VISION: Journal of Indian Taxation
Vol. 1(1), Jan-Jun 2014, pp. 55-73
DOI: 10.17492/vision.v1i1.2414
www.journalpressindia.com/vjit
© 2014 Journal Press India

Indian Law on Double Tax Relief

*Sandeep Jain**

ABSTRACT

International double taxation occurs when a taxpayer is resident in one country but has a source of income from another country and tax is imposed by both the countries on the same income. Thus, international double taxation arises due to overlapping of two tax claims of two or more countries. In most cases, individuals work in countries where they live and companies invest and operate in countries in which they are resident. However, world economies are becoming increasingly international and flow of labour, technology and capital from one country to another is common. Multinationals operate in a number of countries, and individual investors possess internationally diversified investment portfolios. Thus, companies and individuals receive foreign income in the form of profits, dividends, management and professional fees and royalties. When a person undertakes cross-border activities or maintains connections in two or more countries, he is likely to encounter the tax laws of another country. That encounter influences the way in which the person is taxed in his home country. This is how the tax systems of different countries get linked with each other. This paper explains and examines the Indian law on double tax relief.

Keywords: *International double taxation, Tax treaty, Transfer pricing.*

1.0 International Double Taxation

International double taxation occurs when a taxpayer is resident in one country but has a source of income from another country and tax is imposed by both the countries on the same income. Thus, international double taxation arises due to overlapping of two tax claims of two or more countries. OECD has defined international double taxation as "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter for identical periods." (OECD, 1977)

**FCA, practicing Chartered Accountant, Senior Partner-SKC, Delhi, Delhi, India.
(Email: caskcindia@gmail.com)*

In most cases, individuals work in countries where they live and companies invest and operate in countries in which they are resident. However, world economies are becoming increasingly international and flow of labour, technology and capital from one country to another is common. Multinationals operate in a number of countries, and individual investors possess internationally diversified investment portfolios. Thus, companies and individuals receive foreign income in the form of profits, dividends, management and professional fee and royalties. When a person undertakes cross-border activities or maintains connections in two or more countries, he is likely to encounter the tax laws of another country. That encounter influences the way in which the person is taxed in his home country. This is how the tax systems of different countries get linked with each other.

Like international law, there is no such thing as international taxation. Taxes are not international because they are not levied at an international level by any supranational authority. Taxes are levied by central, state and local governments of a country. International taxation (or more appropriately international tax law) includes all those rules which affect the taxation of a person and which are different from the rules that would apply if all his activities and connections were in a single country. These rules include the laws, regulations, juridical pronouncements and practices of different countries. They are meant to minimise/eliminate international tax duplication so that international flow of labour, technology and capital is not unduly obstructed.

2.0 Provisions of Income Tax Act, 1961 on Double Tax Relief

As in most other countries, India gives unilateral as well as treaty relief in respect of foreign taxes suffered by Indian residents on their foreign income. Sections 90 and 91 of the Act deal with relief from international double taxation. Section 90 is for taxpayers who have paid the tax to a country with which India has signed a DTAA, while section 91 provides relief to taxpayers who have paid tax to a country with which India has not signed a DTAA

Section 90 of the Act gives relief bilaterally through tax treaties. It provides, *inter alia*, that a treaty may be entered into (a) for grant of relief in respect of income which is taxed in both the countries, (b) for the avoidance of

double taxation on income, (c) for exchange of information for the prevention of evasion or avoidance of income tax and (d) for the recovery of income tax.

Broadly speaking, India's tax treaties contain two alternatives: 1. Income which arises in the territory of one of the contracting States is not taxed by the other contracting State (exclusion method). 2. Income is taxed in both the countries in accordance with their respective tax laws but the country of the residence of the taxpayer allows him a credit against the tax charged thereon in the country of the source of such income (tax credit method). Where any such agreement for avoidance of double taxation exists, the provisions of the Act apply to the extent they are more beneficial to the assessee.

Section 91 grants unilateral relief from double taxation to the residents in respect of foreign tax paid abroad. It is noteworthy that Section 91 comes into force only when relief is not available under Section 90. Following are the requirements of Section 91: (a) the assessee should be a resident of India in the previous year, (b) such income should not be deemed to accrue in India under the provisions of the Act, (c) the income should be taxed in both the countries and there is no double tax treaty with that country and (d) the assessee should have in fact paid the tax in such foreign country either by deduction or otherwise.

Thus, if an Indian resident proves that tax has been paid in respect of his income which accrued or arose to him in the countries with which India has no agreement for double taxation relief, he is entitled to a deduction from the Indian income tax payable by him.

2.1 Salient Features of Tax Treaties between India and Other Countries

India has entered into tax treaties with 83 countries. This means that there are agreed rates of tax and jurisdictions on specified types of income arising in a country to a tax resident of another country.

Scope of the Treaty: A typical tax treaty between India and another country covers only residents of India and the other contracting country who have entered into the agreement with India. Such agreement generally provides that the laws of the two contracting states will govern the taxation of income in respective states except when express provision to the contrary is made in the agreement.

Chapter I (Articles 1 and 2) of a typical tax treaty contain the personal scope of the tax treaty and the taxes covered under the treaty. Chapter II (Articles 3 and

4) deal with general definitions. For instance, Article 3 generally deals with definitions of the terms like State, tax, person, company, enterprise, international traffic, nationals, competent authority etc. Article 4 defines the term "resident" for the purpose of a given tax treaty. Normally, the term "resident of one of the States" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.

A situation may arise when originally the tax provision in the other contracting state gave concessional treatment compared to India at a particular time but Indian laws were subsequently amended to bring incidence of tax to a level lower than the tax rate existing in the other contracting state. Since the tax treaties are meant to be beneficial and not intended to put taxpayers of a contracting state to a disadvantage, Section 90 of the Income Tax Act, 1961 specifies that where the Government of India has entered into a Double Taxation Avoidance Agreement with other countries, then the provision of the relevant DTAA or the Income Tax Act, 1961 whichever is more beneficial to the assessee, shall be applicable.

Permanent Establishment: Article 5 of the tax treaties entered into by India with different countries defines the term "permanent establishment" as fixed place of business through which the business of an enterprise is wholly or partly carried on. More specifically, the term "permanent establishment" includes (a) a place of management, (b) a branch, (c) an office, (d) a factory, (e) a workshop, (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, (g) a warehouse, in relation to a person providing storage facilities for others, (h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on, (i) a store or premises used as a sales outlet, (j) an installation or structure used for the exploration or exploitation of natural resources and (k) a building site or construction, installation or assembly project or supervisory activities in connection therewith.

A comparative study of articles on permanent establishment in respect of certain selected tax treaties reveals that there is no uniformity or consistency in defining the existence of a permanent establishment based on the minimum threshold period of existence.

Provisions for Taxation under the Tax Treaty: Chapter III of India's tax treaties deals with taxation of income including income from immovable property, business profits, dividends, interest, royalty, technical fees and the like.

A. Income from Immovable Property (Article 6): Article 6 provides that income derived by a resident of one of the States from immovable property situated in the other State may be taxed in that other State.

B. Business Profits (Article 7): Imposition of tax on a foreign enterprise is done only if it has a permanent establishment in the contracting state. Tax is computed by treating the permanent establishment as a distinct and independent enterprise.

In determining the profits of a permanent establishment, most tax treaties allow as deduction, expenses which are incurred for the purposes of the business of the permanent establishment, including executive and general administrative expenses.

The UN Model Convention (generally followed by India), inter alia, states that in the determination of profits of a permanent establishment, no deduction shall be allowed for amounts paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed. In this respect, it is interesting to note that except in respect of tax treaties with a few countries, the above provision of UN Model Convention has not been considered in many of the treaties. This implies that in respect of most of the tax treaties, expenditure incurred by the permanent establishment towards royalties, fees for technical services etc. would become an allowable expenditure, thereby reducing the taxable income leading to loss of revenue.

Further, most tax treaties provide that no profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise. The profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

C. Income from Air and Shipping Transport (Articles 8 and 8A): Income derived from the operation of air transport in international traffic by an enterprise

of one contracting state will not be taxed in the other contracting state. In respect of an enterprise of one contracting state, income earned in the other contracting state from the operation of ships in international traffic, will be taxed in that contracting state wherein the place of effective management of enterprise is situated. However some treaties contain provisions to tax the income in the other contracting state also, although at reduced rate. These provisions do not apply to coastal traffic.

D. Associated Enterprises (Article 9): In order to plug loop holes for tax evasion, Article 9 in tax treaties provides for taxing the notional income in case of associated enterprises. Where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State and conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by the reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

E. Dividends (Article 10): India generally follows the UN Model for taxation of various sources of income like dividends, interest, royalty and technical fees. Rates of tax, which may be withheld from dividends, interest, royalty are to be negotiated bilaterally, unlike the OECD Model which specifies thee maximum rate. However, where a tax treaty provides for a particular mode of computation of income, the same shall be followed irrespective of the provisions of the Income Tax Act.

Dividends paid by a Company which is a resident of a Contracting State to a resident of the other Contracting State will be taxed in both the States. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on dividends paid by the company, except insofar as such dividends are paid to be a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State

F. Interest (Article 11): Interest paid in a Contracting State to resident of the other Contracting State is chargeable to tax in both the States. This, however,

shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other Contracting State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

G. Royalties, Fees for Technical Services (Article 12): Generally, royalties, fees for technical services and payments for the use of equipment arising in one of the States and paid to a resident of the other State is taxed in both the States. The term "royalties" is normally defined as payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience but does not include any payments in respect of the operation of mineral deposits, sources and other natural resources. The term "fees for technical services" is usually defined as payments of any kind to any person, other than payments to an employee of the person making the payments and to any individual for independent personal services, in consideration for services of a managerial, technical or consultative nature. Those tax treaties which have provisions for taxation of "payments for the use of equipment" define it as payments of any kind received as a consideration for the use of, or the right to use industrial, commercial or scientific equipment.

It is noteworthy that while some tax treaties have provisions for taxation of royalties, fees for technical services and payments for use of equipment, some others only have provisions for royalties.

Some Double Taxation Avoidance agreements provide that income by way of interest, royalty or fee for technical services is charged to tax on net basis. This may result in tax deducted at source from sums paid to Non-residents which may be more than the final tax liability. The Assessing Officer has therefore been empowered under Section 195 to determine the appropriate proportion of the amount from which tax is to be deducted at source. There are instances where as

per the Income Tax Act, tax is required to be deducted at a rate prescribed in tax treaty. However this may require foreign companies to apply for refund. To obviate such difficulties Sec. 2(37A) provides that tax may be deducted at source at the rate applicable in a particular case as per section 195 on the sums payable to non-residents or in accordance with the rates specified in DTAAs.

Section 195 specifies the withholding tax rates for various categories of income. Tax is deductible at source under Section 195 at these specified rates or rates specified in Double Taxation Avoidance Agreements entered into by the Central Government under Section 90, whichever is lower.

H. Capital Gains: Capital Gains will be taxed in the state where the capital asset is situated at the time of sale. More specifically, gains derived by a resident of a Contracting State from the alienation of immovable property situated in the other Contracting State may be taxed in that other State. Similarly, gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State may be taxed in that other State. Gains from the alienation of any property other than those mentioned above shall normally be taxable only in the Contracting State of which the alienator is a resident.

I. Independent Personal Services: Income derived by an individual who is a resident of a Contracting State from the performance of professional services or other independent activities of a similar character shall be taxable only in that State. However, if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities, the income may be taxed in the other Contracting State but only so much of it as is attributable to that fixed base. (The term professional services includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants.)

J. Dependent Personal Services: Salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised, in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State. Most of the tax treaties provide that where the recipient is present in the source country

for a period not exceeding 183 days in the concerned year and remuneration is paid by an employer who is not a resident of the source country, then remuneration so received shall be taxable only in the country of residence of the recipient.

K. Directors Fees: Directors fees and similar payments derived by a resident of one of the Contracting States as a member of the Board of Directors of a company which is a resident of the other Contracting State may be taxed in that other State.

L. Entertainers: Income derived by residents of one of the Contracting States as entertainers, such as theatre, motion picture, radio or television artists, musicians and athletes, from their personal activities as such exercised in the other Contracting State, may be taxed in that other State.

M. Pensions and Annuities: Pensions and annuities paid to a resident of one of the Contracting States shall be taxable only in that State.

N. Government Service: Remuneration, other than a pension or annuity, paid by one of the Contracting States or political sub-division or local authority of that State to any individual in respect of services rendered in the discharge of governmental functions shall be taxable only in that State. However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the recipient is a resident of that other State.

O. Professors and Teachers: Where a professor or teacher who is a resident of one of the Contracting States visits the other Contracting State for a period not exceeding two years for the purpose of teaching or carrying out advanced study or research at a University, college, school or other educational institution, any remuneration that person receives for such teaching, advanced study or research shall be exempt from tax in that other State to the extent to which such remuneration is subject to tax in the first-mentioned State.

P. Students and Trainees: Where a student or trainee, who is a resident of one of the Contracting States or who was a resident of that State immediately before visiting the other Contracting State and who is temporarily present in that other State solely for the purpose of his education or training, receives payments from sources outside that other State for the purpose of the his maintenance, education or training, those payments shall be exempt from tax in that other State.

Provisions Regarding Elimination of Double Taxation: In order to avoid double taxation it is provided that if a resident of India becomes liable to pay tax either directly or by deduction in the other country in respect of income from any source, he shall be allowed credit against the Indian tax payable in respect of such income to an amount not exceeding the tax borne by him in the other country on that portion of the income which is taxed in the said other country. The same benefit is available to the resident of the other Country, on income taxed in India.

In respect of incomes on which taxes are either exempted or reduced, the country of residence will not take the exempted income into account while determining the tax to be imposed on the rest of the income.

Non-discrimination Clause: Most of the bilateral tax treaties have a non-discrimination clause which provides that the nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances and under the same conditions are or may be subjected. The same holds for taxation on permanent establishment which an enterprise of a Contracting State has in the other Contracting State.

Mutual Agreement Procedure: Tax treaties lay down a mutual agreement procedure (MAP) for resolving disputes arising out of their application. The taxpayer may approach the competent authority of the contracting state of which he is a resident where he feels that the assessment to be made or order passed is not in accordance with the terms of the treaty. The competent authority shall endeavour to resolve the dispute by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Agreement. (The case is normally required to be presented within two years from the first notification of the action which gives rise to taxation not in accordance with the Agreement.)

The Central Board of Direct Taxes vide instruction of November 2002, has laid down the following procedure for giving effect to the resolution of dispute under MAP:

- Applicant shall be required to give an acceptance to the decision arrived at under MAP and that he will forego any right to appeal on the same issue.

- Where the issue is under appeal, the assessing officer shall also obtain an undertaking from the assessee regarding withdrawal of appeal on the issue.

Exchange of Information: Bilateral tax treaties provide that competent authorities of contracting states shall exchange such information as is necessary for applying the provisions of the treaty or of domestic laws of the contracting states concerning taxes covered by the treaty. This clause is included with a view to prevent fraud or evasion of taxes. It is further provided that any information received by a Contracting State shall be treated as secret and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes which are the subject of the Convention. Such persons or authorities shall use the information only for such purposes but may disclose the information in public court proceedings or in judicial decisions.

The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance.

2.2 Double Taxation Relief Where No Tax Treaty Exists

Section 91 grants unilateral relief from double taxation to the residents in respect of foreign tax paid abroad. It is noteworthy that Section 91 comes into force only when relief is not available under Section 90. Following are the requirements of Section 91: (a) the assessee should be a resident of India in the previous year, (b) such income should not be deemed to accrue in India under the provisions of the Act, (c) the income should be taxed in both the countries and there is no double tax treaty with that country and (d) the assessee should have in fact paid the tax in such foreign country either by deduction or otherwise.

Thus, if an Indian resident proves that tax has been paid in respect of his income which accrued or arose to him in the countries with which India has no agreement for double taxation relief, he is entitled to a deduction from the Indian income tax payable by him.

2.3 Issues Relating to Indo-Mauritius Tax Treaty

As tax treaties (or DTAAs) are country-specific, the contours of taxation and concessions granted vary based on the comparative advantage that India enjoys with them. In this context, Indo-Mauritius tax treaty has been of considerable concern. The trends indicate Mauritius as the top investing country in India. The fact that a small economy like Mauritius is the largest foreign investor in a huge economy like India surpassing developed nations like USA, Japan and UK calls for further investigation.

A study of the articles dealing with residency and taxation of capital gains reveals that special consideration was given to business entities of Mauritius (perhaps in view of the fact that Mauritius was a less developed country than India). The tax treaty with Mauritius was signed in August 1982. The treaty specified that capital gains made on the sale of shares of Indian companies by investors resident in Mauritius would be taxed only in Mauritius and not in India. For almost 10 years, the treaty existed only on paper since foreign institutional investors (FIIs) were not allowed to invest in Indian stock markets. This changed in 1992 when FIIs were allowed into India.

Coinciding with this liberalization of the Indian economy, the Government of Mauritius promulgated the Mauritius Offshore Business Activities Act, 1992 to regulate the offshore business in that country. This Act allowed foreign companies to register in Mauritius for investing abroad. A body corporate registered under the laws in Mauritius would be a resident in Mauritius and thus ‘subject to taxation’ as a resident. Income Tax Act of Mauritius provided that offshore companies were liable to pay ‘zero per cent’ tax. Thus, by bringing an offshore company within the definition of resident, not only was the benefit of offshore company extended to it but also the benefits of residency allowable under the DTAA bestowed on it. This led to establishment of conduit companies in Mauritius through which investors of third countries routed their investment to India. By doing so, they avoided paying capital gains tax altogether and also enjoyed low rates of dividend and income taxes in Mauritius. (Mauritius does not have a capital gains tax.)

The above position has led to concern among tax authorities in India about the loss of rightful revenue. A Report of the Central Board of Direct Taxes observed, “In effect, the whole exercise of avoidance of double taxation turned

out to be avoidance of taxation altogether." Two questions have been challenging the basis of the Indo-Mauritius tax treaty.

- Is India giving away much more in tax exemptions than it is getting in investments?
- Will investments come to India even if the lucrative routes through Mauritius don't exist?

The Joint Parliamentary Committee (that presented its 'Report on Stock Market Scam' to the Parliament on December 21, 2003) in its observation on the Indo-Mauritius tax treaty noted that "there could be substantial revenue loss due to the 'residency clause' in the Indo-Mauritius DTAA". It, therefore, recommended that companies investing in India through Mauritius should be required to file a declaration of ownership with RBI, to the effect that all the directors and effective management was in Mauritius.

Supreme Court on Indo-Mauritius DTAA: The tax authorities in India, recognizing the need to curtail the 'abuse' of the Indo-Mauritius treaty denied the benefit of the treaty (March 2000) to some offshore business companies (OBC) registered in Mauritius that had claimed exemption from tax under the Income Tax Act, by rejecting the certificate of residence furnished by them. Such OBCs were claiming exemption of capital gains from stock market operations, which gave the right of taxation of such capital gains to Mauritius.

At around the same time, there were fluctuations in the stock markets and general perception that the action of the department denying the benefit of Mauritius residency to some Mauritius based FIIs was the root cause for such fluctuations. It was projected that this would have or had resulted in huge outflows of foreign investment from India. To clear the doubts, as also clarify the intent of the Indo-Mauritius DTAA, the Central Board of Direct Taxes issued Circular 789 dated 13 April 2000 requiring, inter alia, the assessing officer to accept the certificate of residence granted under the local legislation of Mauritius to OBCs operating from third countries including India.

Considering a 'public interest litigation' (PIL), Delhi High Court quashed the above circular as bad in law on the grounds that the income tax officer was entitled to lift the corporate veil in order to ascertain whether a company was actually resident of Mauritius or not in exercise of his quasi-judicial powers and any attempt by the Board to interfere with this would be contrary to the

intendment of the Act. In the aftermath of the Delhi High Court judgment foreign direct investment as well as portfolio flows nosedived. Very likely fund managers chose other investment destinations that continued to offer attractive tax concessions. What was needed in India was to plug the loopholes and not invalidate the beneficial provisions of the tax treaty.

The Supreme Court then upheld the sanctity of rules framed under bilateral tax treaties. The honourable Supreme Court in its judgment in the case of Azadi Bachao Andolan on 7 October 2003 upholding the issue of circular by the Board as also the Indo-Mauritius DTAA, held that

- Indo-Mauritius DTAC[1] (1983) is not 'ultra vires' of the powers of the Central Government under section 90, on account of its susceptibility to “treaty shopping”.
- Circular 789 of April 2000 issued by the Board falls within the parameters of the powers exercisable by the Board under section 119. The circular does not in any way crib, cabin or confine the powers of the assessing officer with regard to any assessment. It merely formulates guidelines to be applied in the matters of assessment of assessees covered by the provisions of Indo-Mauritius DTAA.
- Merely because, at a given time there may be an exemption from income tax in respect of particular head of income, it is not correct to say that the taxable entity is not liable to taxation.

The Supreme Court took note of the fact that, “In recent years, India has been the beneficiary of significant foreign funds through the Mauritius Conduit. Although economic reforms in India since 1991 permitted such capital transfers, the amount would have been much lower without the India-Mauritius tax treaty”. The Supreme Court's action in upholding the validity of the Circular had a number of positive implications for currency inflows into the country. Through the circular, the Central Board of Direct Taxes (CBDT) allowed investors incorporated in Mauritius to claim tax exemptions on their investments routed through that country.

During the pendency of the proceedings before the Supreme Court, the Board issued a circular on 10 February 2003 clarifying that where an assessing officer finds and is satisfied that an entity is resident of both India and Mauritius, he

would be free to proceed to determine the residential status under the DTAA by invoking what is otherwise also known as the 'tie-breaker' clause. It further stated that where it was found that the company had its place of effective management in India, then, notwithstanding it being incorporated in Mauritius, *it would be taxed under the DTAA in India*.

In the context of the tax treaty, Finance Minister P. Chidambaram stated, "The government has no intention of introducing long-term capital gains tax or to carry out a one-sided review of the India-Mauritius tax avoidance treaty. The India-Mauritius treaty has been debated threadbare. Due to a host of economic, political and diplomatic reasons, we are not proposing any unilateral revision of the treaty."

The provisions of the Indo-Mauritius tax treaty continue to be a subject of debate. Despite the Supreme Court judgement quoted above and the assurance from the Finance Minister, there is still a section of legislators and bureaucrats who feel that India is giving away much more in tax exemptions than it is receiving in investments and that these tax concessions are uncalled for. In view of the above, it becomes imperative for the Government to constantly review the trends in foreign institutional investments and take adequate precautions to avoid investments by conduit companies formed with the primary purpose of taking advantage of the treaty.

3.0 Transfer Pricing Regulations in India

Taxing provisions for transfer pricing have become imperative, in the context of increasing participation of multinational groups in economic activities in India. However, transfer pricing solutions need to be flexible enough to adapt to the growing business of a multinational group, taking into account the organisation's perception of the risks of adverse tax assessments. Prior to April 2001, there were no detailed provisions in India relating to transfer pricing and determination of arm's length price. Foreign banks in India, for instance, are known to have shown profits after about one-third or even half of the actual profits were siphoned off under various global allocations, including head office costs. Even seemingly innocuous costs like research and development costs overseas, are often transfer pricing irregularities because of the price at which

these transactions take place.

With globalisation of the Indian economy, a need was felt for a detailed and separate regulation for administering transfer pricing. Absence of such regulations not only results in litigation but loss of revenue to the exchequer as well. The Finance Minister, in his Budget speech (2000-01) stated, “The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern.” In the same Budget, the Finance Minister announced that necessary legislative changes for transfer pricing will be made in the Finance Bill based on the recommendations of an Expert Group set up in November 1999.

The Finance Act, 2001 introduced detailed Transfer Pricing Regulations in India with effect from April 1, 2001 corresponding to the assessment year 2002-2003. The rules for transfer pricing were notified on August 21, 2001.

The sections and rules under the Income Tax Act dealing with transfer pricing regulations include Sections 92 to 92F, 271(1)(c), 271AA, 271BA , 271G and rules 10A to 10E.

4.0 Assessment and Collection of Tax from Non-residents in India

Notwithstanding the various concessions/exemptions given to non-residents under the income tax law, a stringent and pervasive system of assessment and collection of tax is followed. For example, the conditions laid down for the test of residence are not diluted and no relief is granted even if the stay of an assessee in India exceeds or falls short of the prescribed limits just by one day.

The income of a non-resident assessee is assessed for tax purposes either directly or indirectly (i.e. through his agent). The agent can either be a duly constituted agent or a person who can be treated as an agent. If there is no duly constituted agent, the tax authorities are empowered to treat any of the following class of persons as the agent of a non-resident.

1. A person employed by or on behalf of the non-resident.
2. A person having a business connection with the non-resident.
3. A person from whom the non-resident is in receipt of any income either

directly or indirectly.

4. A person who is trustee of the non-resident.
5. A person who has acquired any capital asset from a non-resident if that asset is situated in India.

It is noteworthy that any of the persons mentioned above and treated as agent should be in India at the time of assessment, though he need not necessarily be a resident in India. In other words, even a non-resident may be an agent for a non-resident assessee.

Still further, an agent may be a person who does not belong to any of the above-mentioned five categories. In short, any person may be treated as an agent of a non-resident if he has some connection with the income sought to be assessed. Under the law there are elaborate guidelines concerning the appointment and liabilities of a duly constituted agent.

1. The agent is chargeable as a representative assessee of the non-resident for the incomes which are received or deemed to be received and accrue or are deemed to accrue in India.
2. The agent should have some connection with the income sought to be assessed in his hands even though the income belongs to the non-resident.
3. The agent is assessable for such incomes only as may belong to the non-residents and not to the residents.
4. The agent is assessed in the same manner and to the same extent as the non-resident himself would have been.
5. No one would be treated as an agent unless there is a liability to income tax on the non-resident.
6. The liability of the agent is personal and not conditional upon his having in hand any funds of the profit of the non-resident.

A person who is treated as an agent of a non-resident is given an opportunity of being heard before he is treated as such. And if he is treated as the agent of a non-resident, he enjoys the right to deduct from the payments to the non-resident an amount equal to the tax estimated to be paid on the profits made by the non-resident in India.

The problem of tax recovery from the non-resident becomes more serious where there is no agent who can be made liable by the tax authorities for the purpose. To deal with such situations, the income tax law has devised the

following two methods:

1. Deduction of tax at source.
2. Recovery of tax from assets.

Under the law, any income from salaries, interest on securities and dividends is subject to deduction of tax at source. The person responsible for paying such incomes is required to deduct income tax at source at the prescribed rates and deposit the same with the Government within the prescribed time limit. Deduction of tax at source is made on all such sums payable to a non-resident which are chargeable to income tax. Such sums may also include payments other than salaries, interest on securities and dividends [Sec. 195].

In case where there is no agent from whom the tax, payable by a non-resident, may be recovered or if it has not been deducted at source, the tax authorities are empowered to recover the tax from any assets of the non-resident which are in India or which may come to India any time later. Under the law there is no time limit for the recovery of a tax through this method.

The income tax law deals specifically with the assessment and collection of tax (i) on profits of non-residents from shipping business and (ii) on persons leaving India for good.

Cases may arise where non-residents are engaged in shipping business in India as the owners or charterers of ships without employing an agent from whom the tax on profits of such business can be recovered. To meet such cases the law provides that where a ship carries passengers or other items, 7.5 percent of the amount paid or payable in this respect to the owner or the charterer shall be deemed to be his income accruing in India for such carriage [Sec. 44B]. It is immaterial whether such an amount is paid or is payable in or out of India. Before leaving any port in India, the master of the ship has to prepare and furnish to the tax authorities a return of the full amount paid or payable to the owner or charterer of the ship in respect of the carriage of passengers or other items at that port since the last arrival of the ship there. This means the master of the ship is required to furnish a full account of carriage charges of the passengers etc. booked at the Indian port. On receipt of the return, the income tax officer has to assess the income and determine the amount of tax payable at the rates applicable to non-resident assessees.

The master of the ship may be exempted from furnishing such a return if the

income tax officer is satisfied that the former has made satisfactory arrangement of furnishing the return and payment of tax through some other person acting on his behalf. As a cross-checking, port clearance is not granted to the ship until the collector of customs is satisfied that the tax assessable has been duly paid or that satisfactory arrangement for its payment has been made. Thus, cross-checking through inter-departmental co-operation is an important device to collect taxes from non-residents.

Another interesting provision of the income tax law pertains to the assessment and collection of tax from a person, resident or non-resident, who in the opinion of tax authorities, may leave India during the current assessment year for good [Sec. 230]. In such a case the total income of that individual for the period from the expiry of the previous year up to the probable date of his departure from India is chargeable to tax in the same assessment year. [1] Where the income of such an individual cannot be determined properly, the income tax officer is authorised to estimate the same as per his own judgement without prejudice to the assessee. Individuals falling under this provision of the income tax law are required to obtain a tax clearance certificate from the foreign section of income tax office before leaving India.

End Note

1. Understandably, this is a departure from the general practice that the income of the previous year is to be assessed in the assessment year immediately following.

Reference

OECD, *Model Double Taxation Convention of Income and Capital*, 1977, p. 7.