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BASE EROSION AND PROFIT SHIFTING (BEPS)

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I. Introduction

“Taxes are what we pay for a civilised society. I like to pay taxes. With them I buy civilisation”, Justice Holmes mentioned these words in the context of examining the issue of Taxation. By paying taxes honestly, we fulfil our duty to the society and country we live in. At the same time, maximisation of profit by the lawful means is the objective of all persons. Income Taxes are the primary source of revenue for any Government and it helps the Government to provides better infrastructure, to improves the standard of living and provides security to its citizens.

According to Alex Cobham and Petr Jansky (Cobham, 2018) every year around US \$ 500billion of tax is lost due to tax avoidance by big business houses across the world. As per the said report, these large business houses have practice tax avoidance at large scale.

The government of India has always corrected the legal loopholes in the laws by of periodical amendments to the tax law. As always seen that Government in this regard is always behind asthe corporate manipulate tax laws by finding loopholes in laws. These corporations are able to structure complex and elaborate tax avoidance plans and hence causing tax loss to Government.

II. Tax Planning, Tax Avoidance and Tax Evasion

The Shorter Oxford English dictionary defines evasion as an “act of evading or escaping as byartifice or contrivance, dodging, prevarication, shuffling excuse of subterfuge”. In the year 1977Honourable Supreme Court of India in case of McDowell and Co Ltd Vs CTO (1977) 1SCR 914has held that shortest definition of Tax

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avoidance is the art of dodging tax without breaking law.

Thus Tax evasion means not paying taxes as per the provision of the law. Tax evasion could be done by concealment of income or inflation of expenses or falsification of accounts or by knowing violation of rules, etc. Tax Planning is considered to a refined form of "Tax avoidance" and implies arrangement of a person's financial affairs in such a way that it reduces the tax liability without violating any of the provisions of law.

On the matter of tax evasion and Tax avoidance, the judgement by Honourable Supreme Court of India in case of McDowell and Co Ltd vs CTO is considered as a landmark. This Apex Court judgement has thrown considerable light on the subject. The Court frowned upon the colourable devices adopted by the assessee to reduce the tax burden. It is held that „tax planning may be legitimate provided it is within the framework of the law'. However, it is held that colourable devices' cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods'.

In the year 2003, Honourable Supreme Court of India in case Union of India v. Azadi Bachao Andolan (Azadi Bachao') has categorically restored the right of the tax-payer to mitigate taxes by all legitimate means. The issue before the Court about tax benefit to the assessee under the India-Mauritius tax treaty on the basis of a valid tax residency certificate.

In the year 2012, Honourable Supreme Court of India in case of Vodafone International Holdings BV versus Union of India, after reviewing various judgments of the House of Lords in England had reiterated that the Westminster principle¹ are the cornerstone of law and every tax-payer is entitled to arrange their affairs so as to reduce the tax liability. If the motive for a transaction is to avoid taxes then also it does not invalidate it unless a particular law provides so.

Applying this test, the Supreme Court of India in Vodafone case has concluded that

¹IRC vs. His Grace The Duke of Westminster ('Duke of Westminster') in the year 1936 said that "every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be".

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the Offshore Transaction herein is a bonafide structured Foreign Direct Investment (FDI) into India which fell outside India's territorial tax jurisdiction and hence not taxable. All these discussions were before GAAR²⁸ Provisions became law in India. Now with the operation of GAAR provisions these Supreme Court judgments need to be tested with the above principles.

a. Difference between Tax Planning and Tax Evasion.

The distinction between tax avoidance and tax planning is very thin and both of them are entirely within the legal framework of the law. Tax planning can be said to be which are expected from a taxpayer but tax avoidance can be said beyond the expectation from a taxpayer.

Income Tax Act provides for a tax deduction and incentives as per Section 10AA(SEZ), 35(2AB) for Research and Development, Chapter VI-A and others. If an assessee avails such benefit as provided in those provisions, then it amounts to tax planning. On the other hand, if an assessee shifts its taxable profit to other tax jurisdictions without any commercial substance for the only purpose of reducing income tax liability, then it tantamount to tax avoidance. Further, tax evasion is wholly illegal and prohibited under the law of the land. The example of tax evasion is an undisclosed cash transaction, under-invoicing of sales and others.² Some of the companies have aggressively utilised tax strategies for tax avoidance purpose. The Role of tax havens countries and use of subsidiaries³ Companies play a significant role in such tax avoidance.

Below are some of the present context examples of Tax Planning, Tax Avoidance and Tax Evasion which has happened in recent past.

a. Vodafone Case

Vodafone International Holdings B.V. (VIH) of Netherlands had purchased Hutch-Essar mobile business in India in the year 2007. It used a complex overseas holding

²GAAR is an anti-tax avoidance law under the Income Tax Act, 1961. It is known as the general anti-avoidance rule.

³'Subsidiary' means a company in which shares/stock more than 50% controlled by the parent company or the holding company.

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structure. By use of such offshore structure no capital gains tax in India was payable since the shares of the offshore holding company was sold (which held Hutch-Essar mobile business).

The matter reached the Supreme Court since Income tax authorities have argued that since Indian Business has been sold; hence capital Gain needs to be paid in India. The Honourable Supreme Court held that transaction is not taxable in India since this transaction has taken place between non-resident companies of India.

b. Reliance India Limited

Reliance Group was famously known as Zero tax company⁴ in the year 1995. It used to pay almost zero tax to Government at that time. Seeing all these practices the Government brought in a new provision known as Minimum Alternative Tax wherein tax is payable based on Book Profit of the companies.

Controller Auditor General (CAG) of India conducted an integrated audit of Reliance India Limited (RIL) in March 2018. CAG found out that RIL used the merger and demerger option among group entities and transactions with related parties, to reduce the tax burden.

c. Google India

Google India is a subsidiary of Google International LLC. It is also an authorised distributor of Google Ireland's Ad Words' programme. Google Ireland owns Ad Words' technology. The Bangalore Income Tax Appellate Tribunal has held that Google India has to pay taxes on payment made to Google Ireland by Google India for the purchase of advertising space.

d. Tata Industries

In 2007 Tata Industries sold their shareholding in Idea cellular to Birla TMT Holdings. This was done through Tata Industries subsidiary in Mauritius and thus paid no capital Gain tax in India. Income Tax disputed the stands of the company and demanded

⁴Tax haven is a country that offers a minimum tax liability in a politically stable environment, with almost no financial information sharing with foreign authorities.

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Income tax. Income Tax Appellate Tribunal (ITAT) held that in this particular case there was no transfer of capital assets by a tax resident of India to a non-resident, and hence it cannot be taxed on the capital gains that arose on the sale of Idea cellular shares.

These are a few examples of how corporate structure is being used to avoid payment of taxes.

b. Action by the Government with respect to tax avoidance.

Tax avoidance plans used by corporate has caused an enormous loss of tax revenue. Many cases of tax avoidance have come to light in the past few years. The government of India had framed specific law to control tax avoidance by way of the Income Tax Act. Some of such provision is below

- General Anti-Avoidance Rule (GAAR) law came into effect in India from 1st April 2017. The main purpose of such GAAR law to curb tax avoidance through the specific definition of "Impermissible Avoidance Arrangement" under the law. Thus any arrangements or series of arrangements made to obtain a tax benefit and it's the main purpose is to obtain Tax benefit then it is an impermissible arrangement under tax law.
- Place of Effective management for companies was introduced in the year 2015 and it provided that if a foreign company the place of effective management (POEM) in India, then such company will be assessed in India as a Tax Resident of India.
- Various change in tax law has been introduced to align with OECD's Base erosion and profit shifting (BEPS) project.

c. OECD⁵ Base Erosion and Profit Shifting Project.

The business objective of many corporates is to reduce payout of tax and make increase the profits for their shareholders or investors. The idea behind such a plan is that the corporates must not lose any money in the payout of taxes and increase

⁵Organisation for Economic Co-operation and Development (OECD)

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profit by reducing the cash outflow from any business transaction. Thus Corporates sees Tax as an item of business expenditure and wants to reduce the same. Corporates never view taxes as a contribution for building the nation or society.

Across world countries have reduced the income tax rates to attract corporates to invest in those countries which in turn develop the economy of the country. Thus this kind of correlation or nexus of reduced tax rates gives corporates arbitrage for tax avoidance.

To curb practices of Base erosion and profit shifting, Organisation for Economic Cooperation and Development (OECD) ⁶ along with G-20 countries made an Action Project which was called Base Erosion and Profit Shifting (BEPS) Project. BEPS project aimed at providing policy documents international tax laws to plug the law loopholes or gaps. In effect its aims to provide guidelines to every country to levy a fair share of taxes on the business transactions.

In October 2015, the OECD issued the final 15 Action Reports on BEPS Project and the G20 Finance Ministers have endorsed the same at their meeting on 8th October 2015 in Lima, Peru. The underlying principle of the BEPS Project is that tax should be paid in the tax jurisdictions in which the economic substance or the value creation of a transaction are carried out. The tax benefits should not be given to companies which set up to take unfair advantage of tax treaties & rules without any economic substance. These companies use the mismatch in tax rules of different countries and take advantages of the same. The OECD/G20 BEPS Project created a single set of consensus-based international tax rules principles to protect tax bases while offering increased certainty and predictability for taxpayers.

⁶Organisation for Economic Co-operation and Development (OECD) founded in 1960 and it provides a platform to compare policy experiences of various Government and discuss common problems and possible solutions.

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To conclude the OECD guidelines provides that economic activities and value creation is the key for levy of any taxes and it will ensure that the respective country gets their legitimate and fair part of the tax.

Concluding Remarks

In the findings an attempt has been made to understand the perception of respondents using primary data and match the conclusion using statistically / secondary data. Both results were interestingly similar. After summarising the concluding remarks, this chapter captures the results of perception data analysis and secondary data.

Taxes are the main source of income for the Government of a country. Without adequate taxes, the Government cannot meet substantial public expenditure.

India has a slab-based tax system, the first slab being tax-free. Only a small proportion of the income class of the nation, actually pay income taxes. Reform should be made in tax systems to encourage the filing of tax return and paying of taxes by all classes of assesseees. It is a well- established norm that unduly high rates of income tax are counter-productive.

In India, public morality must be raised for the voluntary payment of taxes for nation- building. In this regard politicians, senior civil servants, intellectuals and the media people must play an important role. They must set an example for others to emulate by paying taxes.

Indian tax collection administration must be made more efficient. Honest officials in the tax department must be recognised and rewarded. A thorough overhauling of the economic intelligence division of the tax administration must be made.

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