BEPS impact on India's Finance Bill, 2018

OECD | BEPS MLI

India Finance Bill 2018

Introduction

Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Over 100 countries are collaborating to implement the BEPS measures suggested by OECD. These measures ensuring that profits are taxed where economic activities generating profits are performed and where the value is created. BEPS action will affect only assesses having cross-border business & investment. BEPS Package consisting of 15 actions designed to be implemented through domestic tax rules and through Tax Treaty provisions. The OECD has introduced an international tax framework technically known as Multilateral Instrument (MLI) to stop BEPS through Treaty abuse. MLI will do away with the need to amend the individual bilateral treaties which will automatically be amended amongst the signatories of the MLI provided the bilateral treaty is listed in the MLI position by both the parties to the Treaty.

India & OECD

India is one of the many non-member economies with which the OECD has working relationships in addition to its member countries. While enhanced engagement is distinct from accession to the OECD, it has the potential in the future to lead to membership. India is on the Governing Board of the OECD's Development Centre and it also participates as an observer in some OECD Committees and various working groups.

India & BEPS

- India has been a sincere supporter of BEPS and has also endorsed some of its recommendations.
- In the Budget 2016, the three key proposals to prevent BEPS were introduced

i) Patent Tax u/s 115BBF – based on Action Plan 5 'Countering Harmful Tax practices more effectively, taking into account transparency and substance'
ii) Country by Country Reporting (CbC Reporting) u/s 286 – based on Action Plan 13 'Guidance on Transfer Pricing & Country by Country Reporting '
iii) Equalization Levy under chapter VIII of Finance Bill,2106 – based on Action Plan 1 'Addressing Tax challenges of Digital economy '

- In the Budget 2017, a proposal to insert section 94B in the line of BEPS Action Plan 4 to provide that interest expenses claimed by an entity to its associated enterprise shall be restricted to 30% of EBITDA or interest paid or payable to an associated enterprise, whichever is less.

Finance Bill, 2018 and the two key proposals to prevent BEPS: -

Proposal One- *Relating to BEPS Action Plan 7 on artificial avoidance of Permanent Establishments (PEs) in India*

The agency PE rules in the Indian Income Tax Act a non-resident will be regarded as having a business connection in India if any person acting on behalf of the non-resident habitually exercises in India an authority to conclude contracts for the non-resident in India. However, India is a signatory to Article 12 of MLI the dependent Agent PE provisions in Article 5(5) of the Indian Tax treaties as modified by MLI has expanded the scope of PE in the Treaties in comparison to the Income Tax Act.

Thus an amendment is proposed through Finance Bill, 2018 the so as to align them with BEPS action 7, and modelled on article 12 of the Multilateral Instrument (MLI), a non-resident would also be regarded as having a **business connection in India if a person acting on behalf of the non-resident habitually plays the principal role leading to the conclusion of contracts by the non-resident in India**, and the contracts are:

- In the name of the non-resident;
- For the transfer of the ownership of, or the granting of the right to use, property owned by the non-resident or that the non-resident has the right to use; or
- For the provision of services by the non-resident.

Proposal two- *Relating to BEPS Action Plan 1 relating to digital economy*

India has already introduced the concept of Equalization levy @ 6% as a separate code by Finance Act, 2016, in order to tax certain digital transactions.

As per existing provisions, the term business connection is restrictive as it essentially provides for physical presence based nexus rule for taxation of business income of the non-resident in India. Taking into consideration the BEPS Action Plan 1 on the digital economy, the budget 2018 proposes that a Significant Economic Presence would also constitute a business connection of non-resident in India. The term “significant economic presence” is defined to mean:

i) Any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed; or
ii) systematic and continuous soliciting of its business activities or engaging in interaction with a such number of users as may be prescribed, in India through digital means.

Hence, anybody having digital transactions in India and having significant economic presence without being physically present in India will still be taxable in India to the extent of their activities in India.

The introduction of the above proposal in domestic tax law will make India spearhead an MLI on digital taxation so as to get the treaties re-negotiated, thereby taxing digital companies which have no physical presence in India but have large user base or business in India. This may result in taxation of companies like Netflix, Google etc in India.