International Journal of Environmental Sciences
ISSN: 2229-7359
Vol. 11 No. 11s, 2025
https://www.theaspd.com/ijes.php

Double Taxation Avoidance Agreements: A Critical Analysis From An Indian Perspective

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ABSTRACT

The DTAAs are the most important tools in international taxation where they address the negative impacts of the taxation of cross continent trade and investment but simultaneously preventing fiscal evasion. In this paper, a critical overview of DTAAs is given in an Indian perspective, highlighting the history behind the advent of DTAAs, their principles and the sophisticated provision to curb the abuse that India has put in place. It investigates the intricacies of the notions of Permanent Establishment (PE), taxing of the various sources of incomes (business profits, passive income, and capital gains) and the pitfall in disputing.[1]

A major part of the discussion is on the drastic effects of the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative and the Multilateral Instrument (MLI) on the treaty policy of India. The debate indicates that India has had a policy change in its strategies of taxing and protection of its revenue sources more by asserting higher degrees of source-based tax rights and revenues protection than a historically more investment-driven approach. The article ends by laying out developing concerns such as the digital economy taxation discussions (Pillar One and Pillar Two) and provides prospective reflections of how India is likely to compete with International tax standards in the near future.[2]

Keywords: *Double Taxation, Permanent Establishment, Treaty Abuse, Source Taxation, Multilateral Instrument, Digital Taxation*

INTRODUCTION

DTAAs Tax treaties, or more specifically known as Double Taxation Avoidance Agreements (DTAAs), are a bilateral agreements between two countries whereby the contracts work to deter the occurrence of dual taxation on the same income earned or received in the two countries. These treaties have the twofold aim to eradicate tax obstacles of international trade and investment and thus to foster reciprocal economic ties and ease the way of capital and technical exchange and on the other hand avert the fiscal evasion. India is a fast growing economy that has a major dependence on foreign direct investment (FDI) and large amount of cross border dealings; hence, it has operationalized a wide network of DTAAs with more than 90 countries. This large network highlights the fact that India is an active player in the world economy and that it is tactically involved in the international tax standards. The primacy of DTAAs in Indian context goes down to the fact that they help in granting tax certainty to all foreign investors as well as Indian companies that stay in foreign countries. Through assimilation of taxing rights between the contracting states on different types of income (business profits, dividends, interests, royalties and capital gains among others), DTAAs do not focus taxpayer individuals on grossly excessive and deterrent forms of taxation modalities.[3]

They also put in place channels of coordination and information sharing as well as settling of differences thus enhancing greater transparency and collaboration between tax administrations. Nevertheless, there is a certain tension that accompanies the use of DTAAs. These agreements although made to create investment may also be prone to abuse and be confronted with base erosion and profit shifting (BEPS) and the governments as the source country would also suffer massive revenue loss. This is a natural Tug of War between encouraging investment and defending local tax base and in this regard, it is the heart of this critical analysis. India epitomizes the policy shift it has undergone and is experiencing with DTAAs, shifting its stance out of the stage where it keenly wanted to attract foreign investment by offering tax

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[1] Organisation for Economic Co-operation and Development (OECD), *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing 2017).

[2] OECD/G20 Inclusive Framework on BEPS, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (8 October 2021).

[3] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing 2017)

concession to a time it is more aggressive to defend its wealth in terms of tax revenue and to oppose such aggressive tax planning being carried out by its adversaries.[4]

The volume and strategic significance of India DTAA network can only be understood in terms of the transition of the country as a developing economy into which investment mainly flowed, to a more aggressive global role with a balance between the investment promotion and revenue safeguarding and anti-abuse policies. In the past, DTAA played a significant role in bringing in foreign money into India with the extent of concessions given akin to the one in the initial India-Mauritius agreement. But with the recent amendments done in some major treaties and active implementation of world-wide anti-BEPS measures, it can be seen as an entirely different case. This is an indicator of the increasing economic maturity of India and its efforts to prevent its revenues being eaten up by tax avoidance structures as well as the ability of the country to impose fair taxes on the profits that it has earned in India.[5]

This changing attitude has placed India in a more active and aggressive role in the development of international tax norms, which may have impactful effects on other developing countries to take up the similar type of revenue protective strategies. This article engages in a thorough critical examination of DTAAs in Indian light, including their history, and application of important international tax principles and also the challenges that emerging business models impose on DTAAs and the most relevant issue of all; the digital economy. It will consider the legislative and judicial strategies on tax avoidance in India such as General Anti-Avoidance Rule (GAAR) and the influence thereof of the BEPS project and the Multilateral Instrument (MLI). The remaining parts of this paper will expound historical, legal, policy, and judicial aspects of DTAAs leading to an evaluation of the current policy goals and future of India as far as the tax system of the international environment is concerned.[6]

RATIONALE AND INDIAN HISTORY OF DTAAS

The history of India in terms of its involvement in Double Taxation Avoidance Agreements has seen drastic change due to changes in the economic stand of the country in terms of its economic policy and tax position in the world. The first stage of establishing DTAA, especially after liberalization, in the early 90s, was mainly due to the need of foreign capital and technological drive to attract foreign capital and technology. Some of these early treaties tended to focus residence based taxation on some of the income categories such as capital gains in order to encourage foreign investment. The India-Mauritius DTAA was one prominent case in point, since under article 13 of the DTAA capital gains taxation was only levied in country of residence of an investor, thus making capital gains tax-exempt to the sale of the Indian shares by Mauritius resident entities. This clause, which played a key role in attracting high volume of foreign direct investment into India, also ended up propagating treated shopping on a mass scale, with the recipients routing the investment through Mauritius only in order to enjoy tax benefits whether there was actually some economic substance behind the same. With the change of time the issue of loss of revenue to this treaty shopping increased at a vast level. This was followed by an inertial but firm policy to impose more source based taxing rights.[7]

This paradigm policy shift in India in its treaty policy of having predominantly residence based approach in case of capital gains and shifting to largely source based approach and therefore being more aggressive in its treaty policy was motivated by conditions of wanting to cur below pattern of shopping of treaties and protecting its tax base. Previously the Mauritius DTA had allowed an exemption in India on capital gains and this made it a very attractive place to invest in India but most people have taken to treaty shopping. This evolution took a dramatic turn through the explicit amendments done to India and Mauritius DTAA, which gave kick-start to source-based taxation of capital gains. In this amendment, it was provided that the gain that would result out of the alienation of shares acquired on or after 1 April 2017 would be taxable in the source country, India. Such amendment was later reflected in the India-Singapore DTAA and the amendment brought this treaty in line with the modifications done in the

[4] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing 2013)

[5] Raj Kumar, *International Taxation: Law and Practice* (2nd edn, LexisNexis 2022)

[6] OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One and Pillar Two Blueprints* (OECD Publishing 2020)

[7] Rohatgi A, *Basic International Taxation, Volume I: Principles* (2nd edn, Kluwer Law International 2007); OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing 2013).

Mauritius treaty concerning taxation of capital gains. This did not become a single amendment that was just made but it was a reversed strategic policy.[8]

India is a long run capital importer country and in the past, the priority was to attract investment on tax concessions. It was the movement towards source-based taxation of capital gains that designated that the purpose of protection of revenues now seriously encompassed the objective of attraction of investment particularly when there was the perception of abuse. This step is a clear indication of India getting more confidence over the attractiveness of its economy and being able to put in place more stringent taxation without the fear of India experiencing drastic reduction in FDI and it is also in keeping with international anti-abuse initiative. This policy change represents a precedent upon which future DTAA re-negotiations and revisions will be run and hence, it can be expected that India will continually insist on increased source-state taxing powers over the investment and therefore, the contour of cross-border investments into India by other jurisdictions may get affected.[9]

With regard to model conventions, India has had a history of deriving conventions to OECD Model Tax Convention and UN Model Tax Convention. Although the OECD Model mostly gives an advantage to the residence-state taxation, the UN Model, which is applicable to the developing economies, gives the source state more rights to carry out the tax. India being a capital importing country has many times tended to go along with the ideas of UN Model, demanding greater source-state taxing rights mainly in terms of business profits, royalties and payment of fees to technical services. This inclination is reflected in the bilateral negotiations it makes and also in the active role it plays in international forums where it has always been bold enough to defend the position of the source jurisdictions whenever the taxing rights are being allocated. The history of DTAA policy in India is therefore associated with varied changes and adaptation of the economic and fiscal growth and prosperity ambition of developing countries, the constitutional prerogative of taxation of a country and the adaptation of India to international issues such as tax avoidance.[10]

KEY PRINCIPLES OF INTERNATIONAL TAXATION AND DTAA FRAMEWORK

The entire structure of international taxation is laid on two general and therefore conflicting jurisdiction grounds that most often cause conflict of jurisdiction and thus, double taxation; these two are the residency principle and the source principle. With a residency based taxation system, a nation collects tax on their nationals income with the country ignoring the amount and source of income that is earned. This makes it sure that an economic activity of a resident is thoroughly taxed. On the contrary, the principle of source states that a given nation would tax income that is accorded sources inside the country regardless of whether the beneficiary is resident or not. According to this principle, a nation is able to tax economic activity that takes place on its land. In cases where individual living in one country earns part of his money in the other country, the two countries can each claim jurisdiction to the earning and thus this brings about the aspect of double taxation.[11]

DTAAs are most important tools of overcoming these conflicts to assign taxing rights to the contracting states. They do this mainly by the two common modes of relief of the taxation that is the exemption mode and the credit mode. In the exemption system, the source state pays tax on the revenues then the resident state relives the payment of tax to the revenue previously paid. This avoids any form of a double taxation since the right of the resident state to impose taxes is surrendered. Conversely, credit method leaves the resident state with the leeway to tax the global income of its citizen, which is however offset by a credit deduction of source state tax. India mostly uses the credit method in its DTAA and it permits Indian residents to obtain a credit of foreign taxes paid on income that is taxable in India also.[12]

DTAAs stipulate as to how taxing jurisdiction should be carefully apportioned in respect of various forms of income. As an example, profits of business, normally are taxed only in the state of residence in case of the enterprise having no Permanent Establishment (PE) in the other state, where profits attributable to

[8] CBDT, *Press Release on Protocol Amending the India-Mauritius Tax Treaty* (10 May 2016)
[9] Arbind Modi, *Final Report on Taxation of E-Commerce* (CBDT, India 2016)
[10] Vikram Chand, *The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties: A Policy Analysis* (IBFD 2017);
[11] UN, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (2017);
[12] UN, *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (UN 2003).

the inclusive PE that are taxed in the source state. The withholding tax rates of dividends, interest as well as royalties, is normally lower domestically in the source-state where taxing rights or the territorial rights are usually reserved, again under conditions, to the resident-state. The taxation of capital gains is quite different among the treaties with some giving exclusive taxing rights to the residence state whereas in some cases a source-state taxing right is granted particularly where the immovable property or shares are a source of value.[13]

An important notion in the framework of DTAA, one which is especially applicable towards discouraging the abuse of the treaty, is the idea of beneficial ownership. Beneficial ownership is also essential in DTAAs to deter the misuse of the treaties especially with regard to passive types of income such as dividend, interest and royalties. This principle will make it such that the benefits under treaty, such as the lower rates of withholding tax, are applied to the true owner of the revenue, and not a conduit company that was formed to take advantage of the benefits under the treaty. The focus on the concept of beneficial ownership under DTAAs, especially in the case of passive income, reflects the open attitude of India since the time of exploring possible measures against treaty shopping prior to the inclusive BEPS initiative, which explains the relative awareness of the weak points of its treaty net at an early stage. The fact that "beneficial ownership" is included as a dependent clause in the law, as well as its judicial interpretation, shows how India has made some initial moves to curb BEPS problems way before the actual BEPS Action 6 (Preventing Treaty Abuse) was accepted in treaties. This implies that there is very strong sense of apprehension towards these two challenges in India as far as revenue erosion and treaty shopping are concerned since it is an old policy that started a long time before the global BEPS consensus.[14]

The judicial cautiousness and confounding interpretations in and around the concept of beneficial ownership, even resulting into court battles, stress out the sensitivity of the jurisdiction of establishing effective clauses to anti-abuse in the context of the current treaty regime even with usual categories. This ongoing battle leads us to the necessity of stronger and more detailed anti-abuse provisions that were eventually introduced in the form of Limitations of Benefits (LOB) clause of the Multilateral Instrument (MLI) and local General Anti-Avoidance Rule (GAAR) giving us an illustration of how India used to fix the combater of abuse in particular clause of the treaty progressing to a comprehensive piece of legislation.[15]

PERMANENT ESTABLISHMENT (PE) CONCEPT AND ITS APPLICATION IN INDIA

Permanent Establishment (PE) is amongst the foundations of international tax in regards to a source country exercising its right to tax business profits of a foreign business since the concept acts as a trigger in that case scenario. According to Article 7 of most DTAAs, the business profits of an enterprise of one contracting state will only be taxed in the country in which the business is established and it does not contain business activities in the other contracting state through PE established in that country. In case of the existence of a PE, profits that are attributed to such a PE may be taxed in the other state up to the amount that are associated with the PE. The definition of PE generally has in it the notion of a fixed place of business which the business of an enterprise is wholly or partially conducted, whether that is in the form of a branch, an office, factory or a workshop.[16]

In addition to this, DTAAs also prescribe certain form of PE to include:

1. Construction PE: It is a result of building locations or building/installation where the project has taken a time that has broken a specified limit (e.g. zenrinthlights-six months or twelve months).
2. PE- Service: This is activated in a country when some services are rendered to a specific period of time by the employees or any other staff members.
3. Agency PE: Arises when an individual performs the acts on behalf of a business and in the constant use of an authority to undertake contracts in the name of the enterprise or dealer in

[13] UN Model Tax Convention (n 2), arts 5, 7, 10–13;
[14] Klaus Vogel and others, *Vogel on Double Taxation Conventions* (4th edn, Kluwer Law International 2015).
[15] Saurabh Jain, 'India's Tax Treaty Policy and the Digital Economy: The Road Ahead' (2021) 75(1) *Bulletin for International Taxation* 23.
[16] UN, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (2017) art 5.

keeping has a stock of goods out of which, the person normally delivers goods on behalf of the enterprise.

Judicial approach in India has made a huge difference in thinking and practice of PE regulations. Important landmark decisions have given vital interpretations that in many cases are indicative of a healthy approach on the taxing powers of the state as a source jurisdiction. An example is the decision of the Supreme Court that in the DIT v. The case of E-Funds IT Solutions Inc. has helped to clarify how profits would be attributed to a Permanent Establishment (PE) in India and placed the functional and factual analysis on the fore. The case represents the pragmatism of the Indian judiciary with regard to attribution of PE profit that attempts to go beyond physical presence to functional approach that was an early manifestation of substance-over-form rule that would later become the subject of BEPS.[17]

An actual economic contribution of the PE has to be taken into account by the judges judged by the fact that the "functional and factual analysis" approach (as opposed to a formulary or asset based treatment) shows the judges that it requires a must to give the profits to the PE by reference to substantive economic contribution. This is in line with the BEPS principle of ensuring taxation follows economic substance voiced in the so-called Authorized OECD Approach (AOA) and also the broader BEPS theme of ensuring tax follows economic substance, though the case may predate to have been formulated concerning that very principle. This court position shows knowledge of the international taxation principles with a high degree of sophistication on the part of the Indian judiciary which makes India a jurisdiction whose legal interpretations are evolving in a way that address issues involving complex cross-border taxes. The decision will serve better to set the precedent in the future cases of PE, help tax authorities and the taxpayer in ascertainment of the taxable profits and can also cut arbitrary determinations, and on the other hand it is giving power to India to tax the profits that are meaningfully based within its territory.[18]

The PE rules which were based upon physical economy have had a hard time in being applied in the digital economy that is fast evolving. In many cases, the digital businesses may have a significant economic presence in a given country which is not matched by physical presence thus presenting difficulty in defining the PE on usual terms. This has brought about the issue of base erosion and profit shifting by digital multinational enterprises (MNEs). To cope up with such difficulties and the lack of international agreement towards revised PE rules in the digital economy, India took unilateral steps towards the implementation of Equalisation Levy. This source-based levy became operative in 2016 (and extended in 2020) to levy tax on certain digital services and shows how India is being proactive on the taxation of those digital businesses. The unilateral implementation of the Equalisation Levy in India is a testament to the assertive and impatient attitude to the issues of the slow development of a consensus on the global level that is ready to safeguard its tax base even at the disregard towards conventional international practices in taxation.[19]

Equalisation Levy is unilateral and it is imposed outside the DTAA purview. This signifies how India is not happy with the prolonged actions of the multilateral solution (such as BEPS Action 1 on taxing the digital economy) and would want to hold its ground as far as its tax revenues base against the highly expensive online businesses. It indicates the change to the time lag between waiting to get things agreed upon at the international level to having it passed as domestic policy. This action vindicates the inadequacy of the current DTAA system in responding to new business models and increasing aggressiveness of source jurisdictions, such as India, to exercise their taxing right over the digital profits, to the detriment of the risk of possible double taxation, or trade conflicts. The Equalisation Levy may also experience that other developing countries with similar issues may follow suit, thus resulting in a broken system of international taxation that may not be fixed soon unless they come to consensus. It is also pressuring the international bodies to hasten solutions to the digital economy.[20]

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[17] OECD, *Attribution of Profits to Permanent Establishments: Final Report* (OECD Publishing 2010).

[18] OECD, *BEPS Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status* (OECD 2015); E-Funds IT Solutions (n 3).

[19] OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: Final Report* (OECD Publishing 2015);

[20] Michael Devereux and John Vella, 'Implications of Digitalization for International Corporate Tax Reform' (2018) Oxford University Centre for Business Taxation Policy Paper.

TAXATION OF BUSINESS PROFITS UNDER INDIAN DTAAS

Profits Article 7 of the DTAAs conclusively guides the taxation of business profits in India since provision has been made in Article 7 that generally provides that the profits of an enterprise of a contracting state may only be taxed in that state unless the enterprise is conducted to a permanent establishment (PE) in the other contracting state. The profits attributable to a PE may be something that is taxed in a different state in case the PE subsists. This principle would seek to caution a balance between the residence principle and the source principle in a manner that source state could tax profits that are actually made within its territory by means of fixed or substantial presence. The arm length principle has been an important aspect in taxing business profits particularly in the case of the dealings between related enterprises. The DTAAs in India provided this so that the related party transactions are carried out in the same way as an independent party would have done and profits on the same are not artificially transferred out of the source country.[21]

But one of the major bones of contention is the arm length principle that form the part of India DTAAs and local rules on transfer pricing, especially in attributing the profits to PEs. The never ending controversy over the arm s length principle as well as the attribution of profits to PEs highlights the underlying contradiction in the Indian international tax policy aiming, on the one hand, to receive an adequate share of profits made within the Indian boundaries and on the other hand, the implementation difficulties of the complex transfer pricing regulations as well as the subjectiveness of how profits are attributed to PEs resulting in prolonged litigation and uncertainty on the part of foreign investors. This presents itself in complexity because it is subjective as far as determining an arm length price and allocating profits to a notional PE are concerned. Tax authorities in India have a tendency to take aggressive it takes aggressive positions based on revenue goals and a robust view of taxation based on source. This causes ambiguity to multinational corporation and this has an effect on investment of such corporations and may give perception that there is uncertainty of a predictable tax environment.[22]

The fact that the amount of transfer price and PE attribution disputes is quite high indicates the lack of equilibrium between the Indian revenue demands and tax certainty and ease of conducting business to foreign entities. It also underscores the tax burden that both the administrators of tax and the court of law approach. To address this, a more effective and transparent dispute resolution process needs to be established and this can be done by intensifying Mutual Agreement Procedures (MAP) and promoting Advance Pricing Agreements (APA) to limit the number of litigation and have more predictable tax regime which is key in encouraging and maintaining long term foreign investment. Another controversial topic of the use of PE is the attribution of the profits of a PE. Although increasing the profits by attribution according to its functional activities, assets, and risks may be satisfying considering that according to the "Authorized OECD Approach" (AOA) PE is treated as a business sitting separately and independently to the others, the profit-sharing practice often ends up being a controversial topic.[23]

Indian taxing agencies are using elaborate functional and factual case studies to establish actual economic presence of the PE and this could ultimately lead to attribution of profits to a much higher extent than would be argued by the taxpayer in the first place. More so, controversies have always ensued concerning characterization of income. As an example, the tax authorities may describe a payment of some services as royalties or fees of technical service (FTS) in the country tax rules despite the fact that taxpayer considers the payment as commercial profit. In case they are characterized as royalties or FTS they can be levied at the rate of a withholding tax at their source but business profits are not to be subjected to tax unless it can be traced to a PE. These re-characterizations can have a huge implication on the tax burden and therefore such re-characterizations are often litigated. The case of Vodafone International Holdings B.V. v. Union of India of the Supreme Court had far reaching consequences regarding indirect transfer of Indian assets and this affected the extent of capital gains taxation in DTAAs discussions and it was largely a domestic law interpretation. Though not in legal terms a business profits case, the case reflected on how broadly the scope of taxing power of India has to be described, how to combat conflicting forces of

[21] United Nations, *UN Model Double Taxation Convention between Developed and Developing Countries* (2017) arts 5, 7.

[22] Devangshu Datta, 'India's Transfer Pricing Regime: Complexities and Challenges' (2020) *Economic and Political Weekly* 55(24) 13;

[23] Government of India, Central Board of Direct Taxes (CBDT), *Advance Pricing Agreement Annual Report 2022–23* (2023);

domestic tax laws vs treaties in general terms and it affected the general environment of foreign businesses in India. The basic idea of claiming the right to taxation of values created in India, even indirectly, is echoed through the different classes of income such as profits of business. [24]

WITHHOLDING TAXES ON PASSIVE INCOME (DIVIDENDS, INTEREST, ROYALTIES, FTS)

Taxation of passive income stream income like dividend interests, royalties, and fees levied on technical services (FTS) is one of such few issues that are of great concern in the Indian DTAA network. Tax that is normally charged on these types of income in the source country is withholding tax, but through DTAAs the lower rates of taxes are usually charged than the higher domestic withholding taxes set on the Income-tax Act, 1961. The taxpayers often opt to use the more favourable rates under the DTAA, and this would be commonly known as the idea of the treatment override, where the treaty provisions take precedence over the laws in certain countries which may contradict it to that extent that it is more favourable. One such condition which is basic to the enjoyment of reduced DTAA rates on passive is beneficial ownership. As mentioned above, the notion of beneficial ownership plays a decisive role in DTAAs to countervail the abuse of the treaties especially those related to passive income such as dividends, interest, and royalties. This principle undertakes the guarantee that the lower rates of withholding tax are only applied to the ultimate beneficial owner of such income and not on conduit entities that are just created to take advantage of such treaties so as to be given privilege of the lower withholding tax.[25]

The Indian tax authorities apply a high level of scrutiny when it comes to the beneficial ownership assertions, especially when it comes to the complicated ownership structure of a company and, especially, the companies registered in one of the jurisdictions, which has long been involved with treaty shopping. Interpretation of royalty and fees for technical services (FTS) have been some of the most moot spheres of the withholding taxes implementation in India. The meaning of royalty and fees of technical services (FTS) in Indian DTAAs has been an area of contention and this has resulted in a lot of litigation particularly related to payment of software and payment of off-shore services. The ongoing court-fights over how to define royalty and FTS in India (especially when it comes to software reimbursement), shows a deep-rooted misunderstanding between how broadly an Indian may interpret it according to the country law and how delicately the two terms can be to interpret according to DTAAs between countries, which has given rise to a very substantial tax uncertainty and has possibly been deterrent towards the use of foreign technology providers.[26]

The tax law in India (e.g. Explanation 4 to Section 9(1) (vi) of the Income-tax Act) has a wide definition of Royalty which can easily incorporate payments of software. DTAAs usually have a more limited vision of the definition though. The Indian tax authorities tend to use this wider definition in their country which results in inconsistency with the treaty and consequently there are clashes with the treaty. This forms a very harsh environment to foreign firms that supply Indian with software or technical services since they are at a risk of paying extra tax or and after tax litigation. That this battle of definitions continues highlights a wider policy quandary: India wants to tax more services and digital transactions, since it enjoys taxing powers as the source-state, as compared to the stability of rule and international treaty compatibility as so many other jurisdictions are trying to embrace to support cross-border commerce, and likewise technology transfer. This doubt has the potential of pushing foreign firms into either making their prices higher to consider the possibility of tax which is illegal or shun the idea of penetrating the Indian market altogether. It also points to the importance of India either making its domestic law stand up against the interpretations of its DTAA in a more harmonious manner, or demanding more universal definitions to be used in its treaties, which could be via the Multilateral Instrument (MLI) or bilateral negotiations. In India, software payments are particularly the type of payment that faced long litigation battles surrounding their characterization.[27]

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[24] Nishith Desai Associates, *Taxation of Indirect Transfers of Indian Assets* (Legal & Tax Analysis 2016).
[25] OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing 2017) arts 10–12
[26] Saurabh Jain, 'Taxing Cross-Border Payments for Technical Services: The Indian Experience' (2020) 48(3) *Intertax* 301.
[27] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – Final Report* (OECD/G20 BEPS Project, 2015).

The tax authorities usually state that a payment to use a software is till royalties whereas it may be contended by the taxpayers that it is simply a payment made to get a copyright article or business profits. In the same regard, there has been massive debate in relation to the scope of FTS particularly to offshore services offered with no tangible presence in India. This landscape is further complicated by the introduction of the Equalisation Levy on digital services whereby some of the digital transactions could fall within the provisions of DTAA (in case of a PE is established or classified as FTS/royalty) and levy as well. Action 6 (BEPS) (Preventing Treaty Abuse) and the introduction of the Principal Purpose Test (PPT) via the MLI have placed additional emphasis on preventing treaty abuse and raising the standards of beneficial ownership and the anti abuse regime where passive income is concerned. These are in order to make sure that treaty benefits are not availed in any scenario where one of the main intentions of an arrangement or a transaction was to have a treaty benefit, a move that would strengthen Indian initiatives to avoid battering its tax base through conduit arrangements.[28]

ANTI ABUSE MEASURES: TREATY SHOPPING, LOB AND THE VIEW OF GAAR IN THE CONTEXT OF INDIA

Treaty shopping has been a major issue of concern to India and it occurs when individuals or groups that are motivated by an incentive to use the DTAAs to enjoy the benefits on taxes that were not intended by the contracting nations. In the recent past the India-Mauritius DTAA was a virtual example where investments were routed through Mauritius just to evade capital gains tax in India, even where there was no activity taking place there as far as the economy of Mauritius was concerned. This resulted in massive losses of revenue and the strict anti-abuse measures were required. India has also developed a multi layered mechanism to balance out such practices, by deep incorporating specific treaty provisions on such practices and/ or covering them comprehensively in domestic laws. An example of treaty-specific provision like this is the provision of Limitations of Benefits (LOB) clauses on certain DTAAs like that of the one with United States. The typical conditions in the LOB clauses are that entity must meet certain conditions to qualify as a, and benefit as, a, qualified person to claim treaty benefits thus making sure that the conduit companies do not gain treaty benefits.[29]

These circumstances are usually connected with ownership, being listed in the stock exchange, or the active business transactions. A more detailed domestic anti-abuse is the one in India that is the General Anti-Avoidance Rule (GAAR). Specifically, India has a major domestic anti-abuse rule, General Anti-Avoidance Rule (GAAR) that is aimed at fighting aggressive tax planning and functions in conjunction with the certain anti-abuse provisions of DTAAs. In 2017, GAAR came into existence and it allows tax authorities to disallow tax advantages in the situation where an arrangement is considered to be an "impermissible avoidance arrangement." The deal that is entered mainly to gain tax benefit and is not of commercial substance, does not create rights or obligations that are normally not created between arm length parties or entered flames that are not in a normal undertaking of business is termed as impermissible. GAAR focuses the tests of substance over form as well as the main purpose (in other words, deems the authorities to investigate beyond the literal form of the transaction to the underlying economic sense).[30]

The Base Erosion and Profit Shifting (BEPS) project that was undertaken by the world also strengthened India in its initiatives against abuse. Action 6 of BEPS specifically meant to curb the treaty abuse issue came up with Principal Purpose Test (PPT). The Multilateral Instrument (MLI) provides the Principal Purpose Test (PPT) that supplements India GAAR and denies treaty benefits in case of acquisition of the benefit being one of the core reasons of an arrangement or transaction. India has ratified the MLI which permits incorporation of the PPT in many of the DTAA signed by India and thereby it is more difficult to argue treaty dispensation by taxpayers whose maim purpose in the arrangement was the enjoyment of treaty dispensation. PPT provides an efficient way in which the anti- abuse is provided with the PPT acting

[28] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – Final Report* (OECD/G20 BEPS Project, 2015)
[29] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report* (OECD Publishing 2015).
[30] EY India, *GAAR in India: Fundamentals and Practical Issues* (2017);

as the minimum standard to the anti-abuse under the MLI in lining up the Indian treaty network with the international best practice.[31]

The development of the Court system of the United States of America The change that has occurred through the Union of India v. The use of GAAR and adoption of MLI PPT are a significant and considered shift of the Indian stand on tax avoidance, reflecting in the decision the changes that were part of the global anti-BEPS drive, to hardening in the anti-tax avoidance measures, beyond the formal repackaging that was the characteristic approach to treaty benefits interpretations. Resomi Haji was a decision that came out of case- Union of India vs. The earlier support of Azadi Bachao Andolan in the validity of circulars which may enable the entitlement to treaty benefits without any stringent requirements of substances has changed with the later change of policies and the introduction of GAAR that moves the concept in the opposite direction of the policy changed.[32]

The case of Azadi Bachao Andolan is interesting as it believes that it was sustainable at that time of ruling but eventually became aided as an image of India being susceptible to treaty shopping. This prompted a direct response in the form of subsequent incorporation of GAAR that enjoys the right of India to re-characterize or ignore transactions with no commercial view. This position is further consolidated with the adoption of the PPT of the MLI, and this positions the treaty network of India on par with the international norms of anti-abuse. Such a development shows how there is a strategic shift in the policy of a capital-attraction to revenue-protection-oriented policy. The combination of both the domestic anti-abuse rules known as GAAR, treaty based anti-abuse rules like the anti-abuse clause, and the multilateral anti-abuse regime of the PPT provide a much more robust anti-abuse regime, which is much more difficult to compete against on the international taxation scene of India by aggressive tax planning involving the Indian network of DTAAs. [33]

CONCLUSION

Such an analysis of Double Taxation Avoidance Agreements in their critical meaning and considering them in the Indian perspective would demonstrate the dynamism and evolving nature of its policy in the given sphere. India has experienced a paradigm shift in its involvement with DTAAs it has changed to a more proactive and balanced model, as opposed to its prior focus on attraction of foreign investment by any means, characterised by its early treaties that focused on bringing in foreign investment with little to no regard on the revenue protection aspect of the treaties, especially in large contrast to the heavily aggressive focus on the due diligence of base erosion and profit shifting. Such a tactical shift can be observed in the radical changes to major DTAs, including Mauritius and Singapore, where source-based taxation in relation to capital gains was put in place simply reflecting the past weakness to treaty shopping. There is no overstating the immense influence that world efforts, especially that of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, have had. The eagerness and enthusiastic pace at which India has adopted the BEPS recommendations and in particular Country-by-Country Reporting (CbCR), modified definitions of Permanent Establishment (PE), and the Principal Purpose Test (PPT), via the Multilateral Instrument (MLI) has transformed India, at its very core, in terms of its DTAA network. This is a very thorough implementation of anti-abuse considerations and the very strong domestic General Anti-Avoidance Rule (GAAR) is an indicator that India is on the path of improving its tax policies to be in tandem with those of the international community of fairness and substance over form.[34]

This can be seen as a hardening of attitude against tax avoidance, with the replacement of judicial interpretations that used to ease the gains of treaties being replaced by a legislative and treaty environment which strictly examines arrangements with respect to commercial substance. Though some major progress has been registered in streamlining the tax base of India and curtailing of aggressive tax seem to be paying

[31] Ministry of Finance (India), *India Deposits Instrument of Ratification for MLI* (Press Release, 25 June 2019); KPMG, *India's Implementation of MLI and PPT* (2019).

[32] OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15: 2015 Final Report* (OECD Publishing 2015);

[33] Nirav Mehta, 'India's Strategic Shift in Treaty Interpretation: From Capital Inflows to Base Protection' (2020) 28(6) *Asia-Pacific Tax Bulletin* 412.

[34] OECD, *BEPS Action 13: Transfer Pricing Documentation and Country-by-Country Reporting* (2015); Income-tax Act 1961 (India), Chapter X-A (GAAR);

off, there are still hiccups. The controversy litigation involving such tricky matters as the allocation of profits to Permanent Establishments and the definition of passive income stream points to the fact that in practice it is hard to apply complex international taxation. Also the parameter of dispute resolution mechanisms especially the Mutual Agreement Procedure (MAP) is living up to the scruples of time bound resolution and the zest of India to introduction of mandatory binding arbitration shows the aspect of concern that sovereign interest is to be maintained in priority over the absolute element of tax certainty of taxpayers.[35]

In the future, India will be in the limelight of the global debate in the field of taxing the digitalized economy and will be actively involved in the work of OECD in the field of Pillar One and Pillar Two. This strategic ambivalence, to be able to take unilaterally action (e.g. Equalisation Levy), when the multilateral consensus is very slow, but also being one of those that are building a new world tax order, is an illustration of Indian pragmatism. Although it cannot be predicted what the future path of the policy on DTAA in India would be, it can be said that there would always be modifications of the policy to incorporate developments in the business models or changes in international tax standards in an effort to create a healthy environment to attract foreign investments yet to be able to protect its sovereign right to tax economic activities within the jurisdiction of its land. The longevity of this strategy will be determined by the sparing usage of its strong taxation structure whereby both the revenue is intact and predictable taxing system is provided to international corporations.[36]

RECOMMENDATIONS

The following recommendations are suggested for the further improvement of India DTAA framework along with the international tax policy:

1. Make Dispute Resolution Mechanism Streamlined: As much as the MAP process is of value, it is a bit not efficient enough. India ought to ponder about placing more stringent timeframes by which MAP may be solved as well as allocating more resources to Competent Authority to bring cases to completion. Restructuring the position on compulsory binding arbitration, either in certain types of case or with reservations, may greatly promote the predictability of tax to foreign investors, and the curb of time-consuming trials.
2. Improve transparency and uniformity in tax administration: Taxpayer facing litigation on clarity of guidelines with respect to PE attribution and passive income (royalties/FTS) is evidence on the need to have more clarity of tax laws and tax treaties uniformity of these laws applied by tax authorities. Reduction in ambiguity and creation of a more predictable environment in form of FAQs or comprehensive circulars on controversial issues can be made.
3. India proactive in digital economy taxation: India needs to remain active and influential in the pillars 1 and 2 of the OECD work, which include the pillar one and the pillar two. With the acceptance internationally, it is important that India strategically implements these new provisions into its network of DTAA and it requirements into its legal web in a proper manner so that the end outcome of the challenge of the Equalisation Levy becomes that clear.
4. Encourage Advance Pricing Agreements (APAs): The APA program in India should be capitalized upon whose success has been meritorious in the market. Expansion, democratization of APA and the processing of APA at a fast pace would help in preventing controversy in advance and in this way in providing the business of complex cross American trade with upfront tax assurance.
5. Review and update of DTAA Network: Currently, the global tax regimes and business practices are changing at a rapid pace; therefore, it is of necessity that India regularly updates and revises its current DTAA in such a way that they do not become outdated or ineffective and that they align with the policy objectives of India especially in relation to anti-abuse provisions and newer sources of income.
6. Training and Capacity Building of Tax Authorities and Judiciary: It is essential that tax officials and the judicial system be continually trained and capacitated at developing an understanding of

[35] OECD, *BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status* (2015);
[36] OECD/G20 Inclusive Framework, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (8 October 2021);

intricate international tax principles and BEPS provisions along with appendages and interpretation of DTAA. This will also contribute to an increased, and equitable tax principle. This will lead to less arbitrary taxpaying and also better litigation of tax.

Adopting these proposals, India can further stabilise its status as a mature and active global tax participant with its own revenue needs, yet sensitive to the need to ensure a long-term, stable, and predictable, not to mention attractive, global taxation system, to name but a few.