects are dealt with in detail in the Income-tax Rules, 2026.

Note *– Refer to Chapter 24 Transfer Pricing, wherein the following have been discussed at length -*

(i) Elements relating to CbC reporting requirement and related matters which have been incorporated in section 511 of the Income Tax Act.

(ii) ***Maintenance and furnishing of Master file:*** *Consequent provisions incorporated in section 171 of the Income Tax Act.*

Threshold limit of consolidated group revenue for applicability of CbC reporting requirement

The CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding accounting year of the group, based on consolidated financial statement, exceeds prescribed threshold limit. This threshold for total consolidated group revenue of the international group prescribed under section 511 of the Income Tax Act, 2025 read with Rule 124 of the Income Tax Rules, 2026 is ₹ 6,400 crores.

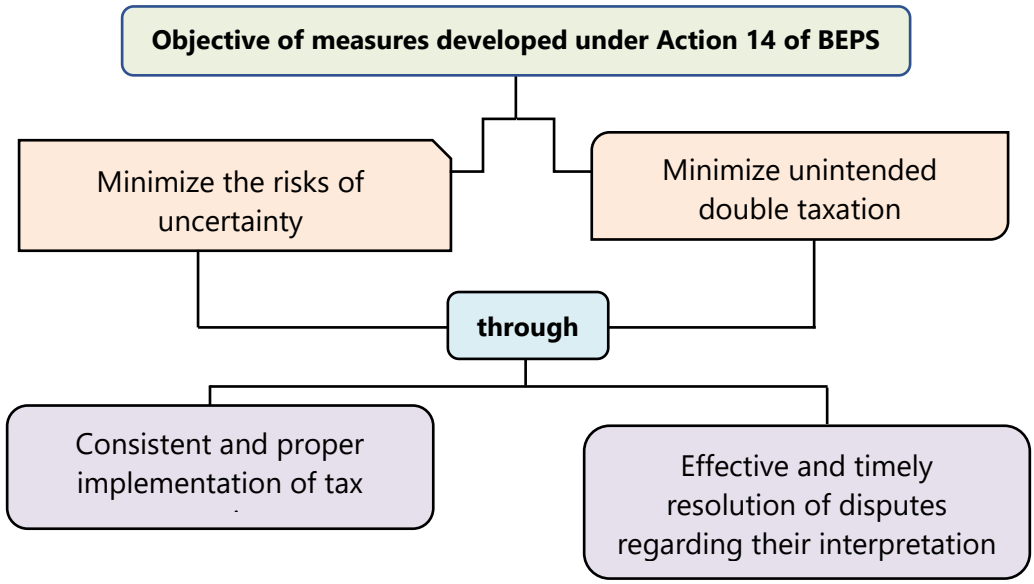
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(12) ACTION PLAN 14 – MAKING DISPUTE RESOLUTION MORE EFFECTIVE

As novel challenges relating to international taxation surface, the necessity of having robust dispute resolution processes in place becomes increasingly apparent.

Recent statistics show that tax administrations are closing more cases than ever before. However, MAP cases from 2016 are increasing significantly, thus putting upward pressure on countries' MAP inventories. Therefore, the total MAP cases keeps increasing every year since the number of cases closed has not been able to keep up with the number of new cases.

The BEPS Action 14 Minimum Standard seeks to improve the resolution of tax-related disputes between jurisdictions. Inclusive Framework jurisdictions have committed to have their compliance with the minimum standard reviewed and monitored by its peers through a robust peer review process that seeks to increase efficiencies and improve the timeliness of the resolution of double taxation disputes.



Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS

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pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

The Action 14 Minimum Standard consists of elements and best practices, which assess a jurisdiction's legal and administrative framework in the following four key areas:

- preventing disputes;
- availability and access to MAP;
- resolution of MAP cases;
- implementation of MAP agreements.

Peer review implications for India

Under Action 14, countries have committed to implement a minimum standard to strengthen the effectiveness and efficiency of the mutual agreement procedure (MAP). The MAP is included in Article 25 of the OECD Model Tax Convention and commits countries to endeavour to resolve disputes related to the interpretation and application of tax treaties. The Action 14 Minimum Standard has been translated into specific terms of reference and a methodology for the peer review and monitoring process. The minimum standard is complemented by a set of best practices.

The peer review process is conducted in two stages. Stage 1 assesses countries against the terms of reference of the minimum standard according to an agreed schedule of review. Stage 2 focuses on monitoring the follow-up of any recommendations resulting from jurisdictions' stage 1 peer review report. This report reflects the outcome of the stage 1 peer review of the implementation of the Action 14 Minimum Standard by India.

As a result, the peer review undertaken for India in 2019 highlighted India's progress on MAP Programme and suggested recommendations for more effective functioning of the MAP. According to the peer review and BEPS Action Plan 14, the Indian tax authorities have taken significant steps to reform the MAP framework and make it effective.

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Rule 121 of the Income-tax Rules, 2026 extensively deals with the implementation and the procedural framework for the MAP process.

(13) ACTION PLAN 15 – DEVELOPING A MULTILATERAL INSTRUMENT

MLI's role in tackling BEPS

Abuse of tax treaties is an important source of BEPS. The MLI helps the fight against BEPS by implementing the tax treaty-related measures developed through the BEPS project in existing bilateral tax treaties in a synchronized and efficient manner. These measures will prevent treaty abuse, improve dispute resolution, prevent the artificial avoidance of permanent establishment status and neutralize the effects of hybrid mismatch arrangements.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

Formation of ad hoc Group to develop MLI

Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS, was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015.

In line with Action 15 report, an ad-hoc group was formed with a pre-defined purpose of development of such Multilateral Instrument (MLI) and that adopted the text of the Convention and accompanying Explanatory Statement in November 2016. India was part of the Ad Hoc Group of more than 100 countries and jurisdictions from G20, OECD, BEPS associates and other interested countries, which worked on an equal footing on the finalization of the text of the Multilateral Convention, starting May 2015. The text of the Convention and the accompanying Explanatory Statement was adopted by the Ad hoc Group on 24th November 2016.

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Features of MLI

The Multilateral Convention is, thus, an outcome of the OECD/ G20 Project to tackle Base Erosion and Profit Shifting (the "BEPS Project") i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI modifies tax treaties that are "Covered Tax Agreements". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

The MLI is a flexible instrument which will modify tax treaties according to a jurisdiction's policy preferences with respect to the implementation of the tax treaty-related BEPS measures. The MLI provides for different types of flexibility:

(i) jurisdictions can choose amongst alternative provisions in certain MLI articles;

(ii) jurisdictions can choose to apply optional provisions (for instance, the provisions on mandatory binding arbitration);

(iii) jurisdictions may also choose to reserve the right not to apply MLI provisions (to opt out through a "reservation") with respect to all of their Covered Tax Agreements or with respect to a subset of their Covered Tax Agreements. Jurisdictions only have the possibility to opt out of provisions that do not reflect a BEPS minimum standard, with the possibility to withdraw their reservation (and opt in) later.

Coverage of the MLI

In the first signing ceremony of the MLI on 7th June, 2017, more than 65 countries signed the MLI making it a historic moment in the international tax framework. As per latest OECD updates, over 100 jurisdictions have signed the MLI. India is an active participant in the BEPS programme and was one of the jurisdictions during the signing event. USA have not signed the MLI and thereby not a party to this convention. The current status of signatories and parties to MLI is available at https://www.oecd.org/tax/beps/beps-mli-signatories-and-parties.pdf.

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The MLI entered into for the avoidance of taxes is a new concept in International Taxation. The fundamentals of MLI can be decoded using the rhetoric 3W1H principles (Why, What, When and How).

Why the need for MLI under the BEPS? – The evolution from Bilateral to Multilateral

Before we embark into what is MLI, we must understand the need for an MLI under the international tax laws. The existing framework of international tax law is through tax treaties entered bilaterally between countries.

The MLI convention is synonymous to a treaty. Treaties are instruments which create international law, it is one of the most common and important sources of international law. They are agreements between sovereign states and are binding on every sovereign state signatory to such agreement. A treaty is defined by the Vienna Convention on the Law of Treaties (commonly referred to as 'VCLT') as 'an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation'. As much as treaties are instruments under international law, conventions, agreements, charters are all synonymously used along with treaty.

The tax treaty framework is through Countries which have entered into Double Tax Avoidance Agreements (generally referred to as 'DTAA') with several other countries on a bilateral basis i.e. agreement between two countries (e.g. Country A with Country B) to prevent double taxation of income. India has entered bilateral tax treaties with more than 90 countries. The bilateral tax treaties are, inter alia, entered with a view, majorly to prevent double taxation of income and give relief in respect of doubly taxed incomes.

The rapid growth of globalization led to the creation of Multinational Enterprises (MNEs) wherein the entities within a group were present all over the world and in many cases at jurisdictions which were set up with the main objective to obtain tax arbitrage using treaty shopping mechanism.

Consequent to the 2008 global economic crisis, the international organizations and the fellow nations came up with the BEPS action plan to recognise and counter unfair tax planning strategies adopted by certain MNEs which had exploited the gaps in the global taxation system by artificially shifting profits to low or no-tax locations (where there is little or no economic activity which leads to little or no tax being paid).

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These tax planning strategies violated the 'Economic Allegiance' principle which means to compensate to a nation or a kingdom for the benefits that one derived from exploiting that nation or kingdom's resources. This resulted in the source taxation principle under the international tax principles.

As a result of the BEPS agenda, 15 Action Plans were brought out by the OECD under G20's mandate to tackle the unfair tax planning mechanisms adopted by MNEs. The action plan 15 can be considered as the machinery action, which is intended to put into play the anti-avoidance tax solutions proposed in the other BEPS action items.

The need for such a machinery action item is because currently there are more than 3000 bilateral tax treaties that are active and to invoke the solutions proposed under the BEPS action plans, these bilateral tax treaties have to be amended. Amending the bilateral treaties and involves cumbersome legal process as each country have their own constitutional or other legal mechanisms to invoke international treaties into their domestic laws.

Further, mere incorporation of these solutions in domestic law will not achieve the desired objective as the tax treaties will remain a tool for tax evaders. Therefore, to ensure the BEPS solutions are transposed into the tax treaty, action plan 15 objective was to bring all these amendments under one single umbrella and hence, the work on developing a multilateral agreement was undertaken.

Multilateral agreements are entered by three or more nations, thus, bringing many countries under one roof. Such agreements are considered effective and less time-consuming. The World Trade Organization (WTO) agreement, in which India is a party, is a classic example of multilateralism.

Multilateral agreements, in the context of international taxation, is not new as there have been precedents from Scandinavian, Caribbean countries entering into such an agreement to avoid double taxation. India also has its experience through the SAARC Limited Multilateral Agreement for the avoidance of double taxation. But what distinguishes those agreements from the BEPS MLI is that the MLI is exclusively entered to ensure there are no double nontaxation and reduction of taxes, unlike the former whose objective was inter alia to avoid double taxation and to promote economic relations.

Therefore, the MLI modifies tax treaties not by directly amending the text of the tax treaty, but by being applied together with the relevant tax treaty. They do not make the existing DTAA otiose, they operate along with the existing DTAA and will modify the application of some clauses in the existing DTAA using the lex

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posterior (later in time) principle. Therefore, the BEPS MLI is an effective tool to implement the anti-avoidance measures in a synchronised manner without the need to bilaterally renegotiate each and every agreement.

The BEPS MLI can act as a retaliatory tool for tax enforcers to use against the tax evaders, as it can disentitle a taxpayer from undertaking treaty shopping or availing unfair treaty benefits based on the anti-avoidance measures initiated under the BEPS action items. Having seen the need for an MLI on tax treaties, we will dwell further on the operational aspects of the same.

What is MLI? – Structure and key organs

The MLI under the BEPS action plan 15 is to implement the BEPS work into the existing treaty network. The MLI will enable to provide a standard language for modification of all the existing DTAAs. This enables elimination of disputes arising on account of different terms being used differently or distinctively in each of the DTAA between contracting states thereby acting as deterrence for tax abuse. It is reiterated that the BEPS MLI is an enabler to the existing tax treaties and does not replace the existing tax treaties. It operates along with the existing DTAA by modifying the application of a provision under the DTAA.

Structure of the MLI

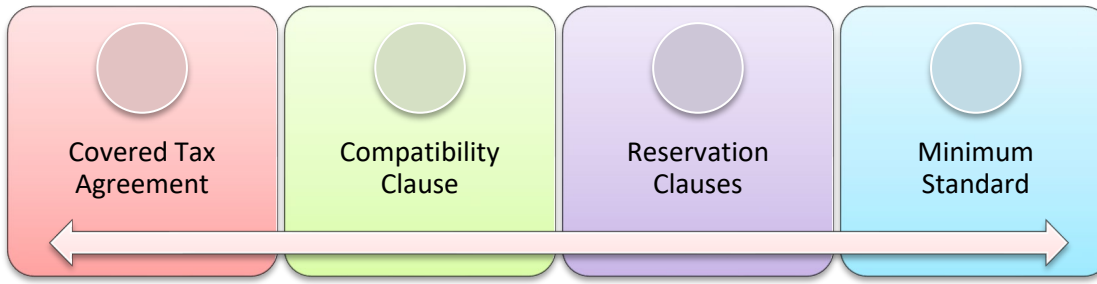
Just as bilateral tax treaties are agreements, the MLI is also a similar instrument and its interpretation will be governed by the principles laid down by VCLT. There are 7 parts and 39 articles in the MLI. The coverage of MLI through its articles in light of the BEPS action plans is structured in the manner provided below. Articles 3 to 17 are recognised as substantive provisions under the MLI convention.

Part	Particulars	Article
Part I	Scope and Interpretation of terms	Article 1-Article 2
Part II	Hybrid Mismatches	Article 3-Article 5
Part III	Treaty Abuse	Article 6-Article 11
Part IV	Avoidance of PE Status	Article 12-Article 15
Part V	Improving Dispute Resolution	Article 16-Article 17
Part VI	Arbitration	Article 18-Article 26
Part VII	Final Provisions	Article 27- Article 39

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Key Organs of the MLI

Each country before becoming a signatory is required to adopt certain 'mandatory minimum standards', make 'notification' of MLI provisions, 'make a reservation' to certain provisions of MLI and also provides for 'compatibility clauses' to 'opt-in and opt-out' of MLI provisions. Here, we will discuss the following key organs of the MLI which acts as a fulcrum for the operation of the instrument.



Covered Tax Agreements (CTA)

The entire scope and starting point of the MLI revolve around CTA. Article 2 of MLI defines a CTA as: 'an agreement for avoidance of double taxation with respect to taxes on income that is in force between two or more parties and/or jurisdictions with respect to which each party has notified to the Depository as a listed agreement under the MLI'.

It is, therefore, extremely relevant that to make the MLI operational between two parties (or) jurisdictions/ states, each country must notify each other's bilateral tax treaty while becoming a signatory to the MLI. Each country has to notify the DTAA with other jurisdiction under the MLI, upon which the said DTAA will be the CTA for the purposes of MLI operation.

India has notified 93 jurisdictions under the MLI at the time of ratifying the MLI convention. Similarly, it is also important that the countries which have signed a bilateral treaty with India must also notify DTAA with India while depositing their instrument with OECD. Therefore, 'the matching principle' is a key attribute and only when the other country also notifies the DTAA with India, the DTAA between India and that country will be considered as a CTA.

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Exhibit 1: Whether the India & Australia DTAA is a CTA under the MLI?

Steps	Considerations	Comments
Step 1	*Whether India and Australia already have a DTAA in existence?*	*Yes, move to step 2*
Step 2	*Whether India and Australia are signatories to MLI?*	*Yes, both the parties are signatories to the MLI.*
Step 3	*Whether India has notified DTAA with Australia as a CTA in its MLI deposit note to the OECD?*	*Yes, India has notified DTAA with Australia as a CTA.*
Step 4	*Whether Australia has notified DTAA with India as a CTA in its MLI deposit note to the OECD?*	*Yes, Australia has notified DTAA with India as a CTA.*
Step 5 - Conclusion	*Article 2 – Scope provisions matched and hence India -Australia DTAA is a CTA.*	*MLI provisions will apply.*

Exhibit 2: Whether the India & Mauritius DTAA is a CTA under the MLI?

Steps	Considerations	Comments
Step 1	*Whether India and Mauritius already have a DTAA in existence?*	*Yes, move to step 2*
Step 2	*Whether India and Mauritius are signatories to MLI?*	*Yes, both the parties are signatories to the MLI.*
Step 3	*Whether India has notified DTAA with Mauritius as a CTA in its MLI deposit note to the OECD?*	*Yes, India has notified DTAA with Mauritius as a CTA.*
Step 4	*Whether Mauritius has notified DTAA with India as a CTA in its MLI deposit note to the OECD?*	*No, Mauritius has not notified DTAA with India as a CTA.*
Step 5 Conclusion	*India – Mauritius DTAA matching provisions not satisfied. Therefore, the said DTAA is not a CTA.*	*MLI provisions will **NOT** apply. Will be governed only by existing DTAA provisions*

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Further, there are countries such as the United States that have not signed the MLI. Consequently, the India–USA DTAA is not a Covered Tax Agreement under the MLI, and the provisions of the existing DTAA continue to govern the tax treaty relationship between the two countries.

In contrast, Brazil signed the MLI on 20 October 2025. However, as at 26 August 2026, Brazil has not deposited its instrument of ratification, acceptance or approval. Accordingly, Brazil is not yet a Party to the MLI and the MLI has not entered into force for Brazil. Therefore, the MLI does not presently modify the India–Brazil DTAA. The BEPS minimum standard applicable to the India–Brazil DTAA has, instead, been implemented through a bilateral amending instrument between the two countries.

Therefore, once an existing tax treaty is recognised as a CTA in the MLI context, the tax treaty will have to take cognizance of the operational aspects of the MLI.

Compatibility Clauses – Bridge between the DTAA and the MLI

Once the existing DTAA becomes a CTA, we move to the next main organ of the MLI i.e. the compatibility clauses. One of the core objectives of the MLI is to ensure consistency amongst the nations to incorporate the BEPS solutions in their treaty network. Further, the objective of MLI is to only modify the application of certain provisions in the existing DTAA. Therefore, parties to the MLI are given the flexibility to choose the relevant provisions of the MLI that needs to be transposed to their existing DTAA. In a bilateral DTAA, two countries negotiate and have the flexibility to decide which provisions to be incorporated. Since tax policy of countries vary, flexibility is important to attract countries to sign the MLI.

Therefore, the flexibility is provided in the form of compatibility clause and the reservation clause.

The compatibility clause is to ensure that there is no conflict between the two treaties i.e. the DTAA and the MLI. This is because of the uniqueness of the MLI, which is not a standalone treaty as it operates alongside the bilateral tax treaties. If there is a possible conflict that may arise between the two treaties i.e., the DTAA and the MLI, the compatibility clause would resolve this conflict. Further, the compatibility clause also gives options to parties to leave an existing provision of the DTAA undisturbed, if the existing provision serves the desired objective with which a particular provision of the MLI was placed to.

There are 4 different categories of compatibility clause(s) which are found under the MLI convention. They are depicted in the following table:

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Compatibility Clause	Meaning	Effect	Notification Criteria
"in place of"	Purpose of this clause is to replace an existing provision of the CTA, with that of mutually notified provisions of MLI between two countries.	The concerned provision of MLI shall replace the existing CTA provision.	Only when both the parties to the CTA notify, the CTA provision be replaced by the MLI provision.
"in the absence of"	Purpose of this clause is to enforce a new provision into the CTA, where such provision is absent in the CTA.	The concerned MLI provision is added to the existing CTA which does not contain such a provision.	Only when both the parties to the CTA notify, the MLI provision gets added in the CTA.
"applies to" or "modifies"	Purpose of this clause is that the relevant CTA provision will be modified by MLI provision without replacing the CTA provision.	This existence of this compatibility clause is that there should be a mutually notified CTA provision on which this condition is made effective. Thereafter, the relevant MLI provision shall be made applicable to an existing CTA provision without replacing the provisions of CTA.	Only when both the parties to the CTA notify, the MLI provision would be made applicable to the existing CTA provision.
"in place of or in the absence of"	Purpose of this clause is to replace an existing provision in CTA	**Use of "in place of":** Where existing provisions of CTA	With regard to the notification, this is different from the earlier clauses,

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	with the MLI provision. Further, where there is no such provision in the CTA, the MLI provision will be added to the existing CTA. This is the most commonly used clause in many of the substantive provisions of the MLI.	are notified by two countries, then, the MLI provisions are replaced with CTA provisions. **Use of "in the absence of":** Where no such provisions exist in a CTA, then the MLI provisions includes them and gets added into the CTA.	wherein even if both the parties to the CTA does not notify this clause, the MLI provision shall apply and supersede the provisions of the CTA to the extent of incompatibility. The same holds good even if only one party notifies this clause.

Reservation Clauses – 'Opt-Out' Mechanism

The reserved provisions of MLI shall not apply to a CTA if either of the parties makes a reservation. A reservation is defined in the VCLT as a "unilateral statement made by a State, when signing, ratifying, accepting, approving or acceding to a multilateral instrument, whereby it purports to exclude or to modify the legal effect of certain provisions of the Convention".

Hence, reservations under treaties, introduce flexibility in treaty negotiations, so that States come forward to be a signatory to such multilateral conventions. The general rule of multilateral instrument is that its parties are bound by the entire instrument unless the parties make a reservation. The MLI enables states to opt-out of the provisions, either entirely or partially, by introducing a mechanism of reservations.

However, reservations concerning minimum standard provisions (discussed later) under the MLI can be made only on limited situations and subject to satisfying certain conditions.



(1) India has reserved its position on Article 3 of the MLI on transparent entities (BEPS Action 2), therefore Article 3 will not be added or modified in any of India's existing DTAA as India has opted-out.

(2) France has reserved its position on Article 4 of the MLI on dual resident entities (BEPS Action 2), therefore when we apply India-France DTAA, Article 4 of the MLI will not affect the DTAA since France has opted-out/reserved its position on the said Article 4 of the MLI.

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A party to the MLI may reserve the right for provisions of the MLI to not apply:

- to its covered tax treaties in their entirety; or
- a subset of its covered tax treaties

Further, the reservations made under the MLI by a party will apply symmetrically wherein it applies to the reserving party and other parties to the convention. In certain exceptional situation, the reservation provision also works asymmetrically, which is a unique feature of the MLI, unlike other multilateral agreements.

Mandatory Minimum Standards

The mandatory minimum standards form the genesis of MLI and without which the object of MLI may not be fulfilled. One of the core objectives of developing the MLI is to ensure consistency amongst the 3000 odd tax treaties that are currently in existence. As we have seen earlier, the MLI also gives flexibility to the parties through compatibility and reservation clause, however, to ensure there is some consistency, the parties have to adhere to incorporating mandatory minimum standard provisions in the MLI.

The objective of the minimum standard provisions is to ensure that these anti-abuse provisions will help eliminating the treaty shopping mechanism and consequentially the elimination of double non-taxation scenarios by tax-evaders. The minimum standards under the MLI, therefore, achieve certain consistency amongst the existing tax treaties. These minimum standard provisions, which have to be incorporated in the tax treaties, help in combating tax avoidance.

Out of the four minimum standards prescribed under the BEPS action plan i.e.

Action 5 - Countering Harmful Tax Practices

Action 6 - Treaty abuse prevention mechanism

Action 13 - Country by Country Reporting

Action 14 - Effective Dispute Resolution Mechanism

Action 6 and Action 14 solutions are specifically provided as a minimum standard provision under the BEPS MLI. With regards to Action 5 and Action 13, the solutions are to be incorporated under domestic laws.

However, in a case where the Contracting States together agree to reflect the minimum standard provisions specified under the MLI into their existing DTAA, then, such treaty partner may opt-out of the minimum standards under the MLI.

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When – Entry into Force and Effective Date

The historic MLI was signed on 07 June 2017 by more than 65 countries at Paris, France during the initial signing ceremony. The Entry into Force and the Effective Date is specified under Articles 34-36 of the MLI. Since the MLI is a new instrument for the signatory countries, many countries which were not part of the initial signing ceremony have been signing the MLI on an ongoing basis. It is, therefore, important to understand when the MLI enters into force and the effective date.

The MLI will apply only to those countries which have:

- Signed the MLI;
- Ratified, accepted or approved the MLI under the domestic law and deposited such instrument of ratification with the OECD depositary.

Article 34 governs the entry into force of the MLI for a particular jurisdiction, whereas Article 35 governs the entry into effect of the MLI provisions with respect to a particular Covered Tax Agreement.

Entry into Force: India has ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), which was signed on 7th June, 2017. On 25th June, 2019, India has deposited the Instrument of Ratification to OECD, Paris alongwith its Final Position in terms of Covered Tax Agreements (CTAs), Reservations, Options and Notifications under the MLI, as a result of which MLI will enter into force for India on 01st October, 2019 [1]..

The fact that the MLI entered into force for India on 1 October 2019 did not mean that the MLI immediately modified every Indian DTAA.

Accordingly, the entry into force of the MLI for India does not, by itself, modify an Indian DTAA. The relevant DTAA must be a Covered Tax Agreement, the MLI must have entered into force for both Contracting Jurisdictions, and the applicable requirements and time periods under Article 35 must be satisfied.

[1] https://www.pib.gov.in/newsite/PrintRelease.aspx?lang=2&reg=3&relid=191125&utm_source=chatgpt.com

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Effective date

Once the MLI is entered into force by both the Contracting States, the effective date of the MLI shall be:

For withholding taxes – 1st day of next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the CTA.

For other taxes – Taxable period that begins on or after the expiration of a period of 6 calendar months from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the CTA.

India's journey with respect to the applicability of the MLI.

Date	Event
7th June, 2017	The signing of the MLI
25th June 2019	Deposit of ratification instrument with the OECD depository.
1st October 2019	Entry into Force of India's MLI

The provisions of the said Convention would have effect in India with respect to a Covered Tax Agreement in accordance with the provisions of Article 35 of the said Convention.

Accordingly, in exercise of the powers conferred by section 159(1), the Central Government has, vide Notification No.57/2019 dated 9.8.2019 (available at https://www.incometaxindia.gov.in/documents/d/guest/notification57_2019-pdf), notified that the provisions of the said Convention shall be given effect to in the Union of India, in accordance with India's Position under the said Convention, as set out in the Annexure thereto.



If a country has signed and notified DTAA with India, however, the MLI has not entered into force, then in such a case, the MLI provisions will not be applicable. For e.g., Italy has notified DTAA with India as a CTA; however, Italy has not ratified its MLI under its domestic laws and hence the provisions of MLI cannot be applied until Italy's MLI is entered into force. Therefore, the MLI does not apply in respect for India Italy DTAA.

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ILLUSTRATION 1

An Indian company intends to withhold taxes on a payment to be made to an Italian Company on 10th April 2026. In this regard, the Indian company wants to understand whether the provisions of MLI are applicable to read it along with the India-Italy DTAA.

SOLUTION

The MLI entered into force for India on 1 October 2019, but entry into effect for a particular treaty depends on the status of both Contracting Jurisdictions and Article 35. As Italy had not deposited its instrument of ratification, acceptance or approval as on 10 April 2026, the MLI had not entered into force for Italy and did not modify the India-Italy DTAA. The Indian company would therefore apply the existing India-Italy DTAA without MLI modifications.

How does the MLI Operates - Mechanics

The MLI is only an addition to the existing DTAA and does not replace the DTAA. It only intends to modify/amend the existing DTAA subject to the discretion of the parties and hence has to be read along with the DTAA between the parties. Due to the unique feature of MLI not being a standalone agreement, the operation of the MLI is critical and needs proper application. The mechanics for applying the MLI is on the satisfaction of the conditions as follows:

Both the Contracting States to the DTAA should be signatories to the MLI.

↓

Both the Contracting States should have duly notified their DTAA as a Covered Tax Agreement (CTA) and the MLI should have entered into force.

↓

The substantive provisions and choices of the Contracting States to be analysed through the compatibility clause and notification clause, regarding the provisions of the CTA that is to be modifed by the MLI.

↓

To identify, whether any reservation is made on the application of a provision of the MLI by either of the contracting parties.

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ILLUSTRATION 2

Whether MLI provisions will apply in the following scenarios?

(a) Country A and Country B are signatories to the MLI. Both countries have ratified the MLI agreement as per their domestic legislative process. Country A has notified DTAA with Country B as a CTA, however, Country B has not notified DTAA with Country A.

(b) Country A - Country B DTAA is a CTA under Article 2 of the MLI as both the countries have notified the concerned DTAA. Country A has ratified the MLI under their domestic laws and has deposited the ratification instrument. Country B has not ratified the MLI owing to political instability in their country. In this regard, Country A wishes to invoke the MLI provisions while accessing the Country A – Country B DTAA. Is the action of Country A valid?

SOLUTION

(a) Since Country B has not notified DTAA with Country A as CTA, the MLI provisions will not apply with regard to the Country A - Country B DTAA, as per Article 2 of the MLI.

(b) Under Article 34 - Entry into Force of the MLI, only when a Country deposits its instrument of ratification, the MLI will enter into force according to the timelines stipulated in the mentioned Article. In the given scenario, since Country B has not ratified the MLI, consequently, the MLI with regards to Country B has not entered into force yet. Hence, Country A - Country B CTA under MLI is not in force yet and, therefore, provisions of the MLI are not applicable. The action of Country A is, therefore, invalid.

Resources: The discussion on BEPS Action Plans contained in this chapter is essentially based on the Action Plans developed in the context of the OECD/G20 BEPS Project and available at the website https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html#beps-actions

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SUMMARY

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Significant economic presence of a non-resident in India shall also constitute business connection in India. Significant economic presence means-
<table><tr><th></th><th>Nature of transaction</th><th>Condition</th></tr><tr><td>(a)</td><td>in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India</td><td>Aggregate of payments arising from such transaction or transactions during the tax year should exceed ₹ 2 crores.</td></tr><tr><td>(b)</td><td>systematic and continuous soliciting of business activities or engaging in interaction with users in India</td><td>The number of users should be atleast 3 lakhs.</td></tr></table></td></tr>
<tr><td>ii</td><td>A virtual fixed place of business PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction & carries on business through that website.</td></tr>
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iii	Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider.	Section 393(1) [Table Sl. No. 8] of the Income-tax Act, 2025 provides that where sale of goods or provision of services by an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator is liable to deduct tax at source @0.1% of the gross amount of such sales or services or both.
iv	Imposition of an Equalisation Levy on consideration for certain digital transactions received by a Non-resident from a resident or Non-resident having PE in the other contracting state.	

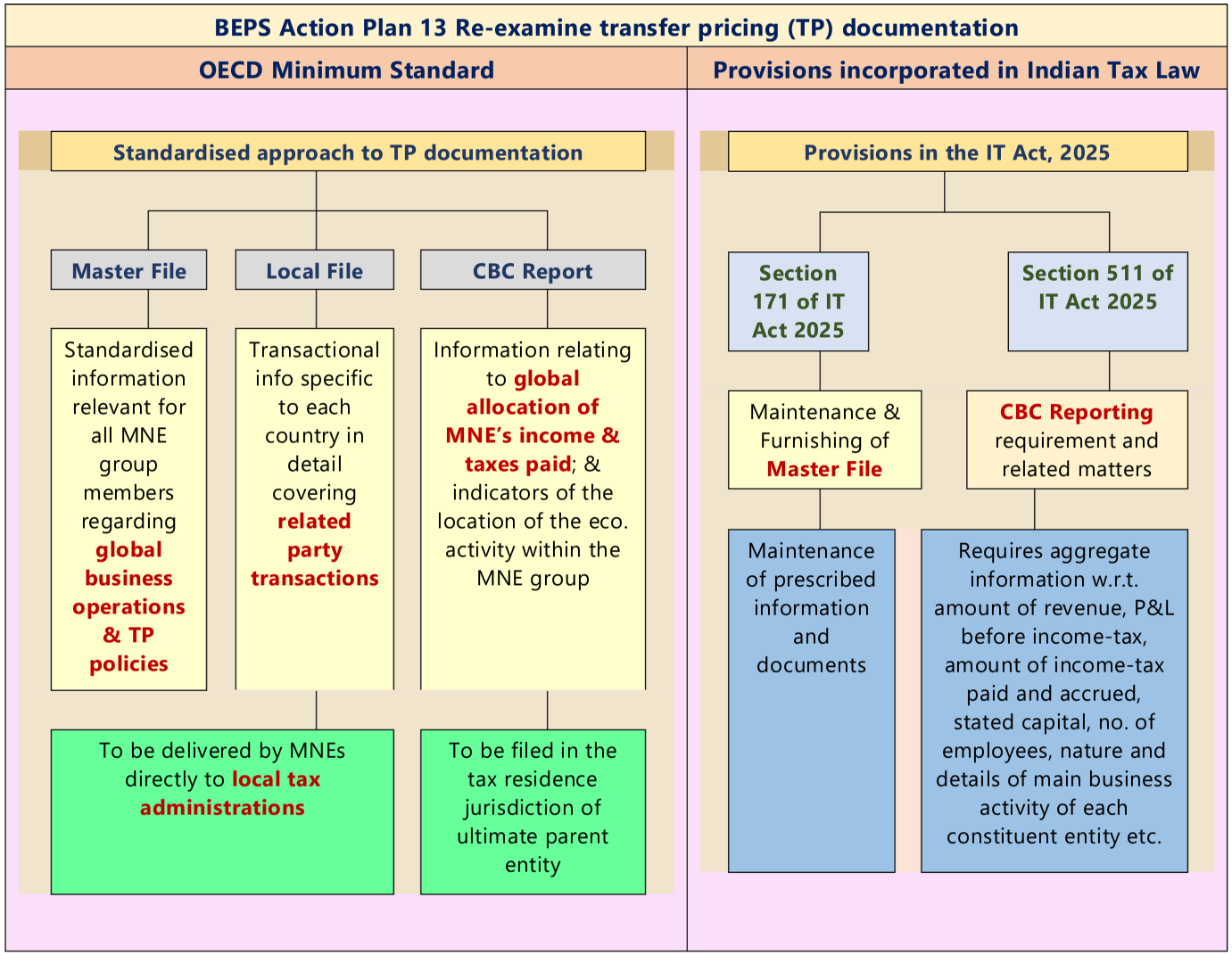
BEPS Action Plan 6: Preventing treaty abuse	
OECD Minimum Standard	**LoB clause incorporated in Indian Tax Treaties**
Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping by including in their treaties: (i) the combined approach of **Limitation of Benefits (LOB)** and **Principal Purpose Test (PPT)** rule, (ii) the **PPT rule** alone, or (iii) the **LOB rule** supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.	**LoB clause in India-Mauritius Tax Treaty** • On 10.5.2016, the India-Mauritius tax treaty was amended and for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. • The tax rate on such capital gains arising from 1.4.2017-31.3.2019 should, however, not exceed 50% of the applicable tax rate on capital gains in India. • LOB Clause provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. • A shell or a conduit Co. claiming to be a resident of a Contracting State shall not be entitled to this benefit. • A shell or conduit Co. is any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. **LoB clause in India-Singapore Tax Treaty** • Capital gains on sale of shares of an Indian company by a resident of Singapore was taxable only in Singapore, if such shares were acquired before 1.4.2017. • The India-Singapore tax treaty has been amended to provide that capital gains on alienation of shares acquired on or after 1.4.2017 would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. • The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty.

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BEPS Action Plan 7: Prevent the Artificial Avoidance of PE Status

OECD Recommendation	Provision incorporated in Indian Tax Law
Review of definition of PE To prevent tax avoidance By way of **Commissionaire Arrangements** Modification of Article 5(5) to **include a person who habitually plays a principal role leading to conclusion of contracts** in the definition of agent By way of **Fragmentation of business activities** Introduction of anti-fragmentation Rule **to prevent fragmentation of functions** which are otherwise a whole activity to avail benefit of exemption	Business Connection includes any business activity carried through a person who, acting on behalf of the NR, habitually concludes contracts or **habitually plays the principal role leading to conclusion of contracts** by the NR. Such contracts should be- (i) in the name of the NR; or (ii) for transfer of ownership of, or for the granting of right to use, property owned by that NR or that the NR has the right to use; or (iii) for provision of services by that NR



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BEPS Action Plan 15 Developing a Multilateral Instrument (MLI)	
BEPS Report	**Entry into Force of MLI**
The MLI helps fight against BEPS by implementing tax treaty-related measures developed through the BEPS Project in existing bilateral treaties in a synchronized and efficient manner to – • **prevent treaty abuse,** • **improve dispute resolution** • **prevent the artificial avoidance of PE status** • **neutralize the effects of hybrid mismatch arrangements**. The MLI is flexible instrument which modifies tax treaties that are "**Covered Tax Agreements**". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.	➢ The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. ➢ India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. ➢ The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification. ➢ The earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)

TEST YOUR KNOWLEDGE

Questions

1. *What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.*
2. *What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?*
3. *Discuss the provisions contained in the Income-tax Act, 2025 in line with the OECD recommendations under Action Plan 4 of BEPS.*
4. *Describe the three-tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.*
5. *Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 2025.*
6. *What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?*

Answers

1. Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity, but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

(1) Governments have to cope with less revenue and a higher cost to ensure compliance.

(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.

(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit

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businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.

(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

2. The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

The concept of 'Significant Economic Presence' (SEP) which is similar to the virtual fixed place PE as recommended in the 2015 BEPS Action Plan 1 report is contained under section 9(9) of the Income Tax Act, 2025.

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Significant economic presence of a non-resident in India shall also constitute business connection in India. As per section 9(9)(d), a non-resident shall have Significant economic presence where there is -

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the tax year should exceed **₹ 2 crores.**
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

Further, the above transactions or activities shall constitute significant economic presence in India, whether or not, -

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, significant economic presence will not be constituted for the transactions or activities are confined to the purchase of goods in India for the purpose of export.

Further, where a business connection is established by reason of significant economic presence in India, only so much of income as is reasonably attributable to the transactions or activities referred to in section 9(9)(d) above shall be deemed to accrue or arise in India.

3. In line with the recommendations of OECD BEPS Action Plan 4, Section 177 of the Income-tax Act, 2025 provides a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that tax year, whichever is less, shall not be deductible.

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The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 tax years immediately succeeding the tax year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks, Insurance business, finance company located in any IFSC and class of NBFCs notified by the Government are excluded from the ambit of the said provisions keeping in view of special nature of these businesses. Also, section 177 of the Income-tax Act, 2025 would not be attracted on interest paid in respect of debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.

4. Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability

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analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

5. In India, Section 194(1) (Table Sl. No. 2) of the Income Tax Act, 2025 contains a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership.

Accordingly, Section 194(1) (Table Sl. No. 2) of the Income-tax Act, 2025 provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent) includes any income by way of royalty in respect of a patent developed and

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registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess).

For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

6. Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

(1) Creation of two deductions for a single borrowal;

(2) Generation of deductions without corresponding income inclusions;

(3) Misuse of foreign tax credit; and

(4) Participation exemption regimes.

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