BASE EROSION AND PROFIT SHIFTING (BEPS): EVALUATING INDIA'S ANTI-AVOIDANCE FRAMEWORK

Doxa P J, LL.M., (Taxation Law), School of Law,
Joy University, Tirunelveli, Tamil Nadu, India

ABSTRACT

Base Erosion and Profit Shifting (BEPS) has emerged as a critical problem for modern-day international taxation due to the fact that multinational corporations now have operations in countries where there are different tax rates. Multinational groups can minimize their taxes by using the mechanism of transfer pricing, high interest expenses, treaty abuse, intangible property, and income shifting to low-tax countries without actually breaching the letter of the domestic tax laws. This base erosion has special relevance in the context of India because of the rapidly growing economy and a large consumer base. This paper presents an analysis of the Indian framework against BEPS, specifically in the form of transfer pricing regulations, General Anti-Avoidance Rule, thin capitalization rules, country by country report, and treaty measures. In addition, the role of India in the international framework against BEPS and the impact of Pillar One and Pillar Two rules on India's taxing powers are examined. This study finds that India's approach towards BEPS has considerably enhanced the capability of tax administration to counter tax avoidance and promote cross-border transactions. Nevertheless, the difficulties still remain in the form of complex international structures, valuation of intangibles, transfer pricing issues, digital businesses, administrative capability, and changing global minimum tax system. This paper recommends that India's BEPS strategy needs to continuously adapt, build its administrative capability, and coordinate internationally without compromising the tax certainty and promoting cross-border investment.

Keywords: Base Erosion and Profit Shifting; BEPS; Tax Avoidance; Transfer Pricing; GAAR; Pillar Two; International Taxation.

1. Introduction

International trade and national economies' globalization have changed the practice of how multinational corporations do business today. They are now able to organize production, financing, intellectual property and digital processes in different countries, making possible to locate different parts of the business in those places where it is more convenient from business and financial perspective. Although international business structures themselves cannot be considered illegal, the difference in taxation policies of nations could give an opportunity for tax aggressive behaviour of multinational corporations that are able to restructure their business in order to minimize the amount of taxable profits generated in the countries where substantial economic activities are taking place.

This practice is called Base Erosion and Profit Shifting (BEPS). Base erosion happens due to deductibility, exemption or any other arrangement that decreases the amount of income that is subjected to tax. Profit shifting is related to the shift of taxable profits from the country in which the corresponding economic activity took place. Local enterprises without access to sophisticated cross-border structures will find themselves having a relatively higher tax burden compared to large multinational groups capable of doing so.

The issue has been an important international policy agenda since there were concerns that international taxation norms were becoming insufficient for the contemporary models of business operation. In response, the OECD and G20 adopted the BEPS Project with the implementation of a comprehensive set of measures to tackle problems ranging from harmful tax practices, treaty abuse, transfer pricing, excessive interest deductions and lack of tax transparency. India has been an active participant in this process and some of the BEPS principles have been adopted by India in its domestic taxation system.

India has also developed its own anti-avoidance policies in areas such as transfer pricing, impermissible avoidance arrangements, interest deductions, international reporting and treaties. This is aimed at protecting the Indian tax base and giving more access to information about multinational operations to the tax authority. The current international tax policy debate has shifted towards the OECD two pillars policy on taxing rights and the establishment of global minimum tax.

In light of the above, the current study analyses India's anti-BEPS regime and questions

whether existing domestic and international policies are sufficient to cope with the modern types of profit shifting. The analysis will look at the interaction of India's anti-avoidance regime and the modern international tax system, along with the problem of enforcement and tax certainty. The current study finds that the Indian framework for addressing BEPS is significantly enhanced but still needs constant improvement due to technological, commercial, and international factors.

2. BEPS and the International Tax System

Base Erosion and Profit Shifting became one of the most significant issues because the traditional international tax law was based on the existence of such business characteristics as physical presence, tangible assets, and transactions taking place across borders. Modern multinational corporations can, nevertheless, allocate different functions to different countries, and heavily use intellectual property, intragroup financing, and digital technologies. This makes it possible to shift places of recognizing income and claiming deductions. Thus, Base Erosion and Profit Shifting refer to the situations when the interaction of the domestic tax systems and the international tax rules results in reducing or relocating taxable income without any relocation of economic activities.

The OECD and G20 introduced the BEPS project in 2013 and have since designed an extensive set of 15 Actions. The aim is not to do away with international tax planning but to increase the alignment between profits and the economic activities that create them. The project has also focused on transparency and increased exchange of information in order to reduce the possibilities for exploiting discrepancies between different national tax systems.

Amongst the BEPS actions, Action 4 focuses on the problem of base erosion through interest deductions. Multinational enterprises can employ intragroup financing in order to allocate large amounts of interest to high-tax jurisdictions and to record income earned in low-tax jurisdictions. Interest limitation rules are aimed at stopping deductions from being used as a way of manipulating taxable profits.

Action 5 aims to tackle harmful tax competition and increased transparency of preferential tax regimes. This action ensures that the preferential regimes are related to economic activities and that the jurisdictions cannot use incentives for mobile income in the absence of economic substance.

Action 6 is aimed at addressing misuse of treaties, such as the use of special arrangements whereby a taxpayer can get treaty benefits that were not originally meant for him/her. The introduction of anti-abuse rules such as the Principal Purpose Test is aimed at ensuring that there is no misuse of treaties but also ensuring that the taxpayers retain their treaty benefits.

Action 7 deals with the prevention of artificial avoidance of permanent establishment status. This is aimed at ensuring that businesses do not find ways to create substantial activity in a jurisdiction without meeting the criteria needed to have a taxable presence.

Actions 8-10 are aimed at enhancing the principle of transfer pricing through ensuring profit allocation according to the creation of value. Much emphasis is put on transactions related to intangibles, risks, contracts and intra-group services.

Action 13 enhanced transparency in taxation through Country-by-Country reporting. The large multinational groups must provide information to the tax authorities concerning the distribution of the income and economic activities.

Finally, Action 15 included in its provisions a Multilateral Instrument to be used as a means of modifying existing bilateral tax treaties in a coordinated fashion. This minimizes the burden on the jurisdictions to negotiate every individual bilateral treaty separately and helps in implementing the anti-avoidance measures already agreed upon.

Consequently, the BEPS Project has brought about a more transparent and substance-based international taxation system along with anti-abuse measures. For India, such developments not only strengthen its domestic tax policies but also create obligations and challenges regarding tax administration and multinational corporations.

3. India's Domestic Anti-Avoidance Regime

A combination of both specific and general anti-avoidance provisions has been put in place in India in order to ensure the integrity of the Indian tax base in situations where tax liability may be reduced or where tax revenues are transferred out of India through any form of tax avoidance practice. These anti-avoidance provisions are contained within the Income Tax Act of 1961 and are supported by means of reporting, documentation, and dispute resolution. In place of depending upon a particular anti-avoidance provision, India has several anti-avoidance measures in place.

Provisions related to transfer pricing are the major components of India's BEPS prevention system. Sections 92 to 92F contain provisions related to the determination of income in international transactions involving associated enterprises. These provisions require that the transactions be done in line with the arm's length principle. These provisions are designed to prevent any form of manipulation in terms of the prices of the transactions in order to move the profits from one jurisdiction to another.

Section 92C provides for the method for determining arm's length price of the transaction, which includes methods such as Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method, Profit Split Method, and Transactional Net Margin Method, or where applicable, the prescribed method. The question relating to the determination of arm's length price may be referred by the Assessing Officer to the Transfer Pricing Officer under section 92CA.

For supplementing this mechanism, India has adopted Advance Pricing Agreements (APAs) and Safe Harbour Rules. In an APA, greater certainty is assured through prior determination of the method of pricing of certain international transactions. Safe harbour rules enable those taxpayers who satisfy the stipulated criteria to adopt certain specified margins or prices. These tools are important for the reason that an efficient anti-avoidance system must not only serve the interest of revenue but also minimize undue and unnecessary uncertainty and litigation for legitimate multinational activities.

General Anti-Avoidance Rule (GAAR) offers a wider system for dealing with arrangements that do technically satisfy the conditions of individual provisions but have been made with the objective of obtaining an improper tax benefit. Sections 95 to 102 confer upon the tax authority powers to investigate any arrangement where the statutory conditions of the impermissible avoidance arrangement exist. Relevant factors include the creation of rights and obligations which are usually not created in arm's length dealings, abuse or misuse of tax laws, absence of commercial reality of an arrangement, and carrying out an arrangement in a manner which is not ordinary.

GAAR is of special importance since the tax planning of high order may not always constitute a clear breach of a particular clause of the legislation. The provision gives an opportunity to consider the entire meaning and the object of the tax planning scheme. However, the application of GAAR needs to be restricted to certain procedural measures as its overly broad

interpretation will result in uncertainty for legitimate business operations.

The second tool is the thin capitalisation rule provided for in Section 94B. A large amount of interest expenses generated by excessive borrowing on behalf of multinational group of companies is possible in India while the income from such borrowings is recorded somewhere else. Section 94B restricts the deduction of the interest or other kind of expense associated with borrowing from an associated enterprise depending on statutory conditions and thresholds.

India has also adopted measures aimed at ensuring transparency of multinationals through the use of Country-by-Country (CbC) reporting and associated documentation. Section 286 demands that multinational enterprise groups, which are eligible, submit information regarding the allocation of income, profits, taxes paid and economic activity indicators for their jurisdictions. This is meant to help tax authorities identify where reported profits do not match the location of economic activity. The Master File requirement also provides tax authorities with information on the structure and transfer pricing policies of the multinational groups.

In all, these regulations have been designed to provide an effective anti-avoidance regime. Transfer pricing relates to the pricing of transactions among related parties, GAAR seeks to address other abusive situations, thin capitalization prevents excessive interest deductions and CbC reporting ensures transparency. However, the effectiveness of these regulations rests on the administration's competency in handling information, consistent enforcement and their ability to deal with complex multinational business models.

4. Implementation of the BEPS Project in India

The implementation of the BEPS Project in India involves the process of ensuring compliance with international standards of tax management while safeguarding India’s national revenue interest. Being a part of the OECD/G20 Inclusive Framework, India can participate in the discussion of international tax avoidance, tax transparency and allocation of taxing rights. The success of these policies is ensured not only by the use of international standards but also by their proper implementation via domestic regulations, bilateral agreements and tax administration practices.

One of the main aspects of BEPS implementation relates to the improvement of transfer pricing rules and documentation. According to India’s current policy, all international transactions

between associated enterprises must conform to the arm's-length principle. Additionally, the introduction of Master File and Country-by-Country reporting ensures a better quality of information that tax authorities have about operations of multinationals in global economy. This helps to detect discrepancies between the geographical location of economic activity and profit distribution. However, such information is useful when it comes to analysing financial deals and identifying artificial profit shifting schemes from legitimate business strategies.

Moreover, India has responded to treaty abuse using anti-avoidance mechanisms within its national legislation and the introduction of treaty-based instruments. The Multilateral Instrument (MLI) as a result of BEPS Action 15 represents the instrument for modification of covered bilateral tax treaties for inclusion of mutual anti-abuse rules. The Principal Purpose Test (PPT) serves as one of such rules, whereby a treaty benefit can be denied in certain situations in case obtaining the benefit was among the main purposes of the arrangements or transactions, depending on the treaty language and other conditions. Such rules seek to avoid misappropriation of treaty chains but preserve treaty benefits for cross-border investments.

Another example of Indian response to the taxation issues related to the digital economy illustrates the evolution of its approach to addressing BEPS issues. The Equalization Levy has been introduced in 2016 and modified in 2020, seeking to solve certain tax problems arising from digital transactions between non-residents. It could be considered as an early attempt at dealing with the issue of taxing digital economic activity under international tax norms. However, the Equalization Levy was discontinued since 1 April 2025 due to amendments to the Finance Act, 2025. It thus becomes imperative for countries to update their tax policies in accordance with ongoing international negotiations and changes in the tax policy landscape.

The other development worth mentioning is the use of information exchange on the international level to facilitate tax administration. CbC reporting allows the tax administration to analyze the worldwide allocation of a multinational enterprise's income, earnings, taxes, and economic activity. Such information can assist in carrying out a risk assessment and identifying cases requiring further analysis. It is noteworthy that just reporting such information does not amount to any evidence of profit shifting and tax avoidance, the information should be evaluated against applicable laws and commercial considerations of each particular case.

Implementation of BEPS measures in India thus contributes to building an open international tax regime. At the same time, domestic implementation needs to take into account a balance

between revenue raising, legal certainty, effectiveness of the administrative process, and needs of international investments. Ongoing evolution of the digital business models and global minimum taxation makes constant review of India's framework to prevent tax avoidance imperative. Next stage of reform needs to be directed at making international standard effective in the context of Indian legislation.

5. Pillar One and Pillar Two: Implications for India

OECD/G20 Two-Pillar Solution is one of the significant developments in international taxation as it is aimed at addressing issues that cannot be effectively solved by means of domestic anti-avoidance rules. While Pillar One relates to reallocating certain taxing rights between jurisdictions, Pillar Two is aimed at ensuring that large multinational enterprise groups will be taxed at a minimum rate. Both Pillar One and Pillar Two have serious implications for India since they pose some questions related to revenue protection, taxing rights, investment policy and the further development of domestic tax legislation.

Pillar One is aimed at allocating a part of the profit earned by the most successful multinational enterprises to market jurisdictions such as those in which customers/users are situated even though the enterprise does not have any physical presence in these jurisdictions.

This issue is highly relevant for India because foreign digital enterprises can earn significant amounts of money from Indian customers even though they do not have any traditional business operations in the country. However, any agreement should take into account the concerns of India about revenue allocation and dispute settlement.

Under Pillar Two, the global minimum effective tax rate of 15% is proposed for the multinational enterprise groups satisfying the threshold of annual consolidated revenue of €750 million. Its GloBE Rules form a coordinated system to impose additional tax when the effective tax rate on the relevant profits in the country falls below the minimum rate based on the application of the rules and exceptions therein.

It will help mitigate the incentives to move profits to low-tax countries and tax competition.

For India, Pillar Two offers certain advantages and challenges as well. The imposition of the minimum tax can help diminish the incentives to move the profits to low tax jurisdictions. Nevertheless, it might influence the use of tax incentives to attract investments. Thus, India

needs to ensure the alignment of its corporate tax regime with the international environment. Subject to Tax Rule in Pillar Two is equally applicable to developing countries since it is aimed at protecting taxing rights of the source country over specified payments made intra-group at low nominal tax rates.

Neither of the two pillars should be perceived as a substitute for the Indian anti-avoidance legislation. It will continue to play an important role in dealing with transactions beyond the reach of the new international regimes. India has to consider the cost of compliance with them, specialisation in expertise required, and potential disputes caused by divergence between domestic and international tax law.

In general, both Pillars One and Two have good prospects of enhancing international cooperation and preserving India's tax base. However, their effectiveness will largely depend on international agreements, India's approach to implementing them and the capacity of tax administration to enforce them consistently. India has to pursue a balanced strategy that ensures protection of revenues and rights of taxpayers and predictable environment for international business operations.

6. Evaluating the Effectiveness of the Indian Anti-Avoidance Framework

The Indian anti-avoidance system has become more comprehensive because of the interplay between the legislation on transfer pricing, GAAR, interest limitation rules, international reporting requirements, and treaties. The introduction of these measures has made the legal toolkit used by the tax authorities for the analysis of cross-border transactions and avoidance schemes that are aimed at decreasing the Indian taxable income more effective. Nevertheless, the assessment of the effectiveness of the system should be based not only on the number of provisions but also on the effect that these provisions have.

One significant advantage of the Indian approach is the increase in transparency and information. The introduction of the requirements regarding master file and country-by-country reporting gives the tax authorities an opportunity to know more about the operations of multinational enterprises all over the world. Moreover, information on transfer prices will allow authorities to check the arm's-length character of transactions. As a result, it will be more difficult for multinational companies to use information differences between jurisdictions.

A second merit lies in the creation of measures that ensure tax certainty. An Advance Pricing Agreement (APA) is a measure that allows a taxpayer who is eligible to enter into an agreement with the tax administration regarding the choice of transfer pricing method for certain international transactions. This would help in avoiding disputes, minimize litigation and enhance certainty in the operations of multinational firms. The APA programme of the CBDT has grown further indicating the need for advance agreements in mitigating transfer pricing uncertainties.

Notwithstanding these gains, there are still many obstacles in implementing them. Transfer pricing of intellectual property, digital services, management charges and intra-group financing is often associated with sophisticated economic analysis. Valuation of specific intangibles is usually a challenge since it could be hard to find comparable market transactions. Disputes may arise due to differences in valuation, functional analysis and risk allocation even when all parties intend to comply with the provisions of the law.

The other issue is that of striking a balance between rigorous enforcement and proper tax planning. GAAR offers an effective means of analyzing the issue of abuse, but there is always some room for uncertainty when this is not predictable. It would not be right to label any genuine business transaction as avoidance simply because it leads to a tax benefit. Guidance is thus important in this case to sustain the integrity of the tax system.

This structure also suffers from issues regarding administration and technology. The tax administrators will have to deal with voluminous financial records, analyze complicated structures of firms and identify cross-border transactions. This will call for expertise on the part of tax authorities, information systems and international coordination. Small taxpayers can also find documentation cumbersome where it is too hard to understand.

On balance, the anti-avoidance regime adopted by India has enhanced the country's ability to detect and deal with aggressive tax schemes. Nevertheless, just because there are extensive legal provisions does not mean that they will be effectively enforced. The effectiveness of the anti-avoidance regime will depend on proper enforcement, prompt dispute settlement, international cooperation and protection from arbitrary assessments. In order to solve the problems of tax avoidance without creating unnecessary uncertainty for legitimate business, India needs to develop the anti-BEPS regime.

7. Challenges and Reform Measures

The development of India's anti-BEPS regime is impressive; however, its effective enforcement will require continuous reforms in law and administration. One of the main difficulties lies in the complexity of multinational business structures. Business involving intellectual property, online services, intra-group financing, among others, may make it hard to decide where profits should be taxed. In order to make proper assessments, the tax authorities need to enhance their expertise in international taxation, finance and digital business.

Another problem is the long-drawn tax litigation and uncertainty in the interpretation of anti-avoidance measures. While GAAR and transfer pricing rules are essential, an inconsistency in their implementation might drive up the cost of compliance and make it unattractive for investors to invest. Therefore, proper guidance by tax administrators, reasonable assessments and prompt settlement of disputes should be considered a priority. The use of Advance Pricing Agreements and other dispute resolution mechanisms can help reduce ongoing disputes.

In addition, there is a need for improved utilization of international tax information. Reports from Country-by-Country reporting and other disclosures can be used for risk assessment instead of automatic adjustments. Cooperation with foreign tax administrations will help in the verification of international transactions, identification of artificial profit shifting and concealment of profits. At the same time, confidential taxpayer information should be well-protected.

The constantly evolving framework of minimum tax globally necessitates that India undertakes periodic evaluations of its corporate tax incentive programs and its international tax regimes in light of Pillar Two regulations. India must also be an active participant in international negotiations so that the interests of developing countries and market countries are taken care of. Finally, reform must strike a balance between protecting revenue and protecting taxpayer rights.

Transparency, consistent application, availability of adequate remedies and appropriate compliance requirement will ensure that the anti-BEPS regime is not only effective but also credible. With the aid of improved administrative capacity, legal certainty and international cooperation, India can enhance the effectiveness of its anti-BEPS regime without unduly interfering in the conduct of cross-border transactions.

8. Conclusion

Base Erosion and Profit Shifting continues to be a major issue in international taxation due to the ability of multinational companies to structure their operations in countries with differing tax regimes and effective tax rates. In the case of India, tackling this issue becomes imperative to safeguard revenue, preserve equity among taxpayers, and tax the profits attributable to the economic activity taking place within the country. The introduction of transfer pricing laws, GAAR, thin capitalization, multinational reporting and treaty abuse provisions by India have provided it with the ability to deal with tax avoidance.

The OECD/G20 BEPS Project has helped in fostering greater transparency and cooperation internationally, whereas the Two-Pillar Solution has brought about changes in the discussion regarding taxation rights and minimum tax. These are examples that indicate that domestic anti-tax avoidance legislation must work in tandem with international coordination. However, complicated transactions, valuation issues, digital economy, long legal proceedings and administrative problems continue to impact the efficiency of India's system.

This paper finds that the anti-BEPS regime of India is comprehensive in scope but needs to continuously improve in terms of its implementation. Improving specialized tax administration, dispute resolution, the use of international information and guidance on anti-avoidance rules must continue to be priorities. In addition, such efforts need to be respectful of taxpayer rights while distinguishing abusive schemes from business arrangements.

The ultimate goal for India should be establishing an anti-avoidance regime that is effective, predictable and reflective of international developments. This would safeguard the interests of India in maintaining its tax base without compromising on its development. In the end, the effectiveness of the Indian response to BEPS is not just about putting more rules into place but in implementing those rules effectively and predictably.

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