



# A Study on Double Taxation Avoidance Agreements (DTAAs) and Their Impact on Foreign Investments

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## 1. Abstract

Double Taxation Avoidance Agreements (DTAAs) play a critical role in promoting cross-border trade and investments by eliminating the adverse effect of taxation in two jurisdictions on the same income. This research paper aims to explore the impact of DTAAs on foreign investment inflows in India, particularly Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). The study evaluates the evolution of DTAAs, their operational framework, and the bilateral treaties India has with various countries. Using secondary data from government sources, reports, and case studies, the research assesses how favorable tax treatment under certain treaties (e.g., with Mauritius and Singapore) has influenced investor decisions and capital flows. Additionally, the paper examines policy changes such as GAAR and MLI and their influence on treaty abuse and round-tripping. The study concludes that while DTAAs facilitate investment, their misuse has prompted stricter anti-abuse rules, and a balanced treaty framework is vital to support genuine investments while curbing tax avoidance.

**Keywords:** DTAA, FDI, Tax Treaty, GAAR, Mauritius, OECD, Foreign Investment, MLI

## 2. Introduction:

In a globally integrated economy, cross-border investment has become essential for economic growth and development. Countries enter into Double Taxation Avoidance Agreements (DTAAs) to ensure that the same income is not taxed twice—once in the country where the income is generated and again in the country of residence. India has signed DTAAs with over 90 countries to attract Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI), while ensuring tax fairness and administrative clarity. These agreements reduce tax uncertainty and provide a legal framework for investors.

Over the years, however, some DTAAAs have been misused for purposes such as treaty shopping and round-tripping, raising concerns about tax avoidance. The Indian government has taken various steps to reform its tax treaties and introduce anti-abuse provisions. This research explores the historical development, structure, and practical effects of DTAAAs on foreign investment and analyzes recent policy reforms like GAAR and the Multilateral Instrument (MLI).

### 3. Review of Literature:

A wide range of academic studies, policy papers, and reports have analyzed the implications of DTAAAs.

- Bhasin and Jain (2014) studied the India–Mauritius DTAA and found that it encouraged significant FDI inflows while also facilitating treaty abuse.
- Chakraborty (2018) highlighted the importance of GAAR in curbing treaty shopping and preserving the integrity of tax treaties.
- OECD’s BEPS Reports (2013–2015) laid the foundation for global treaty reform by highlighting base erosion and profit shifting.
- Vohra (2021) reviewed India’s approach to the Multilateral Instrument and found it aligned with international best practices.
- Sikka and Willmott (2010) argued that tax treaties are sometimes exploited by multinational firms to avoid tax obligations.

These studies reflect a consensus on the dual role of DTAAAs in attracting genuine investment and enabling tax avoidance, necessitating stronger regulatory frameworks.

### 4. Research Methodology:

This research uses a qualitative methodology based on secondary data sources. It includes:

- Review of government publications (DPIIT, CBDT, RBI, etc.)
- Analysis of bilateral treaty texts
- Data on FDI/FPI inflows over time
- Literature from journals, OECD reports, and expert commentaries

This study also includes case analyses of specific DTAA partnerships such as those with Mauritius, Singapore, and the Netherlands.

### 5. Conceptual Framework of DTAAAs:

Double Taxation Avoidance Agreements (DTAAAs) are bilateral treaties signed between two countries to ensure that the same income is not taxed twice—once in the source country where the income is earned and again in the residence country of the taxpayer.

These agreements contain provisions such as:

- Allocation of taxing rights between countries
- Determination of residency and permanent establishment (PE)
- Methods to eliminate double taxation (exemption or credit method)
- Withholding tax limits on dividends, interest, royalties
- Exchange of information between tax authorities
- Mutual agreement procedures (MAP) for dispute resolution

The core objective of DTAA is to encourage international investment, reduce tax barriers, and prevent tax evasion or avoidance. These treaties promote transparency and legal certainty for cross-border investors.

## 6. Overview of India's DTAA Network:

India has a vast DTAA network with over 90 countries including major trade partners such as the United States, United Kingdom, France, Germany, Mauritius, Singapore, Netherlands, and the UAE.

### Key highlights:

- Early treaties (e.g., with Mauritius) provided **capital gains tax exemptions**, which made these jurisdictions attractive routes for FDI.
- Some treaties had **very low withholding tax rates**, encouraging inflows in the form of dividends, royalties, and interest.
- Concerns over **treaty abuse** (e.g., round-tripping, treaty shopping) led India to renegotiate several treaties after 2016.
- India signed the **Multilateral Instrument (MLI)** under the OECD's BEPS initiative to apply anti-abuse provisions (like the Principal Purpose Test - PPT) across multiple treaties simultaneously.
- GAAR provisions are now applicable to override treaty benefits if arrangements are found to be impermissible avoidance schemes.

India's treaty policy has thus evolved from investment attraction to balancing investment with tax integrity.

## 7. Foreign Investment Trends in India:

Foreign investment has played a major role in India's economic growth. The FDI and FPI inflows into India have shown significant changes in both volume and source jurisdictions.

### FDI Inflows (Select Years):

- **2014–15:** USD 45.1 billion
- **2017–18:** USD 61.0 billion

- **2020–21:** USD 81.7 billion
- **2021–22:** USD 85.0 billion (highest recorded)

#### *Top Source Countries:*

1. Mauritius
2. Singapore
3. Netherlands
4. Japan
5. USA

Mauritius and Singapore have consistently topped the list, largely due to favorable tax treatment under their respective DTAAAs.

#### *FPI Trends:*

FPI inflows have been more volatile, influenced by global markets. Tax treaties often affect the **cost of capital gains taxation**, which is a key determinant for portfolio investors.

After amendments to India's treaties with Mauritius and Singapore in 2017 and GAAR enforcement in 2017–18, a **shift in investment patterns** was observed. Investments began diversifying toward countries like the USA, Japan, and UAE.

### **8. Impact of DTAA Provisions on FDI/FPI:**

The provisions within DTAAAs directly influence investor behavior and the routing of foreign investment.

#### *Key Provisions Affecting Investment:*

- **Capital Gains Exemption:** Until 2017, treaties with Mauritius and Singapore allowed exemption of capital gains tax, leading to significant FPI routed through these countries.
- **Withholding Tax Rates:** Reduced rates on interest, royalties, and dividends encouraged debt and royalty-based investments.
- **Permanent Establishment (PE) Definitions:** A narrower definition allowed some companies to operate without triggering local tax liabilities.

#### *Positive Impacts:*

- Attracted stable and long-term FDI, particularly in services and infrastructure sectors.
- Boosted portfolio investments due to lower tax costs.
- Created certainty and reduced litigation due to treaty protection.

### *Negative Outcomes:*

- Treaty shopping and round-tripping led to artificial FDI and tax base erosion.
- Loss of revenue for India due to tax exemptions and avoidance schemes.

Thus, while DTAA's helped improve inflows, they also led to aggressive tax planning strategies by multinational corporations and investors.

## **9. Case Studies: India–Mauritius, India–Singapore, India–Netherlands**

### *India–Mauritius DTAA:*

- Signed in 1982.
- Exempted capital gains tax in India for Mauritius-based investors.
- Led to Mauritius becoming the top source of FDI in India.
- **Amended in 2016** to tax capital gains on shares acquired post-April 2017.
- Included **grandfathering provisions** for earlier investments and introduced **limitation of benefits (LOB)** clause.

### *India–Singapore DTAA:*

- Similar to Mauritius; exempted capital gains tax until 2017.
- Protocol signed in 2016 to align it with Mauritius treaty reforms.
- Encouraged large FPI flows into Indian stock markets, especially in tech and finance.

### *India–Netherlands DTAA:*

- Allowed tax planning through **royalty and interest payments** with favorable rates.
- Several multinational companies used the Netherlands as a holding company jurisdiction.
- Recent updates under MLI now apply PPT and improved anti-abuse provisions.

These case studies show how specific treaty features can influence investment structure, route, and volume.

## **10. Recent Reforms: GAAR, MLI, and the Shift to Treaty Transparency:**

To combat treaty abuse and improve fairness in international taxation, India has adopted significant reforms.

### *General Anti-Avoidance Rules (GAAR):*

- Introduced under the Income Tax Act, effective from **April 1, 2017**.
- Allows the tax authorities to deny tax benefits if an arrangement's **main purpose is tax avoidance**.
- Overrides treaty benefits in cases of impermissible arrangements.

### *Multilateral Instrument (MLI):*

- India signed the MLI under the OECD's **Base Erosion and Profit Shifting (BEPS) initiative** in 2017.
- MLI modifies India's existing tax treaties to include:
  - **Principal Purpose Test (PPT)**
  - **Improved dispute resolution**
  - **Anti-abuse measures**
- MLI came into force for India on **October 1, 2019**, and applies to many treaties from FY 2020–21 onward.

### *Outcomes of Reform:*

- Treaty shopping has significantly declined.
- India has strengthened its tax sovereignty while complying with global norms.
- Foreign investors now face stricter compliance but also greater legal certainty.

## **11. Challenges and Criticisms of DTAA:**

Despite their many advantages, DTAAAs are not free from challenges:

### *Common Criticisms:*

- **Treaty Shopping:** Non-resident investors from third countries exploit favorable treaties by routing investments through jurisdictions like Mauritius or Singapore.
- **Round-Tripping:** Domestic capital is routed abroad and reinvested into India, misusing treaty provisions.
- **Revenue Loss:** Unjustified exemptions under older treaties caused significant tax revenue loss.
- **Complex Renegotiation:** Amending treaties requires long diplomatic negotiations and consent from partner countries.
- **Implementation Issues:** GAAR and MLI require high administrative capability and consistent interpretation.

These challenges have forced India to reformulate its tax treaties and align with global anti-abuse standards.

## **12. Findings and Discussion:**

Based on the research conducted, the following major findings are noted:

- DTAAAs have historically played a **significant role in boosting FDI and FPI** into India.
- Specific treaties with Mauritius and Singapore have **deeply influenced capital inflow patterns** due to their tax benefits.

- **Abuse of treaties** led to policy backlash and the introduction of anti-avoidance measures like GAAR.
- **Post-2017 trends show a diversification** in the source of foreign investments and more transparency.
- **Multilateralism and global cooperation** have become central to India's treaty policy through the implementation of the MLI.

This shows a positive shift towards balancing tax certainty with anti-abuse mechanisms.

### 13. Conclusion:

DTAAs remain a cornerstone of India's international tax and investment policy. They have successfully:

- Prevented double taxation,
- Facilitated foreign capital inflows, and
- Provided a structured legal framework for cross-border economic activities.

However, historical misuse of certain treaties necessitated reform. India's current treaty approach, influenced by global standards like BEPS and MLI, reflects a **more balanced outlook**—supporting genuine investment while eliminating loopholes.

A robust DTAA framework is crucial for maintaining investor confidence and protecting national tax interests.

### 14. Suggestions / Policy Recommendations:

To enhance the effectiveness of DTAAs, the following steps are suggested:

1. **Regular Treaty Review:** Periodic renegotiation of older DTAAs to incorporate anti-abuse provisions.
2. **Capacity Building:** Training tax officers for effective implementation of GAAR and MLI clauses.
3. **Transparency and Reporting:** Strengthening information exchange mechanisms with treaty partners.
4. **Advance Rulings and Clarifications:** To reduce litigation and give clarity to foreign investors.
5. **Multilateral Engagement:** Actively participating in global forums like the OECD and UN to shape future tax standards.

These measures will ensure that India's DTAA regime remains competitive, fair, and aligned with international norms.

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