Advance Pricing Agreements and Double Taxation Avoidance Agreement

For Prelims: Central Board of Direct Taxes**,** Advance Pricing Agreements**,** Double Taxation Avoidance Agreement**,** Tax evasion

For Mains: Significance of APAs in ensuring tax certainty, Double Taxation Avoidance Agreements and their significance, Ease of Doing Business

Source: PIB

Why in News?

The **Central Board of Direct Taxes (CBDT)** has achieved a remarkable milestone by signing 125 **Advance Pricing Agreements (APAs)** during the fiscal year 2023-24.

- This surge in APA signings underscores the growing importance of transfer pricing regulations and the efforts to provide certainty to taxpayers.
- In an additional development, India and Mauritius have amended their **Double Taxation Avoidance Agreement (DTAA)** to curb **tax evasion** and ensure fair taxation practices,

What is an Advance Pricing Agreement?

- **About:**
  - An APA is a formal arrangement between a taxpayer and a tax authority on transfer prices.
  - APAs allow businesses to reduce the risk of their transaction prices being challenged by tax authorities.
  - The APA programme has significantly contributed to India's mission of **promoting** ease of doing business**,** especially for **Multinational Enterprises (MNEs)** with a large number of cross-border transactions within their group entities.
- **Types of APAs:**
  - **Unilateral APAs:**
    - Limit risks for transactions between domestic entities. No guarantee of avoiding **double taxation for transactions** with foreign entities.
    - Relatively shorter proceedings compared to other APA types.
  - **Bilateral APAs:**
    - Limit risks for transactions between a domestic entity and a foreign entity. **Eliminate the risk of double taxation.** Longer proceedings as two states must agree.
  - **Multilateral arrangements:**
    - They mitigate risks for transactions between related entities in 3 or more states, serving as a protective instrument for complex transactions and ensuring safety for both parties, although the proceedings take longer.
- **Key Features of APAs:**

- The APA process is **voluntary and will supplement appeal and other Double Taxation Avoidance Agreement (DTAA)** mechanisms for resolving transfer pricing disputes.
- The **term of APA can be a maximum of 09 years** (Including **five years prospective and 04 years** retrospective if the taxpayer has opted for roll rollback mechanism).
- The procedure ensures the protection of sensitive data provided by businesses.
- Statistical data and summary information are published, but without disclosing names of entities with concluded arrangements or applicants.

- **Importance of APAs for Businesses:**
  - Provides tax certainty for determining arm's length price of international transactions.
  - Reduces risk of potential double taxation through bilateral or multilateral APAs.
  - Reduces compliance costs by eliminating transfer pricing audit risk and resolving disputes.
  - Alleviates burden of record keeping by knowing required documentation in advance.
  - APAs allow businesses to reduce the risk of their transaction prices being set incorrectly or challenged by tax authorities.
  - APAs can be an effective tool for businesses to manage their tax risks and planning.

Central Board of Direct Taxes (CBDT):

- It is a statutory body, established under the **Central Board of Revenue Act, 1963**, and is a part of the **Department of Revenue in the Ministry of Finance.**
- CBDT provides essential inputs for policy and planning of direct taxes in India, at the same time it is also responsible for administration of direct tax laws through the **Income Tax** Department.

Double Taxation Avoidance Agreement (DTAA)

- A DTAA is a tax treaty signed between two or more countries. Its key objective is that tax-payers in these countries can avoid being taxed twice for the same income.
- A DTAA applies in cases where a taxpayer resides in one country and earns income in another.
- DTAAs can either be comprehensive to cover all sources of income or be limited to certain areas such as taxing income from shipping, air transport, inheritance, etc.
- In **1983, India and Mauritius agreed on the DTAA** to prevent double taxation. The DTAA applies to residents of both countries.

What Does the India and Mauritius DTAA Amendment Entail?

- **Principal Purpose Test (PPT):**
  - The amended protocol introduces the **Principal Purpose Test (PPT)** to the India-Mauritius Double Taxation Avoidance Agreement (DTAA).
    - The PPT denies treaty benefits if obtaining those benefits was the primary purpose of any transaction or arrangement.
- **Article 27B:**
  - A new article, Article 27B, is included in the treaty, defining the 'entitlement to benefits.'
    - This article specifies conditions under which treaty benefits, such as reduced withholding tax on interest, royalties, and dividends, are denied.
- **Focus on Preventing Treaty Abuse:**
  - The amendment aims to address concerns related to **tax evasion and avoidance** through the abuse of the DTAA.
  - By incorporating the PPT, the revised treaty seeks to ensure that tax benefits are not misused for improper purposes.
- **Uncertainty Regarding Past Investments:**
  - Despite the amendment, clarity is lacking regarding the treatment of past investments made under the previous provisions of the DTAA.
  - The Ministry of Finance is yet to issue clarification regarding the applicability of the new provisions to existing investments.

India and Mauritius Commercial Relations

- India has been one of the largest trading partners of Mauritius since 2005.
- Indian exports to Mauritius for FY 2022-2023 were USD 462.69 mn, while Mauritian exports to India were USD 91.50 mn, with total trade amounting to USD 554.19 mn.
- Trade between India and Mauritius has grown by 132% in the last 17 years.
- **Petroleum products were the largest export item for India to Mauritius** until mid-2019. Other Indian exports to Mauritius include pharmaceuticals, cereals, cotton, shrimps, prawns, and bovine meat.
- Main Mauritian exports to India include vanilla, medical devices, needles, aluminum alloys, scrap paper, refined copper, and men's cotton shirts.
- Cumulative FDI worth USD 161 billion came from Mauritius to India between 2000 - 2022, largely due to the **DTAA.**
- Mauritius and India signed the **Comprehensive Economic Cooperation and Partnership Agreement (CECPA)** in 2021.
  - CECPA is the first trade agreement signed by **India with an African country.**
- In 2024, the **Unified Payment Interface (UPI) and also RuPay card services were launched in Mauritius.**
  - Users in Mauritius and India will experience convenience in making transactions, both domestically and internationally, through the **adoption of RuPay and UPI.**

Drishti Mains Question:

Q. Evaluate the impact of the surge in APA signings by the Central Board of Direct Taxes (CBDT) during the fiscal year 2023-24 on India's efforts to promote ease of doing business and attract foreign investment.

Q. Evaluate the objectives of the amendment in curbing tax evasion and ensuring fair taxation practices between India and Mauritius.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q. With reference to India’s decision to levy an equalization tax of 6% on online advertisement services offered by non-resident entities, which of the following statements is/are correct? (2018)

1. It is introduced as a part of the Income Tax Act.
2. Non-resident entities that offer advertisement services in India can claim a tax credit in their home country under the “Double Taxation Avoidance Agreements”.

Select the correct answer using the code given below:

(a) 1 only
(b) 2 only
(c) Both 1 and 2
(d) Neither 1 nor 2

Ans: (d)