Centre for Tax Laws (CTL)

Directorate of Distance Education

NALSAR University of Law, Hyderabad

In collaboration with

TAXMANN

Course Material

M.A. (INTERNATIONAL TAXATION)

1.1.1. UNDERSTANDING INTERNATIONAL TAX TREATIES AND ITS IMPLICATIONS ON DOMESTIC TAX LAWS

Prepared by

CA Prerna Peshori

FCA, LL.B., LL.M.(Int. Tax., Vienna), DIIT, M.Com.

NALSAR University of Law, Hyderabad (Print 2021)
(For private circulation only)

Understanding International Tax Treaties and its Implications on Domestic Tax Laws

Module I - Interplay between Domestic Tax Laws and Tax Treaties

		7.7.4.	Concessional Tax Treatment for GDR/ Bonds Acquired in course of Amalgamation [Section 115AC(5)]
		7.7.5.	Special Provision for Computing Tax on Non-resident Sportsmen or Sports Associations [Section 115BBA]
	7.8.	Exempt Income of Non-Residents	
		7.8.1.	Interest on Moneys Standing to the Credit of Individual in his NRE A/c [Section 10(4)(ii)]
		7.8.2.	Interest Income of a Non-Corporate Non-Resident or Foreign Company on Specified Off-Shore Rupee Denominated Bonds issued by an Indian Company or Business Trust [Section 10(4C)]
		7.8.3.	Income of a Specified Fund on Transfer of Certain Asset [Section 10(4D)]
		7.8.4.	Remuneration received by Officials of Embassies etc. of Foreign States [Section 10(6)(ii)]
		7.8.5.	Remuneration received for Services Rendered in India by a Foreign National Employed by a Foreign Enterprise [Section 10(6)(vi)]
		7.8.6.	Salary received by a Non-citizen for Services Rendered in connection with Employment on Foreign Ship [Section 10(6)(viii)]
		7.8.7.	Remuneration received by Foreign Government Employees during their Stay in India for Specified Training [Section 10(6)(xi)]
		7.8.8.	Income accruing or arising to or received by a Unit Holder from a Specified Fund or on Transfer of Units in a Specified Fund [Section 10(23FBC)]
		7.8.9.	Certain Incomes of Wholly Owned Subsidiary of Abu Dhabi Investment Authority, Sovereign Wealth Fund and Specified Pension Fund [Section 10(23FE)]
		7.8.10.	Tabular Representation - Exempt Income of Non-residents

1. <u>Introduction</u>

A tax treaty embodies an important aspect of the international tax rules of many countries. In 1928, the League of Nations developed its first model tax treaty to prevent double taxation and this was the foundation of the *2010 OECD Model*, the UN Model and other modern tax treaties. The current tax treaties still reflect the principles and arrangements developed in 1920s by the League of Nations.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a "treaty" as an international agreement concluding between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.

1.1. What is Tax Treaty?

"Treaty" represents various compromises agreed upon by countries to the contract depending upon the economic expediency of a particular country. A tax treaty is a **bilateral (two-party) agreement made by two countries to resolve issues involving double taxation of passive and active income of each of their respective citizens.** Income tax treaties generally determine the amount of tax that a country can apply to a taxpayer's income, capital, estate, or wealth. An income tax treaty is also called a Double Taxation Avoidance Agreement (DTAA).

The use of term 'treaty' signifies that the parties intend to create rights and obligation enforceable under international laws.

1.2. Need for Tax Treaty

When an individual or business invests in a foreign country, the issue arises as to which country should tax the investor's earnings. Both the countries – the source country and the residence country may enter into a tax treaty to agree on which country should tax the investment income to prevent the same income from getting taxed again and again.

The source country is the country that hosts the inward investment. The source country is also sometimes referred to as the capital-importing country. The residence country is the investor's country of residence. The residence country is also sometimes referred to as the capital-exporting country.

Tax treaties are aimed at eliminating double taxation and helps in achieving balance and equity. They aim at sharing of tax revenues by the countries to the contract on rational basis. Therefore, in order to eliminate the incidences of double taxation, various countries may enter into a tax treaty.

In addition to eliminating double taxation and allocating taxing rights, other significance of tax treaties are mentioned below:

- To ensure non-discrimination between residents and non-residents;
- Provide assistance in collection of legitimate share of tax; and
- Resolution of disputes arising due to difference in interpretation of tax treaties.

2. Status of International Tax Conventions and Treaties under the Constitution

Article 51 of the Indian Constitution has outlined some directives principles which must be followed by the State in context of International agreements and relationships. It has been provided that-

The State shall endeavour to:

a) Promote international peace and security,
b) Maintain just and honourable relations amongst nation,
c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and
d) Encourage settlement of international disputes by arbitration.

Article 253 of the Indian Constitution states that the Parliament has power to make any law for the whole or any part of the territory of the India in order to implement any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.

Also entries 10 and 14 of List I of the Seventh Schedule of **Article 246** to the constitution of India confer the power on Parliament to legislate treaties with foreign countries. Further this power of Parliament has been delegated to the Central Government vide **sections 90** and **90A** of the Income Tax Act, 1961.

In other words, it is the Parliament and not the State Legislature which is competent to approve treaties even in respect of subjects in the state list. This has been ratified by the supreme court in the ***Maganbhai Ishwarbhai Patel v. Union of India*** case wherein Justice Shah had rightly observed "The effect of **Article 253** is that if a treaty, agreement or convention with a foreign State deals with a subject within the competence of the State Legislature, the Parliament alone has, notwithstanding **Article 246(3)**, the power to make laws to implement the treaty, agreement or convention or any decision made at any international conference, association or other body. In terms, the Article deals with legislative power; thereby power is conferred upon the Parliament which it may not otherwise possess. But it does not seek to circumscribe the extent of the power conferred by **Article 73**. If, in consequence of the exercise of executive power, rights of the citizen or others are restricted or infringed, or laws are modified, the exercise of power must be supported by legislation: where there is no such restriction, infringement of the right or modification of the laws, the executive is competent to exercise the power." Therefore, any international treaty or convention, if it has to become binding on the country, it has to be approved by the Indian parliament. In other words, it is the Indian parliament, who represent the people of India has the inherent power to decide whether an international treaty/convention/agreement is good for the country or not. **Article 253**, thus empowers the people of India to decide whether an international treaty or convention should be followed or not.

3. Double Taxation Relief Provisions under Income Tax Act, 1961

Double taxation means taxing the same income twice in the hands of an assessee. A particular income may be taxed in India in the hands of a person based on his/its residence. However, the same income may be taxed in his/its hands in the Source Country also, as per the domestic laws of that country. This gives rise to double taxation. It is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief. Sections 90 and 91 of the Income-tax Act, 1961 provide for double taxation relief in India.

3.1. Bilateral Relief [Section 90]

Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India:

(a) for the granting of relief in respect of:

(i) income on which income-tax has been paid both in India and in that country or specified territory; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory); or

Note: Accordingly, the Central Government has notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement [Notification No. 91/2008, dated 28.8.2008].

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

This section empowers Central Government to make such provisions as may be necessary for implementing the agreement. These provisions shall be made by notification in official Gazettee.

3.1.1. Charge of Tax where DTAA Exists [Section 90(2), 90(2A)]

Section 90(2) provides where the Central Government has entered into such an agreement with the Government of any country outside India or specified territory outside India for granting relief of tax, or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

As per ***Explanation 1 of Section 90*** provides that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Section 90(2A) provides that the provisions of Chapter X-A, General Anti-Avoidance Rule, shall apply to the assessee even if such provisions are not beneficial to him.

3.1.2. Meaning of Terms used in any DTAA with a Foreign Country or Specified Territory [Section 90(3)]

Reference in Income Tax Act, 1961	Particulars	Meaning of the Term
Section 90(3)	Term used in any DTAA with a foreign country or specified territory, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official Gazette, which is still in force.	The term shall have the meaning assigned in the said notification issued by the Central Government in the Official Gazette.
Explanation 3 to Section 90	Term used in any DTAA with a foreign country or specified territory, which is defined in the DTAA itself.	The term shall have the same meaning assigned to it in the DTAA.
Explanation 4 to Section 90	Term used in any DTAA with a foreign country or specified territory, which is not defined in the said DTAA, but defined in the Income-tax Act, 1961.	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.

3.1.3. Tax Residency Certificate [TRC] Necessary for Claiming Treaty Benefits [Section 90(4)]

The DTAAs under section 90 are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, **section 90(4)** provides that the non-resident to whom the agreement referred to in **section 90(1)** applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory, is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be**.** Also, **section 90(1)(b)** provides that treaties shall not be used for claiming reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory).

Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, the assessee would be required to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

3.2. Double Taxation Relief to be Extended to Agreements between Specified Associations Adopted by the Central Government [Section 90A]

Section 90A provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement for -

(a) grant of double taxation relief,

(b) avoidance of double taxation of income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory),

(c) exchange of information for the prevention of evasion or avoidance of income-tax, or

(d) recovery of income-tax.

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation.

The Central Government has, vide *Notification No.90/2008 dated 28.8.2008*, notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

3.2.1. Charge of Tax

In relation to any assessee to whom the said agreement applies, the provisions of the Income- tax Act, 1961 shall apply to the extent they are more beneficial to that assessee. However, the provisions of Chapter X-A, General Anti-avoidance Rule, shall apply to the assesse even if such provisions are not beneficial to him.

The charge of tax at a higher rate for a company incorporated in the specified territory outside India as compared to a domestic company would not be considered as less favourable charge or levy of tax in respect of such company.

3.2.2. Meaning of Terms used in any Agreement which any Specified Association in India may enter into with any Specified Association in the Specified Territory Outside India for Double Taxation Relief

Particulars	Meaning of the term
Term used in any such agreement, and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government in the Official	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the agreement came into force.

Gazette, which is still in force.	
Term used in any such agreement, which is defined in the agreement itself.	The term shall have the same meaning assigned to it in the said agreement.
Term used in any such agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 1961.	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.

3.2.3. Tax Residence Certificate (TRC) Necessary for Claiming Treaty Benefits [Section 90A(4)]

The DTAAs under **section 90A** are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a contracting country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.

Therefore, **section 90A(4)** provides that the non-resident to whom the agreement referred to in **section 90A(1)** applies, shall be allowed to claim the relief under such agreement if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory is furnished, declaring his residence of the country outside India or the specified territory outside India, as the case may be. Also, **section 90A(1)(b)** provides that treaties shall not be used for claiming reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory).

Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate issued by the foreign Government, **section 90A(5)** requires the assessee to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

Note: For the purpose of this section, the 'specified association' means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government and 'specified territory' means any area outside India which may be notified by the Central Government.

3.3. Countries with which No Agreement Exists – Unilateral Agreements [Section 91]

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

In other words, lower of the following sums shall be deductible from Indian Income Tax:

(i) Doubly Taxed Income × Average rate of Indian Income Tax

(ii) Doubly Taxed Income × Average rate of Foreign Income Tax

- Average rate of Indian Income Tax:

Average rate of Indian Income Tax shall be determined as follows:

$$\frac{\textbf{Tax Payable in India} \times \mathbf{100}}{\textbf{Total Income}}$$

- Average rate of Foreign Income Tax:

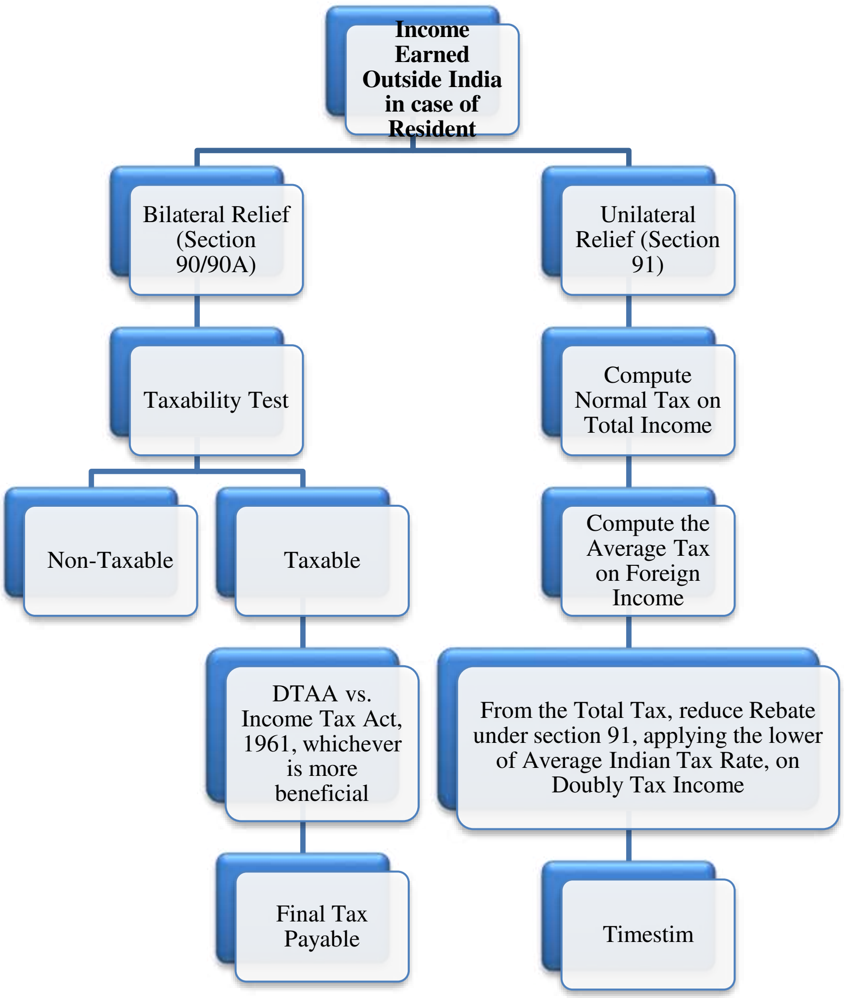
Average rate of Foreign Income Tax shall be determined as follows:

$$\frac{\textbf{Tax Payable in Foreign} \times \mathbf{100}}{\textbf{Foreign Total Income}}$$

Fig: Analysis of Provision Avoiding Double Taxation

4. <u>Recovery of Tax in Pursuance of Agreements with Foreign Countries [Section 228A]</u>

Where an agreement is entered into by the Central Government with the Government of any country outside India for recovery of income tax under this Act and the corresponding law in force in that country and the Government of that country or any authority under that



Government which is specified in this behalf in such agreement sends to the Board a certificate for the recovery of any tax due under such corresponding law from a person having any property in India, the Board may forward such certificate to any Tax Recovery Officer within whose jurisdiction such property is situated and thereupon such Tax Recovery Officer shall-

a) proceed to recover the amount specified in the certificate in the manner in which he would proceed to recover the amount specified in a certificate drawn up by him under section 222]; and
b) remit any sum so recovered by him to the Board after deducting his expenses in connection with the recovery proceedings.

Recovery from Assessee-in-default

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee has property in a country outside India (being a country with which the Central Government has entered into an agreement for the recovery of income-tax under this Act and the corresponding law in force in that country), forward to the Board a certificate drawn up by him under **section 222** and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

5. <u>Extent of Laws made by Parliament and by the Legislatures of States [Article 245 of the Constitution]</u>

Article 245 of the Constitution provides that subject to the provisions of this Constitution, Parliament may make laws for the whole or any part of the territory of India, and the Legislature of a State may make laws for the whole or any part of the State. Further no law made by Parliament shall be deemed to be invalid on the ground that it would have extra territorial operation

6. <u>Extra-territorial Operations of Indian Income-tax Act, 1961</u>

The concept of extra-territorial jurisdiction is an extension as well as a contradiction to the concept of sovereignty. Sovereignty, a nation’s exclusive right to govern itself, has its roots in public international law but has been internalised to the extent that it has become a cornerstone for the constitutions of various nations around the world. India, in this case, is not different and has sovereignty mentioned as one of its characteristics in the first line of its Preamble to the mammoth Constitution. On the other hand, the concept of extraterritoriality finds its roots under **Article 245(2)** of the Constitution which reads as “No law made by Parliament shall be deemed to be invalid on the ground that it would have extraterritorial operation.”

Thus, a combined reading of the concept of sovereignty and **Article 245(2)** leads to an inference that India not only has the sole right to govern itself by legislating, enacting and executing various laws and regulations but it also has a right to frame laws that gives it unbridled powers to govern beyond its territory. However, this inference is unacceptable as it is in direct contravention to the concept of sovereignty.

For sovereignty and extra-territorial operation of laws to co-exist, a balance between the two should be achieved. In the case of *GVK Industries Ltd. v. Income Tax Officer*, it was held by the Supreme Court of India that only those extra-territorial laws are valid that have a nexus with India. In other words, only those extra-territorial laws that seek to address/remedy a cause through which the Indian interests are getting affected and the one that is in direct contravention with the law of the land, are valid. In India, there are no detailed laws that are extra-territorial in nature. However, there are laws that have specific provisions confirming their extra-territorial jurisdiction.

For instance, **Section 4 of the Indian Penal Code, 1860** provides that:

(1) any citizen of India in any place without and beyond India; and

(2) any person on any ship or aircraft registered in India wherever it may be.

This provision of the Indian Penal Code uses the active nationality principle through which the nationality of the accused is invoked consequent to which the trial is as per the national laws. The nexus that invokes the operation of Section 4 is the nationality of the accused.

Section 9(1) of the Income-tax Act, 1961 provides a deeming fiction to effectively treat income of a non-resident assessee taxable which accrues or arises in India. **Section 9**, thus is extra-territorial in nature as it is applicable to non-resident assesses, although it seeks to tax only that part of their income which has a nexus in India.

Information Technology Act, 2000 was amended by notification dated October 27, 2009. Apart from its application to the whole of India, its provisions also apply to any offence or contravention committed outside the territorial jurisdiction of the country by any person irrespective of his nationality. In order to invoke its extra-territorial operation, such an offence or contravention should involve a computer, computer system or computer network located in India. Thus, extra-territorial provisions having a nexus with Indian interests are considered to be intra-vires and valid.

6.1. Section 9 of Income-tax Act, 1961

This section talks about the categories of income deemed to accrue or arise in India. This is an important concept because it serves as a foundation for taxation of income of a person. This section provides for taxation on both, residents as well as non-residents.

Section 9 originally brings a **“source income”** rule of taxation, ranging from income from a business connection to royalty paid by the government as accruing or deeming to accrue from India for the purposes of taxation. Due to its nature of taxing non-resident corporations as well, this section has been criticised as ultra vires to the Constitution of India on the grounds of being outside the legislative competence of the legislature as well as violation to the fundamental rights.

6.1.1. Income Deemed to Accrue or Arise in India through Business Connection [Section 9(1)(i)]

The term business connection has been explained in Explanation 2 to section 9(1)(i) which include any business activity carried out through a person, acting on behalf of the non-resident.

‘Business connection’ shall include any business activity carried out through a person acting on behalf of the non-resident ***[Explanation 2 to section 9(1)(i)]***

For a **business connection** to be established, the person acting on behalf of the non-resident:

a) must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and such contracts are:
    - in the name of the non-resident; or
    - for the transfer of the ownership of; or
    - for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
    - for the provision of services by that non-resident, or

b) Where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

c) Who habitually secures orders in India, mainly or wholly for the non-resident. Further, there might be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non- residents would be established if:
    (i) such other non-resident controls the non-resident or

(ii) such other non-resident is controlled by the non-resident or

(iii)such other non-resident is subject to same control as that of non-resident.

However, such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having independent status, if they are acting in ordinary course of business.

Where a business is carried on in India through a person referred to in (a), (b) or (c) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India ***[Explanation 3 to Section 9(1)(i)].***

In the case of a non-resident, the following shall not, however, be treated as business connection in India ***[Explanation 1 to section 9(1)(i)]***:

Sr. No.	Scenario	Explanation
(i)	**Where all the operations are not carried out in India *[Explanation 1(a) to section 9(1)(i)]***	In the case of a business of which all the operations are not carried out in India, the income of such business shall be deemed to accrue or arise in India shall be only for such part of income as is reasonably attributable to the operations carried out in India. Therefore, it provides that such part of income which cannot be reasonably attributed to the operations in India shall not be deemed to accrue or arise in India.
(ii)	**Purchase of goods in India for export *[Explanation 1(b) to section 9(1)(i)]***	In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.
(iii)	**Collection of news and views in India for transmission out of India *[Explanation 1(c) to section 9(1)(i)]***	In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined

		to the collection of news and views in India for transmission out of India.
(iv)	**Shooting of cinematograph films in India** ***[Explanation 1(d) to section 9(1)(i)]***	In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is: a. an individual, who is not a citizen of India or b. a firm which does not have any partner who is a citizen of India or who is resident in India; or c. a company which does not have any shareholder who is a citizen of India or who is resident in India.
(v)	**Activities confined to display of rough diamonds in SNZs** ***[Explanation 1(e) to section 9(1)(i)]***	In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unsorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

6.1.2. Income from Property, Asset or Source of Income in India

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India. For example, hire charges or rent paid outside India for the use of the machinery or buildings situated in India, deposits with an Indian company for which interest is received outside India, etc.

6.1.3. Income through Transfer of Capital Assets Situated in India

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

a) The capital asset is movable or immovable, tangible or intangible;
b) The place of registration of the document of transfer etc., is in India or outside; and
c) The place of payment of the consideration for the transfer is within India or outside.

The expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of" ***[Explanation 4 to section 9(1)(i)].***

It is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India ***[Explanation 5 to section 9(1)(i)].***

However, ***Explanation 5 to section 9(1)(i)*** shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly in:

a) An asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India

b) A Foreign Institutional Investor as referred to in clause (a) of the Explanation to Sec. 115AD for assessment year commencing on or after 01.04.2012 but before 01.04.2015.

Explanation 6 to section 9(1)(i) states that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets, -

(i) exceeds the amount of 10 crore; and
(ii) represents at least 50% of the value of all the assets owned by the company or entity, as the case may be.

Note: Definitions of the various terms used are provided in the table below:

Terms	Definition
Value of an asset	The fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in prescribed manner.
Specified date	Specified date means: (i) the date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest. (ii) the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer.
Accounting period	Each period of 12 months ending with 31st March. **Different date of year-end:** Where a company or an entity, referred to in ***Explanation 5***, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of— (i) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (ii) reporting to persons holding the share or interest, Then the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity.
First Accounting Period	It shall begin from the date of its registration or incorporation and end with the 31st March or such other day, as the case may be, following the date of such registration or incorporation.
Later accounting period	The later accounting period shall be the successive periods of twelve months.
Accounting period of an entity which ceases to exist	If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Explanation 7 to section 9(1)(i): No income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the ***Explanation 5***;

(i) If such company directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a) neither holds the right of management or control in relation to foreign company or entity;
b) nor the voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or

(ii) If such company indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a) neither holds the right of management or control in relation to foreign company or entity;
b) nor holds any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India;
c) nor holds such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

However in case where all the assets owned, directly or indirectly, by a company or an entity reffered to in Explanation 5, and not located in India, the income of non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets lacated in India and determined in such manner as may be prescribed.

"Associated enterprise", in relation to another enterprise, means an enterprise:

- that participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

6.2. Income from Salaries Earned in India [Section 9(1)(ii)]

Income, which falls under the head "Salaries", deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

6.3. Income from Salaries Payable by the Government for Services Rendered Outside India [Section 9(1)(iii)]

Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

6.4. Dividend Paid by an Indian Company Outside India [Section 9(1)(iv)]

Dividend paid by an Indian company outside India is deemed to be accrues or arise in India and would be taxable in India in the hands of non-resident shareholders.

It is clarified that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would not be deemed to income accruing or arising in India by the virtue of the provision of ***Explanation 5 to section 9(1)(i)***.

6.5. Interest Payable Outside India [Section 9(1)(v)]

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by –

(i) the Government;
(ii) a person resident in India;
(iii) a non-resident, when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on in India by him.

Explanation Section 9(1)(v) states that in case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment (PE) in India of such non-resident to the head office or any PE or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the PE in India and the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly.

"Permanent Establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

6.6. Royalty [Section 9(1)(vi)]

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;
(ii) a person who is a resident in India except where it is payable for the transfer of any right or the use of any property or information or for the utilisation of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, or
(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

6.7. Fees for Technical Services [Section 9(1)(vii)]

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India except where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

6.8. Any Sum of Money paid by a Resident Indian to a Non-Corporate Non-Resident or Foreign Company [Section 9(1)(viii)]

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ` 50,000.

It may be noted that this deeming provision applies only to sum of money paid outside India to a non-corporate non-resident or foreign company, and not in respect of property, movable or immovable, transferred outside India without consideration or for inadequate consideration to a non-corporate non-resident or foreign company.

6.9. Some Relevant Case Studies to Understand the Concept of Extra-territorial Jurisdiction

Vodafone International Holding (VIH) v. Union of India (UOI)
Issue Involved: The issue before the Apex court was whether the Indian Revenue Authority had power to tax a sale of shares between two non-resident companies on an offshore transaction whereby the controlling interest of a resident Indian corporation is purchased on the basis of that transaction. **Case Scenario:** In February 2007, the Dutch Group Vodafone International Holding (VIH) purchased 100% of the shares in CGP Investments (Holding) Ltd (CGP), a Cayman Islands group, from Hutchison Telecommunications International Limited for USD 11.1 billion. 67% of Hutchison Essar Limited (hereinafter HEL), an Indian Company, was governed by CGP through various transitional organizations/ authoritative courses of action. The acquisition resulted in Vodafone acquiring control over CGP and its subsidiaries downstream, including eventually Hutchison Essar Limited. HEL was a joint effort between the gathering at Hutchison and the gathering at Essar. As of November 1994, it had obtained telecom licences to provide cell contact in different circles in India. In September 2007, Vodafone Company received a show-cause notice from the Indian Tax Department to explain why tax was not withheld on payments made to HTIL in connection with the transaction in question above. The tax department argued that the afore-mentioned transaction involving the sale of CGP shares had an effect on the aberrant or indirect sale of India-based properties. The revenue argued that the entire trade of HTIL's selling of CGP to VIH was in the substance transfer of capital assets in India and therefore triggered capital gain taxes, which culminated in the transfer of all direct/indirect rights in HEL to VIH, and that the entire selling of CGP was a tax evasion scheme. **Judgment Involved:** Key principles set out in the decision were: • It was not possible to read the tax legislation dealing with transfers of capital assets situated in India as extending to indirect transfers: that would amount to reading words into the provision under Section 9(1) of the Income Tax Act 1961 (IT Act) which were not there. • There was nothing objectionable about multinationals using special purpose vehicles

(SPVs) and holding companies in cross border structures for tax planning, commercial and regulatory reasons. However, if a SPV or a holding company was created without any commercial or business substance only to avoid tax, then the tax authorities may ignore such entity. Structuring transactions to achieve tax efficiency is permissible provided that the structure used is not a sham or a colorable tax avoidance device.

- The corporate veil could not be pierced except in exceptional circumstances where companies were used as tax avoidance devices or to perpetrate tax evasion such as round tripping of funds back into India.

- While looking at such structures, the courts and the tax department should look at transactions as a whole and not dissect them at the outset in search of an unacceptable tax motive. The factors that the tax authorities and courts should consider include:
    i. duration of time for which such structure has been in existence,
    ii. the period of business operations in India,
    iii. the timing of the exit, and
    iv. the continuity of business on such exit.

- The burden is on the tax authorities to determine the dominant purpose of a transaction and to establish that a given transaction is a sham or a colourable device designed to avoid tax.

- Whether a structure represents a genuine tax planning on the one hand or a sham or a colourable device to avoid tax on the other has to be determined at the threshold, by looking at the transaction as a whole in the context to which it properly belongs and not by dissecting the individual parts and looking at them in isolation. According to the Supreme Court, examples of colourable devices include structures that are “used for circular trading or round tripping or to pay bribes.” On the other hand, structures designed to avoid the lengthy approval and registration processes in India may be permissible.

Following its holistic approach, the Supreme Court found that the transaction between Vodafone and the Hutchison Group was exactly as the parties contemplated: an offshore sale between offshore parties of an offshore asset and was not subject to tax in India.

Conclusion: The Supreme Court denied the Indian government’s review petition for the decision in Vodafone, leaving legislation as the government’s only option to overturn the ruling. Therefore, the Indian Revenue Authorities can’t tax the above transaction.

However, the above judgement has been nullified by retrospective amendments in Section 9(1) which are discussed below:

Explanation 4 to section 9(1)(i) was included to clarify that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Explanation 5 to section 9(1)(i)was inserted to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

However, ***Explanation 5 to section 9(1)(i)*** shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly in:

a. An asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India
b. A Foreign Institutional Investor as referred to in clause (a) of the Explanation to Sec. 115AD for assessment year commencing on or after 01.04.2012 but before 01.04.2015.

Explanation 6 to section 9(1)(i) was also inserted which states that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets, -

(i) exceeds the amount of 10 crores; and
(ii) represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

Explanation 7 to section 9(1)(i) was inserted. According to which no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the

Explanation 5;

(i) If such company directly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a. neither holds the right of management or control in relation to foreign company or entity;
b. nor the voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or

(ii) If such company indirectly owns the assets situated in India and the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

a. neither holds the right of management or control in relation to foreign company or entity;
b. nor holds any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India;
c. nor holds such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India.

However in case where all the assets owned, directly or indirectly, by a company or an entity referred to in Explanation 5, and not located in India, the income of non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed.

CIT vs. M/s Eli Lilly & Co. (India) P. Ltd.
Issue Involved: Whether the JV is liable to deduct Indian tax on home salary and whether provisions dealing with TDS which are in nature of machinery provisions for collection of taxes are independent of the charging provisions, which determines chargeability of income under the head "Salaries" in the hands of the expatriates. **Case Scenario:** Expatriates were seconded to the Indian JV by the foreign enterprise. The JV had deducted tax at source on the salary payable in India u/s 192 but did not deduct tax on the home salary paid to expatriates. The department took a position the JV/BO should have deducted tax on the home salary as well. The department also initiated penal proceedings for non-deduction of tax at source. **Judgement Involved:** The Supreme Court held that the provisions relating to TDS, which are in nature of machinery provisions to enable collection and recovery of tax forms an integrated code with the charging provisions which determines charge to tax in the hands of expatriates. The Supreme Court ruled that an Indian company is responsible for withholding tax on remuneration paid to its expatriates by a foreign company outside India if the services are rendered solely in India. Section 192 has extra-territorial jurisdiction when salaries taxable u/s 9(1)(ii) are payable outside India. **Conclusion:** The Indian company would be liable to deduct tax at source on the salary paid by it and also on the salary paid by the foreign employer outside India if the employees are working for the Indian company in India.

7. <u>Overview of the Framework of Provisions related to Non-residents under the Income-Tax Act, 1961</u>

The rules for determination of the residential status of a person are laid down in section 6 of Income-tax Act, 1961. The taxpayers are classified into three broad categories on the basis of their residential status viz.

(i) Resident and ordinarily resident (ROR)
(ii) Resident but not ordinarily resident (RNOR)
(iii) Non-resident

7.1. Determination of Residential Status

(1) Residential Status of an Individual

The provisions of residential status of an individual are covered under Section 6(1) of the Income Tax Act, 1961, which are as mentioned below.

a) Residential Status of an Individual on the basis of Number of Days of Stay in India

As per **section 6(1) of Income-tax Act, 1961**, an individual is said to be resident in India in any of the previous year if he satisfies any one of the below-mentioned conditions:

(i) He has been in India during the previous year for a total period of 182 days or more; or

(ii) He has been in India during the 4 years immediately preceding the previous year for total period of 365 days or more and has been in India for at least 60 days in that previous year.

If the individual satisfies any one of the above conditions, he will be considered as resident in India. If the individual does not satisfy both the conditions, he is considered to be non-resident.

Exception to above section:

(i) Indian citizen, who leaves India during the relevant previous year as a member of the crew of an Indian ship or for the purposes of employment outside India, or

(ii) Indian citizen or a person of Indian origin, who, being outside India comes on a visit to India during relevant previous year.

b) Deemed Resident [Section 6(1A)]

(i) An individual, being an Indian citizen, having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding **15 lakhs** during the previous year would be deemed to be resident in India in that previous year, if he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

(ii) Further, it is clarified that in case an individual is said to be resident in India in the previous year under section 6(1), the provision of deemed resident would **not** be applicable.

c) Resident and Ordinarily Resident/ Resident and not Ordinarily Resident

Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assesses are either a resident or non-resident. A not-ordinarily resident person is one who satisfies any one of the conditions mentioned in section 6(6) of Income-tax Act, 1961.

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has, during the 7 previous years preceding the relevant previous year, been in India for a period of 729 days or less.

(iii)If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any previous year) having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding 15 lakhs during the previous year, who has been in India for 120 days or more but less than 182 days during that previous year, or

(iv)If such individual is an Indian citizen who is deemed to be resident in India under section 6(1A)

(2) Residential Status of HUF, Firm, AOPs/BOI, Artificial Juridical Person, Local Authorities, etc.

In case of assessees like HUF, Firm, AOPs/BOI, Artificial Juridical Person, Local Authorities, etc., the residential status is determined on the basis of the concept of Control and Management. These assessees would be considered as resident in India if the control and management of their affairs is situated wholly or partly in India. If the control and management is situated wholly outside India, they would become non-resident.

Control and management of HUF	Karta or its manager
Control and management of Firms/BOIs	Partners or its members

An HUF can be resident and ordinarily resident if it satisfies the additional conditions as applicable in case of individuals.

Additional Conditions:

(i) Karta of Resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year; and

(ii) Stay of Karta during 7 previous year immediately preceding relevant previous year should be 730 days or more.

Note: All assessees other than HUF and individual can be resident or non-resident but cannot be resident and ordinarily resident or resident and not ordinarily resident.

(3) Residential Status of a Company

As per **section 6(3)** of Income-tax Act, 1961, a company would be considered resident in India in any previous year, if-

(i) it is an **Indian company**; **or**

(ii) its **place of effective management (POEM)**, in that year, is in India.

An **"Indian Company"** means the company registered under the Companies Act, 1956 or under the Companies Act, 2013

Note: *The concept of POEM has been discussed in detail in 1.1.4. "Residence for Treaty Purpose".*

7.2. Presumptive Taxation for Non-Residents

Certain provisions have been provided in the Income-tax Act, 1961, whereby the "Profits and gains of business or profession" of certain non-resident assessee is calculated on the basis of certain percentage of the amount accrued or arisen and received in India.

7.2.1. Profits and Gains of Shipping Business in case of Non-residents [Section 44B]

Section 44B provides that profits and gains of a non-resident engaged in the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

(i) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

The amounts referred to in (i) and (ii) shall include demurrage charges or handling charges or any other amount of similar nature.

7.2.2. Occasional Shipping Business of Non-residents [Section 172]

As per **Section 172(1)** the provisions of this section shall, notwithstanding anything contained in the other provisions of this Act, apply for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non- resident, which carries passengers, livestock, mail or goods shipped at a port in India.

(i) Presumptive tax [Section 172(2)]: Where a ship carries passengers, livestock, mail, or goods shipped at a port in India, a sum equal to 7.5% of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether that amount is paid or payable in or out of India, shall be deemed to be income accruing in India to the owner or charterer on account of such carriage.

(ii) Furnish a return of the amount paid to the owner [Section 172(3)]: This section imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

A return may, however, be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

(iii) Assessment [Section 172(4)]: This section provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the tax payable on the taxable income. The tax payable on such taxable income is to be calculated at the rate or rates in force applicable to the total income of a foreign company. The master of the ship is liable for payment of such tax.

(iv) Time limit for passing the assessment order [Section 172(4A)/(5)]: It is incumbent on the Assessing Officer to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed. For the purpose of determining the tax payable, Assessing Officer is empowered to call for such accounts and documents as he may require.

(v) Grant of port of clearance to the ship [Section 172(6)]: A port clearance shall not be granted to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(vi) Option to pay tax as per normal provisions of the Income-tax Act, 1961 on the income chargeable to tax under section 172 [Section 172(7)]: The owner or charterer has the option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax levied for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him, as the case may be.

A Comparative Analysis between section 44B and section 172:

Particulars	Section 44B	Section 172
Assessment and Collection	Presumptive tax provisions for non-residents engaged in shipping business. It does not, however, contain any procedure for assessment and collection of tax.	Complete code for taxation of occasional shipping business of non-residents, including assessment and collection of tax.
Manner of Computation of Presumptive Income	Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the - (i) amount paid or payable (whether in or outside India) to the non-resident or to any other person on his behalf on account of the carriage of	Where a ship carries passengers, livestock, mail, or goods shipped at a port in India, a sum equal to 7.5% of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether that amount is paid or payable in or out of India, shall be deemed to be income

	passengers, livestock, mail or goods shipped at any Indian port and (ii) the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".	accruing in India to the owner or charterer on account of such carriage.

7.2.3. Special Provision for Computing Profits and Gains in connection with the Business of Exploration, etc. of Mineral Oils [Section 44BB]

Section 44BB provides for determination of income of taxpayer being a non-resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.

(i) Presumptive rate of tax: In such case, the profits and gains shall be deemed to be equal to of the following amounts:

(i) paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
(ii) received or deemed to be received in India by or on behalf of the assesse on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India.

Note: The provisions of section 44BB shall not apply to any income to which the provisions of section 42 or section 44DA, 115A or 293A apply for the purpose of computing profit or gains or any other income referred to in these sections.

(ii) Option to claim lower profits: An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

7.2.4. Special Provision for Computing Profits and Gains of the Business of Operation of Aircraft in the case of Non-residents [Section 44BBA]

Section 44BBA provides presumptive rate in case of a non-resident engaged in the business of operation of aircraft.

Income from such business is calculated at a flat rate of 5% of the following:

(i) amount paid or payable, in or out of India, to the tax payer or to any person on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India **and**

(ii) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

7.2.5. Special Provision for Computing Profits and Gains of Foreign Companies Engaged in the Business of Civil Construction etc. in Certain Turnkey Power Projects [Section 44BBA]

A foreign company engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf.

(i) Presumptive rate: A sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(ii) Option to claim lower profits: An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

7.2.6. Deduction in respect of Head Office Expenses in case of Non-residents [Section 44C]

Deduction in respect of head office expenditure is restricted to the least of the following:

(i) an amount equal to 5% of "adjusted total income" or in the case of loss, 5% of the "average adjusted total income"; or
(ii) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Meaning of Certain Terms

Particulars	Meaning
Meaning of "Plant" and "Mineral Oil"	(i) "Plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business; (ii) "Mineral oil" includes petroleum and natural gas.
Adjusted Total Income	Total income computed in accordance with the provisions of the Act without giving effect to the following:- i. Allowance under this section ii. Unabsorbed depreciation allowance under section 32(2). iii. Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix). iv. Business loss brought forward under section 72(1). v. Speculation loss brought forward under section 73(2). vi. Loss under the head Capital Gain under section 74(1). vii. Loss from certain specified source brought forward under section 74A(3). viii. Deductions under Chapter VI-A.
Average Adjusted Total Income	(a) The total income of the assessee, assessable for each of the three assessment years immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income. (b) When the total income of the assessee is assessable only for

	two of the aforesaid three assessment years, one half of the aggregate amount of the adjusted total income in respect of the previous year's relevant to the aforesaid two assessment years is taken on average adjusted total income. (c) Where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.
Head Office Expenditure	Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of: (i) rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession. (ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India; (iii) traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and (iv) such other matters connected with executive and general administrative as may be prescribed.

7.2.7. Special Provision for Computing Income by way of Royalties etc. in case of Non-residents [Section 44DA]

Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31.03.2003 where:

(a) such non-resident carries business/profession in India through permanent establishment or fixed place of profession; and
(b) the right, property, or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of service.

(i) Expenses not allowed as deduction: While computing the income chargeable to tax under this section, the following expenses are not allowed as deduction:

(a) expenditure or allowance incurred which is not wholly and exclusively for such permanent establishment or fixed place of service in India

(b) amount paid (otherwise than reimbursement of actual expenses) by the permanent establishment to head office or to any of its other offices.

(ii) Mandatory requirement to maintain books of account and get them audited: Under this section, the non-resident is mandatorily required to keep and maintain the books of account under section 44AA and get them audited before the date one month prior to the due date for furnishing the return of income under section 139(1) and furnish by that date a report of such audit.

(iii) Non-Applicability of the section: The provisions of section 44BB do not apply in respect of income covered by this section.

7.3. Withholding Tax Provisions for Non-Residents

Following are the provisions relating to withholding of tax of non-residents:

Section	Nature of Payment	Rate of Tax
192	Salary	Normal slab rates
192A	Premature withdrawal from EPF, aggregating to ` 50,000 or more	10%
194B	Income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort, where payment to a person > ` 10,000	30%
194BB	Income by way of winnings from horse races, where payment to a person > ` 10,000	30%
194E	Income referred to under section 115BBA payable to non- resident sportsmen/ sports association or an entertainer	20%
194G	Commission etc. on the sale of lottery tickets, where amount payable to a person > ` 15,000	5%
194LB	Interest payable by infrastructure debt fund to a non-	5%

	corporate non-resident or foreign company	
194LBA(2)	Distribution of any interest income, received or receivable by a business trust from a SPV, to its unit holders.	5%
	Distribution of any dividend income, received or receivable by business trust from a SPV exercising option to pay tax at concessional rate under section 115BAA, to its unit holders. However, if the SPV is not exercising the option to pay tax at concessional rate under section 115BAA, dividend income would be exempt in the hands of unit holders and tax would not be deductible at source.	10%
194LBA(3)	Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.	At the rates in force
194LBB	Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].	At the rates in force
194LBC(2)	Income in respect of investment made in a securitisation trust (specified in Explanation to section 115TCA)	At the rates in force
194LC	Interest payable by an Indian Company or a business trust to a non-corporate non-resident or foreign company	5%
194LD	On interest payable - between 1.6.2013 and 30.6.2023 on (a) rupee denominated bond of an Indian Company or (b) Government securities or - between 1.4.2020 and 30.6.2023 on municipal debt securities to a Foreign Institutional Investor or a Qualified Foreign Investor	5%
194N	On withdrawal of cash in excess of ` 1 crore	2% on amount exceeding ` 1 crore
	In case the recipient has not filed ROI for all the 3	(i) @ 2% of

	immediately preceding P.Y.s, for which time limit u/s 139(1) has expired, such sum shall be the amount or aggregate of amounts, in cash > ` 20 lakh during the P.Y.	the sum, where cash withdrawal > ` 20 lakhs ≤ ` 1 crore (ii) @ 5% of sum, where cash withdrawal exceeds ` 1 crore
195	Any other sum payable to a non-resident	At the rates in force
196A	Income on units of a mutual fund specified under section 10(23D) or from the specified company referred to in section 10(35) payable to non-corporate non-resident or foreign company	20%
196B	Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund	10%
196C	Income by way of interest or dividend on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs) payable to a non-resident	10%
196D	Income of foreign Institutional Investors from securities (not being income by way of interest referred to in section 194LD or capital gain arising from such securities)	20%
	Income of specified fund from securities [not being income by way of interest referred to in section 194LD or capital gain arising from such securities or income exempt u/s 10(4D)]	10%

7.3.1. Mandatory Requirement of Furnishing PAN in all TDS, Bills, Voucher and Correspondence between the Deductor and Deductee [Section 206AA]

With a view to strengthening the PAN mechanism, section 206AA provides that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –

(a) the rate prescribed in the Act;

(b) at the rate in force i.e., the rate mentioned in the Finance Act; or

(c) at the rate of 20% (5%, if tax is deductible under section 194-O)

(i) Mandatory PAN: No certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(ii) In case of Invalid PAN: If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (i) above.

(iii) Non-applicability of the section: The provisions of section 206AA shall not apply in respect of payment of interest on long - term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

(iv) Non-applicability of section 206AA to non-residents subject to fulfillment of certain conditions: For the purpose of reducing the compliance burden, section 206AA provides for non-applicability of the requirements contained in section 206AA to a non-corporate non-resident or a foreign company not having PAN in respect of payment in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, subject to the deductee furnishing the following details and documents to the deductor, namely:-

a. name, e-mail id, contact number;
b. address in the country or specified territory outside India of which the deductee is a resident;
c. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;
d. Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified

territory of which he claims to be a resident [Notification No. 53/2016 dated 24th June, 2016].

7.4. Provisions Relating to Conversion of Indian Branch of a Foreign Bank into Subsidiary Company [Chapter XII-BB]

The provisions related to conversion of Indian Branch of a Foreign Bank into Subsidiary Company are as follows:

7.4.1. Conversion of an Indian Branch of Foreign Company into Subsidiary Indian Company [Section 115JG(1)]

The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place. Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

Further, the benefit of set-off of unabsorbed depreciation, set-off or carry forward and set- off of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

- **Conditions Related to Capital Exemptions:**

Accordingly, the Central Government has, vide *notification no. 85/2018*, specified the **conditions** to be fulfilled. Where a foreign company is engaged in the business of banking through its Indian branch and converts such Indian branch into its Indian subsidiary company in accordance with the scheme framed by RBI, the capital gains arising from such conversion would not be chargeable to tax, if -

(a) the Indian branch amalgamates with the Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI;

(b) all the assets and liabilities of the Indian branch immediately before conversion would become the assets and liabilities of the Indian subsidiary company;

(c) the asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.

    Note: Any change in the value of assets consequent to their revaluation would not be considered while determining the value of the assets.

(d) the foreign bank or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place and continue to hold the shares of Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year;

(e) the foreign company does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Indian subsidiary company.

- **Consequences of failure to comply with the specified conditions**

If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

- **Consequences of subsequent failure to comply with the conditions**

i. If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

ii. In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

iii. The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

iv. Every notification under issued under this section shall be laid before each House of Parliament.

- **Application of the provisions of the Income-tax Act, 1961 with modifications/exceptions**

The provisions of the Income-tax Act, 1961 relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary company shall apply with following modifications, exceptions and adaptation –

a) Allowance of Depreciation under section 32:

The aggregate deduction, in respect of depreciation on buildings, machinery, plant or furniture, being tangible assets, or know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets, allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates as if the conversion had not taken place. Such deduction would be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them.

b) Set-off and c/f of loss and depreciation:

The accumulated loss and the unabsorbed depreciation of the Indian branch would be deemed to be the loss or allowance for depreciation of the Indian subsidiary company for the previous year in which conversion was effected; and provisions of the Income-tax Act, 1961, relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

c) Determination of Actual cost u/s 43(1):

The actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the date of its conversion into the Indian subsidiary company. The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD, shall be treated as 'nil' in the case of the Indian subsidiary company if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch.

d) Cost of acquisition of other capital assets:

Where the capital asset other than those referred to in (c) above became the property of the Indian subsidiary company as a result of conversion of the Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which previous owner has acquired it.

e) Tax Credit:

The tax credit of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected; and the provisions of section 115JAA of the Income-tax Act, 1961 shall apply accordingly.

f) Amortization of VRS Expenditure:

The provisions of 35DDA of the Act shall be applicable to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place.

g) Deemed credit balance in provision for bad and doubtful debts:

The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Income- tax Act, 1961, shall apply accordingly.

h) Non-Applicability of section 56(2)(x):

The provisions of section 56(2)(x) shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company or its nominee in consequence of the conversion of the Indian branch into the Indian subsidiary company.

7.5. Tax on Capital Gain for Non-residents

Any person including a foreign company or non-resident is liable to capital gain tax in India, if there is a transfer of capital assets which results in gain or profit. The provisions relating to Capital Gain taxation of non-residents include the following:

7.5.1. First Proviso to Section 48 read with Rule 115A

In order to give protection to non-residents who invest foreign exchange to acquire capital assets, the first proviso to section 48 provides that capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares or debentures were acquired.

- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company.

Benefit of indexation will not be applied in this case.

Rule 115A of the Income-tax Rules, 1962 provides that the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in purchase of the capital asset as on the date specified in column (3) in the table below, shall be used to convert rupees into foreign currency for the purpose of computation of capital gains.

However, the benefit of indexation and currency fluctuation would not be available in respect of capital gains arising from the transfer of the following long term capital assets referred to in section 112A –

i. equity share in a company on which STT is paid both at the time of acquisition and transfer
ii. unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

- **Other Important Points:**

a) It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian company.

b) If the total income of an assessee includes any income chargeable under the head 'Capital Gains' arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund or unit of a business trust, then, tax on short term capital gains shall be payable at the rates specified in section 111A if transaction of sale of such security has been entered on or after October 1, 2004 on which STT is chargeable; and tax on long-term capital gains shall be payable on such securities as per section 112A, if STT has been paid both at the time of acquisition and transfer of equity share or at the time of transfer of unit of equity oriented fund or unit of business trust.

c) Section 50CA provides that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

This provision would, however, not be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

d) Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be a full value of consideration received or accruing as a result of such transfer.

e) The shares and debentures (whether listed or non-listed) of Indian companies only are covered under this proviso. Indian company shall include Government company. However, bonds of Central Government/State Government and RBI are not covered for this purpose.

7.5.2. Rupee Denominated Bonds of an Indian company

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assesses, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation **[Fifth Proviso to Section 48].**

7.6. Special Provisions Prescribed under Chapter XII-A

Chapter XII-A, introduced in the Income-tax Act 1961 with effect from June 1, 1983, contains seven sections viz. **115C, 115D, 115E, 115F, 115G, 115H and 115-I.** The provisions of this Chapter are applicable to a non-resident Indian who derives investment income from a foreign exchange asset and/ or long-term capital gains in respect thereof.

7.6.1. Meaning of Certain Terms [Section 115C]

Sr. No.	Term	Meaning
1.	**Convertible Foreign Exchange**	Foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999, and any rules made thereunder.
2.	**Foreign Exchange Assets**	Any specified asset which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange.
3.	**Investment Income**	Any income derived from a foreign exchange asset.
4.	**Long-term capital assets**	Income chargeable under the head "Capital gains" relating to a capital asset, being a foreign exchange asset which is not a short-term capital asset.
5.	**Non-Resident Indian**	An individual, being a citizen of India or a person of Indian origin who is not a "resident. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India.
6.	**Specified Assets**	Any of the following assets, namely: (i) Shares in an Indian company; (ii) Debentures issued by an Indian company which is not a private company; (iii) Deposits in an Indian Company which is not a private company; (iv) Any security of the Central Government; and (v) Any other asset which the Central Government may notify.

7.6.2. Taxation of Investment Income and Long-term Capital Gains of a Non-resident [Section 115D]

Section 115D deals with the computation of total income of non-residents. In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance thereabout. No deduction under Chapter VI-A shall be allowed and indexation benefit will not be available, where the gross total income of a non- resident Indian consists only of investment income or/and long-term capital gain.

However, where the gross total income includes investment incomes or/and long-term capital gain, the deduction under Chapter VI-A shall be allowed only on that portion of gross total income which does not include the investment income and long term capital gain.

7.6.3. Tax Rate on Investment Income and Long-term Capital Gains [Section 115E]

Under section 115E, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates.

Tax payable by shall be aggregate of –

a) income-tax on Investment income at 20%;
b) income-tax on long term capital gains from transfer of specified assets (i.e., purchased in foreign currency) at 10%; and
c) income-tax on his other total income

7.6.4. Exemption for Long-term Capital Gains [Section 115F]

Where a non-resident Indian has transferred a long-term foreign exchange asset and has within a period of six months after the date of such transfer, invested the whole or part of the net consideration in any specified asset then,

(a) If the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of the capital gains shall not be charged to tax under section 45.
(b) If the cost of the new asset is less than the net consideration in respect of the original asset, the amount as calculated below shall not be charged to tax under section 45.

$$\frac{Capital\ Gains\ \times\ Cost\ of\ Aquisition\ of\ New\ Assets}{Net\ Consideration}$$

Note:

a. Net consideration means the full value of consideration from transfer less expenditure incurred wholly and exclusively in connection with transfer.
b. Where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier shall be deemed to be the income under the head "Capital Gains" relating to long term capital assets. The same shall be charged to tax in the previous year in which new asset is transferred or converted into money.

7.6.5. Option Not To File Income Tax Return [Section 115G]

A non-resident Indian need not furnish a return of income under section 139(1) if he satisfies the following two conditions:-

(a) His total income consists only of investment income or income by way of long-term capital gains or both; and

(b) Tax deductible at source has been deducted from such income.

7.6.6. Continuance of Benefits after the Non-resident Becomes a Resident [Section 115H]

(a) Where a person who is NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under section 139 for the year in which he is so assessable.

(b) The declaration shall be to the effect that the provisions of this chapter shall continue to apply to him in respect of the investment income derived from foreign exchange assets being debentures, deposits, securities of Central Government and such other notified assets as specified under section 115C.

(c) If he does so, the provisions of this chapter shall continue to apply to him in relation to such income for that assessment year and every subsequent year until the transfer or conversion into money of such assets.

7.6.7. Option to Opt Out of Chapter XII-A [Section 115-I]

This section gives an option to a non-resident Indian to elect that he should not be governed by the special provisions of Chapter XII-A for any particular assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of Chapter XII-A shall not apply to him for that assessment year. In case where such an option is exercised by a non-resident Indian, his total income for that assessment year would be charged to tax under the general provisions of the Act.

7.7. Determination of Tax in Certain Special Cases [Chapter-XII]

The special provisions contained in other sections under Chapter XII are discussed hereunder:

7.7.1. Special Provisions for Computing Tax on Income by way of Royalty, Fees for Technical Service, Interest, etc. [Section 115A]

The provisions contained in Section 115A are as under:

Sr. No.	Where the total income of a foreign company or a non-corporate non-resident includes any income by way of	Rate of Tax
1	Dividends	20%
2	Interest received from the Government or an Indian concern on moneys borrowed or debt incurred by the Government/ Indian concern in foreign currency, other than 3 and 4 mentioned below.	20%
3	Interest received from an infrastructure debt fund referred to in section 10(47).	5%
4	Interest referred to in section 194LC received from an Indian company or business trust – i) in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India (a) Under a loan agreement between 1.7.2012 and 30.6.2023 or (b) by way of issue of long-term infrastructure bonds between 1.7.2012 and 30.9.2014 or (c) by way of issue of long-term bonds including long term infrastructure bond between 1.10.2014 and 30.6.2023 as approved by the Central Government.	5%
	ii) in respect of monies borrowed from sources outside India by way of rupee denominated bond on or before 30.6.2023. iii) in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre.	4%

5	Interest to a Foreign Institutional Investor or Qualified Foreign Investor - payable between 1.6.2013 and 30.6.2023 on investment made in • Rupee denominated bond of an Indian company • Government security - payable between 1.4.2020 and 30.6.2023 on investment made in municipal debt security.	5%
6	Distributed income referred to in section 194LBA(2), - interest income of a business trust from a SPV, distributed by business trust to its non-resident unit holders - dividend income of a business trust received or receivable from a SPV exercising the option to pay tax at concessional rate under section 115BAA, distributed by business trust to its non-resident unit holders However, if the SPV has not exercised the option to pay tax at concessional rate under section 115BAA, dividend income would be exempt in the hands of unit holders.	5% 10%
7	Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India.	20%
8	Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS) other than the income referred to in section 44DA is received from the Government in pursuance of an agreement made by the non-resident/foreign company with the Government.	10% of such royalty or FTS. However, if DTAA provides for a rate lower than 10%, then, the provisions of DTAA would apply.
9	Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS)	10% of such royalty or FTS. However, if DTAA provides for a rate lower

	other than the income referred to in section 44DA is received from the Indian concern in pursuance of an agreement made by the non-resident/foreign company with the Indian concern and the agreement is approved by the Central Government or where it relates to industrial policy of Government of India, the agreement in accordance with that policy.	than 10%, then, the provisions of DTAA would apply.

7.7.2. Special Provision for Computing Tax on Income from Units Purchased in Foreign Currency or Capital Gains arising from their Transfer in case of Offshore Fund [Section 115AB]

Where the total income of an overseas financial organisation (Offshore Fund) includes the following incomes namely-

i. Income received in respect of units purchased in foreign currency or
ii. by way of long-term capital gains arising from the transfer of units of a mutual fund specified under section 10(23D) or units of UTI purchased in foreign currency,

Then, the income tax payable shall be the aggregate of the following:

(a) 10% on income referred to above
(b) the amount of income-tax with which the Offshore Fund would have been chargeable had its total income been reduced by the amount of Long term Capital Gains and income received referred to above.

7.7.3. Special Provision for Computing Tax on Income from Bonds or Global Depository Receipts Purchased in Foreign Currency or Capital Gains arising from their Transfer [Section 115AC]

According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as the Central Government may notify or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency; or
(b) income by way of dividends on Global Depository Receipts –
    i. issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or

ii. issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or

iii. issue or re-issued in accordance with such scheme as the Central Government may specify against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary; or

(c) income by way of long-term capital gains arising from the transfer of above bonds or GDRs,

then, income-tax will be charged at the rate of 10% on the above income.

- **Deductions not allowable [Section 115AC(2)]:** Where the gross total income of the non-resident consists only the aforesaid interest or dividend income referred to in (a) and (b) of (i) above, no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under Chapter VIA.

  Deduction under Chapter VI-A is also not allowable against long term capital gains arising from transfer of bonds or GDRs.

  Where the gross total income of the non-resident consists of incomes other than interest, dividend and long term capital gains referred to in (a), (b) and (c) of (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

- **Non-availability of indexation benefit and computation of capital gains in foreign currency [Section 115AC(3)]:** The indexation benefit and benefit of computation of capital gains in foreign currency, shall not be available for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or GDRs.

- **Filing of Return of Income not required [Section 115AC(4)]:** It shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of aforesaid interest or dividend income, and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

7.7.4. Concessional Tax Treatment for GDR/Bonds Acquired in Course of Amalgamation [Section 115AC(5)]

Where the assessee acquired GDR or bonds in an amalgamated or resulting company by virtue of his holding GDR or bonds in the amalgamating or demerged company, in accordance with the provisions of 115AC(1) the concessional tax treatment would apply to such GDR or bonds.

- **Meaning of Global Depository Receipts**

"Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of —

(a) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India; or

(b) foreign currency convertible bonds of issuing company

7.7.5. Special Provision for Computing Tax on Non-resident Sportsmen or Sports Associations [Section 115BBA]

- **Applicability of Section 115BBA**

Following income shall be chargeable to a tax @ 20%:

(a) any income received or receivable by sportsman (including an athlete), who is not a citizen of India and is a non- resident by way of-

  i. participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB, being winning from crossword puzzles, races including horse races, card games and other games of any sort of gambling or betting) or sport; or

  ii. advertisement; or

  iii. contribution of articles relating to any game or sport in India in newspapers, magazines or journals

(b) any amount guaranteed to be paid or payable to a non-resident sports association or institution in relation to any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport played in India

(c) Any income received or receivable by an entertainer who is not a citizen of India and is a non- resident from his performance in India.

- **Deduction of expenditure not permissible:** No deduction in respect of any expenditure or allowance shall be allowed under any provision of Income Tax Act, 1961.

- **Filing of return of income not required:** The assessee is not required to furnish under section 139(1) a return of his income if—

  (i) his total income in respect of which he is assessable under this Act during the previous year consisted only of income referred to in (a) or (b) or (c) above; and

  (ii) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

7.8. Exempt Income of Non-Residents

Section 10 of the Income-tax Act, 1961 exempts from tax various incomes including the following in the hands of a non-resident:

7.8.1. Interest on Moneys Standing to the Credit of Individual in his NRE A/c [Section 10(4)(ii)]

As per section 10(4)(ii), in the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account (NRE A/c) in any bank in India in accordance with the Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

(i) is a person resident outside India, as defined in FEMA, 1999, or

(ii) is a person who has been permitted by the Reserve Bank of India to maintain such account.

7.8.2. Interest Income of a Non-corporate Non-resident or Foreign Company on Specified Off-shore Rupee Denominated Bonds issued by an Indian Company or Business Trust [Section 10(4C)]

Interest payable by an Indian company or business trust to a non-corporate non-resident or a foreign company in respect of money borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019 would be exempt.

7.8.3. Income of a Specified Fund on Transfer of Certain Asset [Section 10(4D)]

Following income accrued or arising to or received by specified fund would be exempt -

(i) any income from transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond of an Indian company or derivative or any other notified security, on a recognized stock exchange located in any IFSC and where the consideration is paid or payable in convertible foreign exchange or

(ii) any income from transfer of securities (other than shares in a company resident in India) or

(iii) any income from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India or

(iv) any income from a securitisation trust which is chargeable under the head "profits and gains of business or profession", to the extent such income accrued or arisen to, or is received is attributable to units held by non- resident (not being the permanent establishment of a non-resident in India) computed in the prescribed manner.

7.8.4. Remuneration received by Officials of Embassies etc. of Foreign States [Section 10(6)(ii)]

The remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official is exempt.

Provided that the remuneration received by the corresponding Government officials resident in such foreign countries should be exempt and the above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

7.8.5. Remuneration received for Services Rendered in India by a Foreign National Employed by a Foreign Enterprise [Section 10(6)(vi)]

The remuneration received by a foreign national as an employee of a foreign enterprise, for services rendered by him during his stay in India is exempt from tax.

The above section is applicable provided the conditions mentioned below is fulfilled:

(a) The foreign enterprise is not engaged in any business or trade in India;

(b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such previous year; and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961.

7.8.6. Salary Received by a Non-citizen for Services Rendered in Connection with Employment on Foreign Ship [Section 10(6)(viii)]

Any income chargeable under the head "Salaries" received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed 90 days during the previous year.

7.8.7. Remuneration Received by Foreign Government Employees during their Stay in India for Specified Training [Section 10(6)(xi)]

Any remuneration received by employee of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by,-

(a) the Government; or
(b) any company owned by the Central Government or any State Government or partly by the Central Government and partly by one or more State Government; or
(c) any company which is subsidiary of a company referred to in (b) above, or
(d) any statutory corporation; or
(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

7.8.8. Income Accruing or Arising to or received by a Unit Holder from a Specified Fund or on Transfer of Units in a Specified Fund [Section 10(23FBC)]

Any income accruing or arising to or received by a unit holder from a specified fund or on transfer of units in a specified fund would be exempt.

- **Meaning of Specified Fund:** A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, –

  (i) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992
  (ii) which is located in any IFSC
  (iii) of which all the units are held by non-residents other than units held by a sponsor or manager.
- **Meaning of Unit:** It means beneficial interest of an investor in the fund and shall include shares or partnership interests.

7.8.9. Certain Incomes of Wholly Owned Subsidiary of Abu Dhabi Investment Authority, Sovereign Wealth Fund and Specified Pension Fund [Section 10(23FE)]

Any income of a specified person in the nature of-

- dividend,

- interest or
- long-term capital gains

arising from an investment made by it in India, whether in the form of debt or share capital or unit would be exempt, if such investment –

(a) is made on or after 1st April, 2020 but on or before 31st March, 2024; and

(b) is held for at least three years

- **Meaning of Eligible Investment:** Such investment shall mean to include the following:

(a) a business trust; or

(b) a company or enterprise or an entity carrying on the business of developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility as defined in Explanation to section 80-IA(4)(i) or such other business as notified by the Central Government in this behalf; or

(c) a Category-I or Category-II Alternative Investment Fund regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the SEBI Act, 1992, having 100% investment in one or more of the company or enterprise or entity referred to in (b) above.

- **Power of CBDT to issue guidelines:** In case any difficulty arises regarding interpretation or implementation of the provisions of this clause, the CBDT may issue guidelines for the purpose of removing the difficulty with the approval of the Central Government.

- **Consequences of failure to satisfy the conditions:** Where any income has not been included in the total income of the specified person due to the aforesaid provisions, and subsequently during any previous year the specified person fails to satisfy any of the conditions mentioned so that the said income would not have been eligible for such non-inclusion, such income shall be chargeable to income-tax as the income of the specified person of that previous year.

7.8.10. Tabular Representation - Exempt Income of Non-residents

Section	Income	Exemption available to
10(4)(ii)	Interest on money standing to the credit in a Non-resident (External) account of an Individual in any bank in India as per the FEMA Act, 1999.	Individual resident outside India (under FEMA Act) or an individual who has been permitted to maintain said account by RBI.
10(4C)	Interest payable by an Indian company or business trust in respect of moneys borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019.	A non-corporate non-resident or foreign company.
10(4D)	Income accrued or arising to or received by specified fund - (i) on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond of an Indian company or derivative or any other notified security, on a recognized stock exchange located in any IFSC and where the consideration is paid or payable in convertible foreign exchange or (ii) on transfer of securities (other than shares in a company resident in India) or (iii) from securities issued by a non-resident (not being a permanent establishment of a non-resident in	A specified fund.

	India) and where such income otherwise does not accrue or arise in India or (iv) from a securitization trust which is chargeable under the head "Profits and gains of business or profession", to the extent such income accrued or arisen to, or is received is attributable to units held by non-resident (not being the permanent establishment of a non-resident in India) computed in the prescribed manner.	
10(6)(ii)	Remuneration received by Foreign Diplomats/ Consulate and their staff (Subject to conditions)	Individual (not being a citizen of India)
10(6)(vi)	Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India, if: a) Foreign enterprise is not engaged in any trade or business in India; b) His stay in India does not exceed the aggregate a period of 90 days in such previous year; and c) Such remuneration is not liable to deducted from the income of employer chargeable under this Act.	Individual - Salaried Employee (not being a citizen of India) of a foreign enterprise
10(6)(viii)	Salary received by or due for services rendered in connection with his employment on a foreign ship if his total stay in India does not exceed 90 days in the previous year.	Individual Salaried Employee (Non-resident who is not a citizen of India) of a foreign ship

10(6)(xi)	Remuneration received as an employee of the Government of a foreign state during his stay in India in connection with his training in any Government Office/ Statutory Undertaking/ corporation/ registered society etc.	Individual - Salaried Employee (not being a citizen of India) of Government of foreign state
10(6A)	Tax paid by Government or Indian concern (under terms of agreement entered into after 31-3-1976 but before 1-6-2002 by the Government or Indian concern with the foreign company) on income derived by way of royalty or fees for technical services by the foreign company from Government or Indian concern.	Foreign Company
10(6B)	Tax paid by Government or Indian concern under terms of agreement entered into before 1-6-2002 by Central Government with Government of foreign State or international organization on income derived by a non-corporate non-resident or foreign company from the Government or Indian concern, other than income by way of salary, royalty or fees for technical services.	Non-corporate non-resident or foreign company
10(6BB)	Tax paid by Indian company, engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by Central Government) agreement entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007, on lease rental/income derived(other than payment for providing spares or services in	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident).

	connection with the operation of leased aircraft) by the Government of a Foreign State or foreign enterprise.	
10(6C)	Royalty income or fees for technical services under an agreement with the Central Government for providing services in or outside India in projects connected with security of India.	Foreign company (notified by the Central Government).
10(6D)	Royalty income from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO).	Non-corporate non-resident or foreign company.
10(8)	– Foreign income; and – Remuneration received by an individual from the Government of a foreign State, in connection with any co-operative technical assistance programme and project under agreement between Central Government and the Government of a foreign State.	Individual who is assigned to duties in India.
10(8A)	– Foreign income; and – Any remuneration or fee received by such person (agreement relating to his engagement must be approved) out of funds made available to an international organization (agency like World Bank or any other multi-lateral agency) under a technical assistance grant agreement between that agency and the Government of a foreign State (such technical assistance should be in accordance with an agreement between the Central Government and	Consultant, being (i) An individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India, or (ii) any other person, being a non- resident engaged by the agency for rendering technical services in India in connection with

	the agency).	any technical assistance programme or project in accordance with the approved agreement.
10(8B)	– Foreign income; and – Remuneration received, directly or indirectly, by an individual who is assigned to duties in India in connection with any technical assistance programme and project in accordance with an agreement entered into by the Central Government and the agency from a consultant referred to in section 10(8A)	Employee of a consultant, being an individual: a) not being an Indian citizen; or b) being an Indian citizen who is not ordinarily resident in India Contract of service must be approved by the prescribed authority before commencement of service.
10(9)	Foreign income	Any family member of individual as referred to in section 10(8)/(8A)/(8B), accompanying him to India.
10(15)(iiia)	Interest on deposits made by a foreign bank with scheduled bank with approval of RBI.	Bank incorporated outside India and authorised to perform Central Banking functions in that country.
10(15)(iv)(fa)	Interest payable by scheduled bank on deposits in foreign currency where acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank]	a) Non-resident b) Individual or HUF being a resident but not ordinary resident
10(15)(viii)	Interest on deposit on or after 01.04.2005 in an Offshore Banking Unit	
10(15)(ix)	Interest payable by a unit located in an IFSC in respect of monies borrowed by	Non-resident

	it on or after 1.9.2019	
10(15A)	Lease rental paid by Indian company, engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease (other than payment for providing spares or services in connection with the operation of leased aircraft) under an approved (by Central Government) agreement not entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(23BBB)	Income of European Economic Community derived in India from interest, dividends or capital gains from investment out of its funds under notified scheme of Central Government.	European Economic Community
10(23BBC)	Income of SAARC Fund for Regional Projects set up by Colombo Declaration.	SAARC Fund for Regional Projects.
10(23FBC)	Any income accruing or arising to or received by a unit holder from a specified fund or on transfer of units in a specified fund	Unit holder of specified fund
10(23FE)	Dividend, interest or long-term capital gains arising to specified person from an investment made by it in India, whether in the form of debt or share capital or unit, if such investment (i) is made between 1.4.2020 and 31.3.2024; (ii) is held for at least 3 years (iii) is in a business trust, a company/ enterprise in developing/ operating/	Specified person, being (i) a wholly owned subsidiary of the Abu Dhabi Investment Authority (ii) a sovereign wealth fund (iii) Pension fund satisfying the prescribed conditions.

	maintaining an infrastructure facility or a SEBI Category I or II AIF.	
10(48)	Income received in India in Indian currency on account of sale of Crude oil or any other goods or rendering of services as may be notified by the Central Government in this behalf. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India.
10(48A)	Income accruing or arising on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom.
10(48B)	Income from sale of leftover stock of crude oil from facility in India after the expiry of agreement or arrangement referred to in section 10(48A) or on termination of the said agreement or arrangement, in accordance with the terms mentioned therein, as the case may be, subject to such conditions, as may be notified by the Central Government.	Foreign company from sale of leftover stock of crude oil from the facility in India.

Test Your Knowledge

QUESTIONS	
1.	Examine the following statement with reference to the provisions of Income-tax Act, 1961. *The double taxation avoidance treaties entered into by the Government of India override the domestic law.*
2.	Heena Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2020. The Indian branch has filed return of income for assessment year 2021-22 disclosing income of ` 50 lakhs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher education cess @ 4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows: "*The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."* However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus higher education cess @ 4%. Is the action of the Assessing Officer in accordance with law?
3.	The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance of such transactions as governed by Double Taxation Avoidance Agreements (DTAA).
4.	Ram, an individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.
5.	The Income Tax Act, 1961 provides for taxation of certain income earned in India by Eric, a non-resident. The DTAA, which applies to Eric provides for taxation of such income in the country of residence. Is Eric liable to pay tax on such income earned by him in India? Examine.

6.	Sea Shore Shipping Group, a non-resident foreign company, is engaged in the business of carriage of goods shipped at Mumbai Port. During the previous year ended on 31.3.2021, it had collected freight of ` 100 lakhs, demurrages of ` 20 lakhs and handling charges of ` 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ` 110 lakhs. Compute its income applying the presumptive provisions under section 44B.
7.	The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2021 was a loss of ` 100 lakhs after charge of head office expenses of ` 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its ret urn for the assessment year 2021-22.
8.	During the financial year 2020-21, Siya, a tennis professional and a Spanish citizen participated in India in a Tennis Tournament and won prize money of ` 15 lakhs. She contributed articles on the tournament in a local newspaper for which she was paid ` 1 lakh. She was also paid ` 5 lakhs by a Soft Drink company for appearance in a T.V. advertisement. Although her expenses in India were met by the sponsors, she had to incur ` 3 lakhs towards her travel costs to India. She was a non-resident for tax purposes in India. What would be his tax liability in India for A.Y. 2021-22? Is she required to file her return of income?
9.	ABC Inc. is a company incorporated under the laws of Country X. The value of its global assets is ` 50 crores. The values of assets in India are ` 25 crores. Its turnover during the P.Y. 2020-21 is Country X $ equivalent to INR 90 crores. Out of 10 board meetings held during the F.Y.2020 -21, only 4 meetings are held in India. The key management and commercial decisions for conduct of the company's business as a whole are, however, made by the directors located in India at the meetings held in India. Your client, Lisa Ltd., an Indian company, wishes to remit an amount towards professional fees to ABC Inc. on which tax is required to be deducted in India. Determine the residential status of ABC Inc. for A.Y.2021-22 under the Income-tax Act, 1961. Advise Lisa Ltd. as to whether tax on fees for professional services paid

	to ABC Inc. has to be deducted under section 194J or section 195.
10.	Mr. Aryan Trivedi, an Indian born person but currently a resident and citizen of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ` 10 lakhs during F.Y. 2020-21. Determine the taxability of such income earned in India.
11.	Mr. Z, citizen of India but resident of USA since year 2012, was appointed in India in October, 2019 as an employee of a US enterprise. Such US enterprise is not engaged in any business in India. Z's job requires him to visit his US office every twenty five (25) days for reporting purposes. During F.Y. 2020-21, Mr. Z earned a remuneration of ` 10 lakhs for his India related assignment and his stay in India in aggregate was 85 days. Further, such US enterprise has not claimed any deduction of such remuneration under the Income-tax Act, 1961. Determine whether such remuneration will be taxable.

SOLUTIONS	
1.	**Section 90(2)** provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee. In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), provided they are more beneficial to the assesse
2.	Under **section 90(2)**, where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Heena Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%). However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a

	foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax @ 40% on the Indian branch of Heena Ltd. is in accordance with law.
3.	Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment. As per **section 92F (iiia)**, the term **"Permanent Establishment"** includes a fixed place of business through which the business of an enterprise is wholly or partly carried on. As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place. **Section 9(1)(i)** requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India. **As per section 90(2),** the provisions of the Income-tax Act, 1961 or the DTAA, whichever is beneficial, shall apply. The PE concept is narrower than the business connection concept. Therefore, in a case where the Indian Government has entered into DTAA with a country, unless and until the PE test is satisfied, the business income would not be taxable in the source country. However, in cases not covered by DTAAs, business income attributable to business connection is taxable.
4.	Ram assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, **section 91** specifies that if a person resident in India has paid tax in any country with which no agreement under **section 90** exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at

	the Indian rate of tax, if both the rates are equal. Accordingly, Ram shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of **section 91** read with *Rule 128 on Foreign Tax Credit*.
5.	**Section 90(2)** makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where the DTAA has been entered, the assessee can opt to be governed by the provisions of DTAA if the provisions are beneficial in comparison to provisions of Act. However, as per **section 90(4)**, the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in *Form No. 10F*: (i) Status (individual, company, firm etc.) of the assessee; (ii) PAN of the assessee, if allotted; (iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others); (iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident; (v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and (vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable. However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in **section 90(4)** or **section 90A(4)**. Eric is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of

	the other country, and provides such other documents and information as may be prescribed.
6.	Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”. (i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and (ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. The above amounts will include demurrage charges and handling charges. These provisions for computation of income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961. Therefore, in this case, M/s. Sea Shore Shipping Group is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Group is required to pay tax on deemed profit of ` 9.75 lacs (7.50% on the total receipts of ` 130 lacs). The tax payable would be
7.	Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India. For the purpose of computing the adjusted total income, the head office expenses of ` 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2021-22 will be as under:

Particulars	**Amount**
Net loss for the year ended on 31.03.2021	(`100 Lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	`200 Lakhs
Adjusted total income	`100 Lakhs
Less: Head Office expenses allowable under section 44C is the lower of - (i) ` 5 lakhs, being 5% of ` 100 lakhs, or (ii) ` 200 lakhs.	`5 Lakhs
Income to be declared in return	**`95 Lakhs**

8. Under section 115BBA, all the three items of receipts in India viz. prize money of ` 15 lakhs, amount received from newspaper of ` 1 lakh and amount received towards TV advertisement of ` 5 lakhs - are chargeable to tax. No expenditure is allowable as deduction against such receipts. The rate of tax chargeable under section 115BBA is 20%, plus health and education cess @ 4%. The total tax liability works out to ` 4,36,800 being 20.8% of ` 21 lakhs. Thus, Siya will be liable to tax on the income earned in India.

She is not required to file her return of income if -

(i) her total income during the previous year consists only of income arising under section 115BBA; and

(ii) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

9. In the given case, ABC Inc. is a company incorporated under the laws of Country X. It is a foreign company under the Income-tax Act, 1961. However, the said company shall be considered to be resident in India if its place of effective management is in India.

In this case, the company does not satisfy the active business test outside India since

	50% of its assets are located in India. Therefore, since it has failed the active business test outside India on account of 50% of its assets being located in India, the persons who take key management and commercial decisions for conduct of the company's business as a whole and the place where the decisions are made are the key factors in determining whether the POEM of the company is in India. The facts of the case clearly state that the key management decisions and commercial decisions for conduct of the company's business as a whole are made by the directors located in India and at the meetings held in India. Therefore, the POEM of ABC Inc. is in India in the P.Y.2020-21, irrespective of the fact that majority of the board meetings are held outside India. Section 194J applies when professional fees are being paid to a resident, whereas section 195 applies when payments are made to a non-corporate non-resident or a foreign company. Section 194J is income specific and section 195 is payee specific. CBDT vide Notification No. 29/2018 dated 22nd June 2018 has clarified that the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India on account of its POEM being in India, and all the provisions of the Act shall apply accordingly. Where more than one provision of Chapter XVII -B of the Act applies to the foreign company as resident as well as a foreign company, the provision applicable to the foreign company alone shall apply. Further, in case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the latter shall generally prevail. Therefore, the rate of tax in case of foreign company shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residential status of the foreign company changes from non-resident to resident on the basis of POEM. Hence, Lisa Ltd. shall deduct tax under section 195 while making payment of fees for professional services to ABC Inc., a foreign company resident in India.
10.	As per Section 10(6)(ii) the remuneration received by an individual, who is not a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official is exempt. The above section is subject to certain conditions: (a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.

	(b) The above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India. Being an Individual who is not a citizen of India and also fulfilling other conditions of the section, such remuneration shall be exempt in his hands for A.Y. 2021-22, subject to fulfilment of conditions.
11.	The remuneration received by a foreign national as an employee of foreign enterprises, for services rendered by him during his stay in India is exempt from tax. The above section is subject to certain conditions: (a) The foreign enterprise is not engaged in any business or trade in India: (b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such previous year, and (c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961. Being an Individual who is a citizen of India, such remuneration shall not be exempt in his hands for A.Y. 2021-22 under this section i.e., section 10(6)(vi), though he may get exemption under any other provision of the Income-tax Act, 1961, subject to fulfilment of conditions stipulated thereunder.

Understanding International Tax Treaties and its Implications on Domestic Tax Laws

Module II - Past and Present of DTAA

		documentation
	8.12.	Action Plan 14: Making dispute resolution mechanisms more effective
	8.13.	Action Plan 15: Developing a Multilateral Instrument
9.	Multilateral Instruments	
	9.1.	Meaning of MLI
	9.2.	Features of MLIs
	9.3.	Structure of MLI
	9.4.	Organs of the MLI
	9.5.	Application of MLI
10.	Synthesized Treaty Text	
	10.1.	Challenges in Preparing Synthesized Texts
11.	International Tax Arbitration	
	11.1.	Difficulties which can be resolved by mutual agreement
12.	Unified Framework Pillars	

1. Introduction

Double Taxation Avoidance Agreements (DTAAs) are intended to make a country an attractive investment destination by providing relief on dual taxation. Such relief is provided by exempting income earned abroad from tax in the resident country or providing credit to the extent taxes have already been paid abroad. DTAAs also provide for concessional rates of tax in some cases. For instance, interest on NRI bank deposits attract 30 per cent TDS (tax deduction at source) here. But under the DTAAs that India has signed with several countries, tax is deducted at only 10 to 15 per cent. Many of India's DTAAs also have lower tax rates for royalty, fee for technical services, etc.

Favorable tax treatment of capital gains under certain DTAAs such the one with Mauritius have encouraged a lot of foreign investment into India. Mauritius accounted for $93.65 billion or one-third of the total FDI flows into India between April 2000 and December 2015. It has also remained a favored route for foreign portfolio investors. But the problem is DTAAs can become an incentive for even legitimate investors to route investments through low-tax regimes to sidestep taxation. This leads to loss of tax revenue for the country.

In order for a person to prosper, the economy has to grow. And for growth in today's globalized world, foreign investments are inevitable. DTAAs basically provide clarity on how certain cross-border transactions will be taxed and this encourages foreign investors to take the plunge.

If one is sent on deputation abroad and you receive emoluments during your stint away from home, his income may sometimes be subject to tax in both the countries. One can claim relief when filing your tax return for that financial year, if there is an applicable DTAA. Similarly, if a person is NRI having investments in India, DTAA provisions may also be applicable to your income from these investments or from their sale. In this module, we will know more about the nature, scope, purposes of tax treaties, three model conventions, Multilateral Instruments and so on.

2. History of Tax Treaty

Tax treaties originated in late 19th and early 20th century "friendship, commerce, and navigation" treaties. The formative work on international tax issues sponsored by the League of Nations in the early part of the 20th century drew on the use of the old treaties to avoid gratuitous impediments to trade attributable to the regulation of business activities. These early model income tax treaties and the work of the League of Nations were significantly influenced by a basic recognition that countries have an interest, both for themselves as nations and on behalf of their nationals, in avoiding impediments to trading relationships and commercial activity occasioned by uncoordinated multiple taxation of the same income and the same taxpayers. At the same time, it must be recognized that each country may nevertheless have a legitimate claim to a shared tax base associated with international commerce; a reliable means of sharing is critical. Countries recognize as well that their national interests are well served, for example, in attracting capital investment, by recognizing their reciprocal tax interests.

It is generally well known that in the early part of the 20th century, the League of Nations sponsored formative work underlying the development of modern tax treaties, and that this work was significantly advanced by Mitchell B. Carroll. It is also well known that the OECD and its predecessor have been responsible for the development of various model treaties, culminating, in the second half of the 20th century, with the widely recognized OECD model tax convention and its commentary (recently updated). These model treaties, together with similar models developed by the United Nations and some countries (such as the United States), have provided the basic framework for international taxation through bilateral and multilateral treaties. The OECD has some information about these developments in its archives; however, there is no central repository for such historical material, and no systematic way of knowing what information exists or how it can be accessed. Although a number of scholars have attempted to delve into this potentially rich history, much of it remains unknown and inaccessible.

Tax treaties represent an important aspect of the international tax rules of many countries. Over 3,000 bilateral income tax treaties are currently in effect, and the number is growing. The overwhelming majority of these treaties are based in large part on the United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations Model Convention) and the Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital (OECD Model). In 1928, the League of Nations developed its first model tax treaty to prevent double taxation and this was the foundation of the 2010 OECD Model, the UN Model and other modern tax treaties. The current tax treaties still reflect the principles and arrangements developed in 1920s by the League of Nations.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a "treaty" as an international agreement concludes between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.

"Treaty" represents various compromises agreed upon by countries to the contract depending upon the economic expediency of a particular country. A tax treaty is a **bilateral (two-party) agreement made by two countries to resolve issues involving double taxation of passive and active income of each of their respective citizens.** Income tax treaties generally determine the amount of tax that a country can apply to a taxpayer's income, capital, estate, or wealth. An income tax treaty is also called a Double Taxation Avoidance Agreement (DTAA).

3. <u>Structure of Tax Treaty</u>

The following describes briefly the structure and major provisions of a typical bilateral tax treaty which is based on the United Nations or OECD Model Conventions.

Chapter I consists of Article 1, which identifies the persons whose tax obligations are affected by the treaty, generally residents of the contracting States, and Article 2, which describes the taxes covered by the treaty, generally income and capital taxes imposed by the contracting States and their political sub-divisions.

Chapter II provides definitions of important terms used in the treaty including general definitions in Article 3, a definition of the term "resident" in Article 4 and "permanent establishment" in Article 5. When an individual or business invests in a foreign country, the issue arises as to which country should tax the investor's earnings. Both countries – the source country and the residence country may enter into a tax treaty to agree on which country should tax the investment income to prevent the same income from getting taxed again and again.

Chapter III contains what are often referred to as the distributive rules of the treaty. Articles 6-21 deal with various types of income derived by a resident of one or both of the States. In general, these provisions determine whether only one or both of the contracting States — the State in which the taxpayer is resident (the residence country) and the State in which the income arises or has its source (the source country) — or whether both of them can tax the income and whether the rate of tax imposed is limited. The Articles and the types of income are as follows:

Article 6	Income from immovable property
Article 7	Business profits
Article 8	Income from the operation of ships or aircraft in international traffic and boats in inland waterways transport
Article 9	Profits of associated enterprises and transfer pricing
Article 10	Dividends
Article 11	Interest
Article 12	Royalties
Article 13	Capital gains
Article 14	Income derived from professional and independent services
Article 15	Income from employment
Article 16	Directors' fees and remuneration of top-level managerial officials
Article 17	Income derived by artistes (entertainers) and athletes
Article 18	Pensions and social security payments
Article 19	Income derived by government employees
Article 20	Income derived by students, business trainees and apprentices
Article 21	Other income; in other words, income not dealt with in Articles 6-20

The source country is the country that hosts the inward investment. The source country is also sometimes referred to as the capital-importing country. The residence country is the investor's country of residence. The residence country is also sometimes referred to as the capital-exporting country.

Chapter IV deals with the taxation of capital (not income from capital).

Chapter V provides two alternative methods for eliminating double taxation: Article 23A (Exemption method) and Article 23B (Credit method). In general, if the contracting State in which income arises is entitled by the rules in Article 6-21 to tax the income, the contracting State in which the taxpayer is resident is obligated to provide relief from double taxation. Under the exemption method, the residence country excludes or exempts the income from residence country tax. Under the credit method, the residence country taxes the income but provides a deduction from that tax for the tax paid to the source country on the income.

Chapter VI is entitled “Special provisions”. Article 24 provides protection against various forms of discriminatory taxation by the source and residence countries. Articles 25, 26 and 27 provide for important types of administrative cooperation between the contracting States. Article 25 provides a mutual agreement procedure (MAP) to resolve disputes concerning the application of the treaty; Article 26 deals with exchanges of information between the States; and Article 27 provides rules for the contracting States to assist in collecting one another’s taxes. Article 28 simply provides that nothing in the treaty affects the “fiscal privileges” enjoyed by diplomats and consular officials under international law or other international agreements.

Chapter VII provides rules to govern the entry into force and termination of the treaty.

4. Scope and Purpose of Tax Treaty

Tax treaties are aimed at eliminating double taxation and helps in achieving balance and equity. They aim at sharing of tax revenues by the countries to the contract on rational basis, Therefore, in order to eliminate the incidences of double taxation various countries may enter into a tax treaty.

In addition to eliminating double taxation and allocating taxing rights, other purpose of tax treaties are mentioned below:

- To ensure non-discrimination between residents and non-residents.
- Provide assistance in collection of legitimate share of tax.
- Resolution of disputes arising due to difference in interpretation of tax treaties.

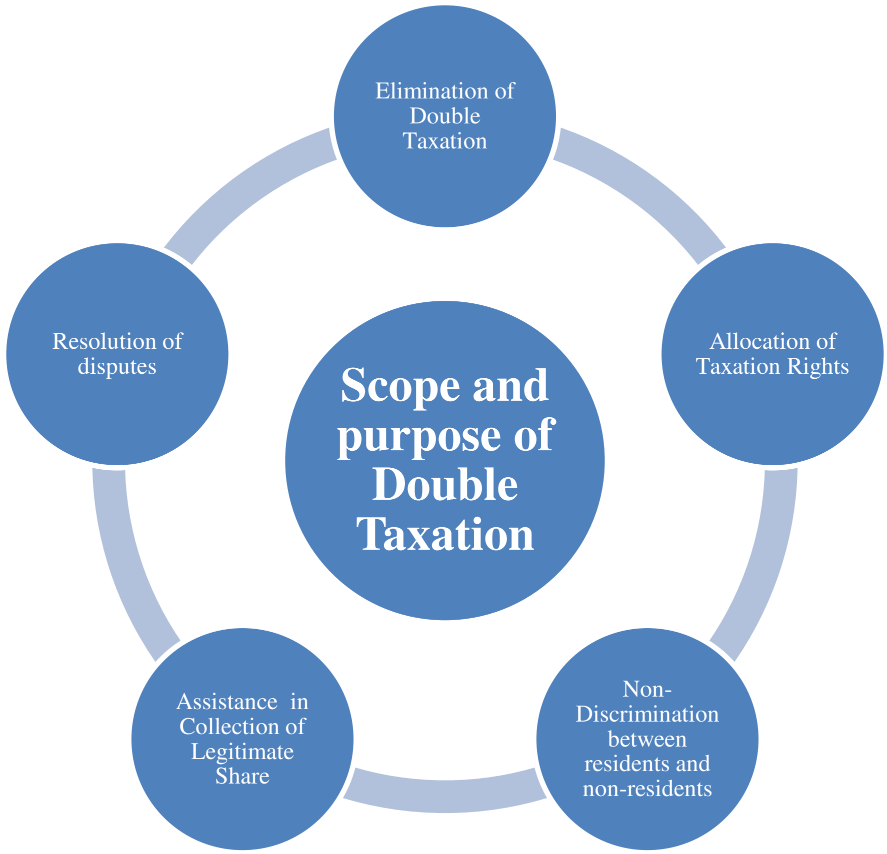


Fig. Scope and Purpose of Double Taxation

5. Double Taxation Avoidance Agreement (DTAA)

Double Taxation Avoidance Agreement (DTAA) means a **Tax Treaty between two or more countries to avoid taxing the same income twice**. When a person is residing in one country and earning income in some other country, they are covered under DTAA. This means that involved countries have agreed upon tax rates and jurisdictions for income arising from their country.

For example, Mr. Arun is an Indian residing in the UK. He has made investments in India on which he earns returns. Now, this Income can be taxable in both India and the UK. But because of DTAA, Mr. Arun will not be taxed in both countries for the same income.

5.1. Types of DTAA

Relief from Double Taxation can be provided in two ways:

(a) Bilateral Treaties: When there is an agreement of DTAA between the two countries, relief is calculated according to mutual agreement between such two countries. Bilateral relief can be granted by either of the following methods:

i) **Exemption method:** Under this method, income is taxed in only one country.

ii) **Tax credit:** Income is taxed in both countries. Relief is granted in the country in which the taxpayer is the resident.

(b) Unilateral Relief: The home nation provides relief when there is no mutual agreement between the countries.

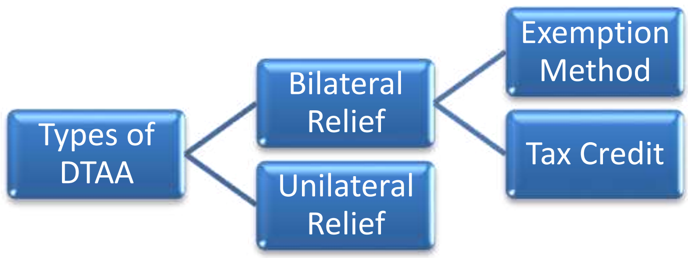


Fig. Types of DTAA

6. Model Tax Conventions

Organization for Economic Co-operation and Development (OECD) and the United Nations (UN) have developed certain Model Tax Treaties to enable different countries enter into such tax treaties. These Model Tax Treaties can be used by different countries as a reference and origin point in their arrangements with other countries. Some countries have incorporated these model tax treaties word for word or with some minor modifications whereas some countries have made desired modifications basis their commercial and economic environment.

There are in all **three** different Model Tax Treaties which have been discussed as below:

a) **OECD Model:** The history of the OECD Model can be traced back to 1927; the Fiscal Committee of the League of Nations prepared the very first draft of the model form. Thereafter, in 1946, the Fiscal Committee of UN Social and Economic Council published the Model Convention in Geneva. In 1961, the OECD was established consisting of developed countries as its members. A final draft of the model tax treaty was prepared in year 1977 with several revisions, latest being in 2017. The OECD Model Convention is a model treaty between two developed nations wherein emphasis is given to residence-based taxation i.e. the right to tax the income shall be with the state of residence.

b) **UN Model:** In order to prepare a draft model convention between developed and developing countries, the United Nations in 1968 set up an adhoc group of experts from various developed and developing countries. The final draft of the UN Model Convention was prepared by this group in year 1980 which has been revised several times, latest being in 2017. The UN Model Convention lays a more emphasis on the source principle than the residence principle. The Model Convention is designed in a way that investments flow from developed countries to developing countries and that the country providing capital should get a share in tax-revenue.

c) **US Model:** The United States uses this model convention while entering into tax treaties with other countries. Last revision in this model convention was in year 2016.

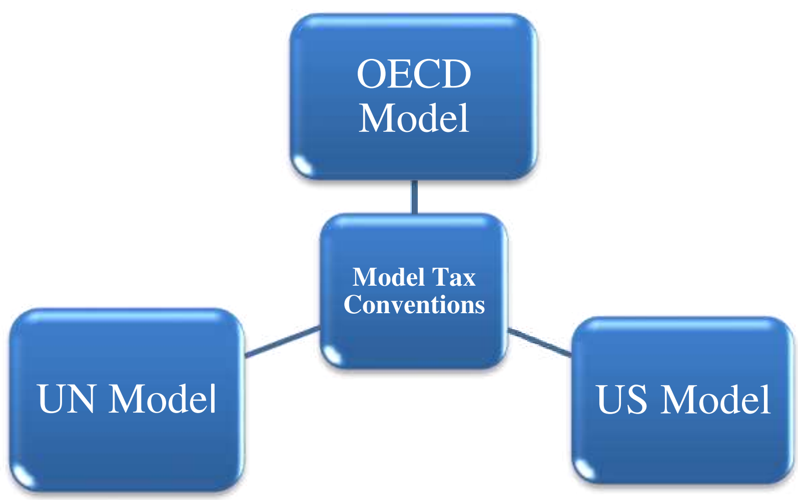


Fig. Model Tax Conventions

7. <u>Basic Distinction in Three Model Tax Conventions</u>

These three Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The basic distinction between the three model have been provided below with the help of diagrammatic presentation:

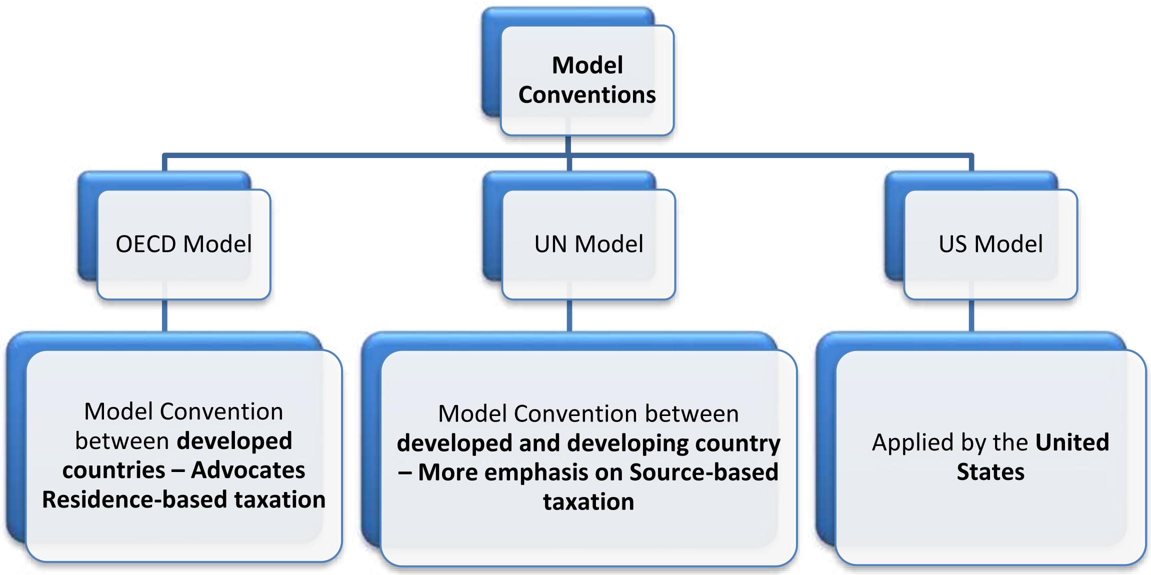


Fig. Model Tax Conventions

8. Overview of BEPS Action Plan

In order to strengthen the international financial system after the global financial crisis in 2009, the G-20 countries mandated the OECD to focus on the issue of tax avoidance, accordingly the OECD published a report on "Addressing Base Erosion and Profit Sharing" in February, 2013 addressing the issue of tax base erosion and profit shifting by global entities. The draft for Action Plan on Base Erosion and Profit Shifting (hereinafter called as BEPS Action Plan) was published by OECD in July 2013 and final reports were published in October 2015.

BEPS Action Plan consists of 15 actions with a view to address BEPS in an extensive manner. It also sets a deadline for implementation of these actions. There are four fundamental pillars around which the action plans were structured:

a. Coherence
b. Substance
c. Transparency
d. Tax Certainty

The 15 action plans are enumerated as below:

i) **Action Plan 1**: Addressing the challenges of digital economy
ii) **Action Plan 2**: Neutralise the effect of hybrid mismatch arrangements
iii) **Action Plan 3**: Strengthen Controlled Foreign Company (CFC) Rules
iv) **Action Plan 4**: Limit interest deductibility and other financial payments
v) **Action Plan 5**: Counter harmful tax practices
vi) **Action Plan 6**: Preventing treaty abuse
vii) **Action Plan 7**: Preventing the artificial avoidance of Permanent Establishment (PE) status
viii) **Action Plan 8 to 10**: Outcomes of Transfer pricing in line with value creation, intangibles, risk and capital and other high-risk transactions
ix) **Action Plan 11**: Measuring and monitoring BEPS
x) **Action Plan 12**: Disclosure of aggressive tax planning arrangements
xi) **Action Plan 13**: Re-examination of transfer pricing documentation
xii) **Action Plan 14**: Making dispute resolution more effective
xiii) **Action Plan 15**: Developing a multilateral instrument

The BEPS measures comprises of new minimum standards, revision of pre-existing international standards and common approaches. The inclusive framework for BEPS ensures that the international framework for MNEs remains relevant even for future so as to promote global welfare and economic efficiency. The framework will also ensure that the governments are able to generate revenues from both traditional as well as digital businesses.

Below-mentioned terms are iterated by OECD to indicate the commitment by various participating countries that are involved as a part of technical group in the development of international tax standards:

a) New Minimum Standard: It refers to application and implementation of new rules by all the countries. Non implementation of such rules by any country may result into negative spill overs on other countries. Action 5, 6, 13 and 14 are the BEPS minimum standards and each of them are subject to peer review in order to ensure timely and accurate implementation. All the members of the inclusive framework on BEPS commit to implement to the minimum standards and participate in the peer review.

b) Revision of an existing standard: Standards that are already in force have been updated and implemented with a condition that the underlying standards on tax treaties or transfer pricing have not been endorsed by the participating countries.

c) **Best Practice:** A best practice is an optional recommendation for the countries to follow. Guidance that is based on best practices will support countries that are proposing to work in areas of CFC legislation or mandatory disclosures initiatives.

8.1. Action Plan 1: Addressing the challenges of digital economy

In a digital domain, business is not carried on in any physical location but instead is carried on in a "cyberspace". Hence, person carrying the business can be located anywhere in the world. Businesses have evolved with time in such a way that more reliance is placed on digital and telecommunication network which do not require physical presence, and which derives its substantial value from the data that is collected and transmitted from such networks.

With rise of e-commerce, it became difficult for tax authorities to tax income earned from digital business due to the concept of intangibility. Hence, to address the challenges faced by the tax authorities, the very first action plan of the BEPS project provides the methods and principles basis which physical and digital economies can be taxed at par. Earlier, physical location of the servers was used to determine the tax jurisdictions in which the profits of digital businesses could be taxed however it was observed that the servers were placed in tax efficient jurisdictions where income generation was from other jurisdictions.

Taxation issues in digital economy are:

a) Difficulty in locating the transaction and the activity and identification of taxpayer for income tax.
b) Difficulty in establishing link between activity, tax jurisdiction and taxable transaction. It is also difficult to characterize the nature of payment involved in transaction.

OECD has recommended several options to face the challenges created by digital economy which includes:

a) Modification of the existing Permanent Establishment (PE) rule
b) A virtual fixed place of business PE
c) Imposition of final withholding tax

- **Indian Taxation Regime:**

With a view to address the challenges of the digital economy, Equalisation Levy was introduced based on the BEPS Action Report 1. The Equalisation Levy was introduced as an interim measure in the Finance Act, 2016 scope of which was further expanded in the Finance Act, 2020.

Moreover, the concept of "Significant Economic Presence" (SEP) is being introduced vide Explanation 2A to section 9(1)(i) effective from AY 2022-23. This concept is introduced because of recommendation of 2015 BEPS Action plan 1, similar to the concept of virtual fixed place PE.

8.2. Action Plan 2: Neutralize the effects of Hybrid Mismatch Arrangements

A hybrid mismatch arrangement is an arrangement that exploits a difference in the tax treatment of an entity or an instrument under the laws of two or more jurisdictions in order to achieve double non-taxation.

The Final Report on Action Plan 2 provides recommendations for both general changes to domestic law and set of anti-hybrid rules. It also recommends treaty changes.

- **Recommended General Amendments:**
  a) A rule denying transparency to entities where the non-resident investors' resident country treats the entity as opaque.
  b) A rule denying an exemption or credit for underlying tax for dividends that are deductible by the payer.
  c) A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity.
  d) Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.

- **Treaty Changes:**
  a) A new provision is recommended by Action Plan 2 for income earned by a transparent entity wherein treaty benefits will be afforded to that extent of the income of the entity as the income of a resident of that State.
  b) A general or specific saving rule is proposed so that it enables a State to tax a resident entity unrestricted by treaty.

- **Anti-hybrid Rules:**

The Final Report also issued a series of anti-hybrid rules that would work in two stages. The primary rules would deny deductions to taxpayers where:

a) Such payments will not be included as a part of ordinary income of the recipient;

b) The same amount is already deducted by any other entity.

- **Treatment of Branch Mismatches:**

The 2015 report mainly addressed mismatches that are a result of differences in the tax treatment or characterization of hybrid entities. It did not directly consider similar issues that can arise when two jurisdictions take a different view as to the existence of or allocation of income and expenses between branch and head office of the same tax-payer.

Branch mismatches arise in cases where the ordinary rules for allocating income and expenditure between the branch and the head office results in the portion of net income that escapes charge to taxation in both the branch jurisdiction and the residence jurisdiction.

The 2017 report identifies five basic arrangements that results into one of the three types of mismatches:

a) Double deduction outcomes
b) Deduction/No inclusion outcomes
c) Indirect Deduction/ No inclusion outcomes

The 2017 report includes specific recommendations with a view to improve domestic laws in such a way that frequency of such mismatches shall reduce. The recommendations shall also result in adjusting the tax consequences in either of the jurisdictions to neutralize the hybrid mismatch without disturbing any of the other tax, regulatory or commercial outcomes.

8.3. Action Plan 3: Strengthen Controlled Foreign Company (CFC) Rules

According to the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until such income is distributed as dividend. Hence, it was common for corporations to form subsidiary companies in such tax havens and shift their portable income to such subsidiaries. Incomes which were shifted were generally income from investments such as interest and dividends, passive incomes such as rents and royalties and sales and service incomes that involved transactions from related parties. Tax on such incomes in parent company was avoided until the company located in the tax haven country paid a dividend to the share holding company. Such dividends could be avoided indefinitely by loaning the earnings to the shareholder without declaring a dividend.

To address such issue, governments of several countries have introduced legislations aimed at eliminating benefits of deferral, by currently taxing income in parent country even if the income has not been remitted to that country. These rules are referred to as Controlled Foreign Corporation (CFC) Rules. These rules are mainly formed to tackle the risk that taxpayers with controlling interest in a foreign subsidiary can strip the base of their country of residence or any other country by shifting income into a CFC.

OECD Final report do not propose a minimum standard for CFC regimes however, according to OECD, CFC rules are important in tackling BEPS and made a series of best practice recommendations regarding the building blocks of an effective CFC regime which are as follows:

a) CFC Definition
b) CFC Exemptions and Threshold Requirements
c) Definition of CFC Income
d) Prevention and Elimination of Double Taxes
e) Computation and Attribution of CFC Income

➢ **Indian Taxation Regime**

There are no CFC Rules in Income Tax Act, 1961 at present. These rules form part of the proposed Direct Tax Code. However, one of the concepts of DTC has been incorporated in the Income Tax Act, 1961 viz. section 115BBD which provides a concessional tax rate of 15% on dividends received from specified foreign companies. Specified foreign companies are such companies in which the Indian company holds 26% or more of the nominal value of equity share.

8.4. Action Plan 4: Limit interest deductibility and other financial payments

Multinational companies can erode their tax base with interest expense in many ways few of them are as listed below:

a) Utilizing third party or related party debt to finance the production of deferred or exempt income;
b) Locating third party debts in countries where taxes are high;
c) Utilizing intra group loans to get interest deductions in excess of actual third party expense.

Action Plan 4 asks of recommendations in order to design domestic rules that prevents tax base erosion by using interest expense and other financial payments that are economically equivalent to interest.

8.5. Action Plan 5: Identify and counter harmful tax practices, taking into account transparency and substance.

The Action Plan 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action Plan 5 Report consists of two parts:

Part 1: It relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions.

Part 2: It includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns.

- **Indian Taxation Regime**

Section 115BBF of the Income-tax Act, a concessional taxation regime for royalty income from patents has been introduced in line with recommendations of Action Plan 5 of BEPS. The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF of the Income-tax Act, 1961 provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, "developed" means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

8.6. Action Plan 6: Prevent treaty abuse by developing model treaty provisions

Action Plan 6 is the minimum standard for protection again treaty shopping. Countries will implement this common intention by including in their treaties:

(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,

(ii) the PPT rule alone, or

(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

➢ **Indian Taxation Regime**

(i) LoB clause inserted in India-Mauritius Tax Treaty: A Limitation of Benefit (LOB) Clause has been introduced on 10th May, 2016 which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Also, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian rupee 15,00,000 or Indian ` 7,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

(ii) LoB clause in India-Singapore Tax Treaty – Similarly, India and Singapore has signed a protocol amending the India-Singapore tax treaty. Capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty. In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 months period immediately preceding the date of transfer.

8.7. Action Plan 7: Permanent Establishment

The report on this Action Plan includes changes to the definition of permanent establishment (PE) in the OECD Model Tax Convention that will address strategies used to avoid having a taxable presence in a country under tax treaties.

Following steps have been advocated:

- **Modifying exceptions to PE definition** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature.

- **Analysing arrangements entered through contractual agreements** – A Commissionaire arrangement can be defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales.

8.8. Actions Plan 8-10: Guidance on several key transfer pricing areas

This Action plans represent the OECD's work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on intangibles, risks and capital and other high-risk transactions.

Action Plan	Details
8	Action Plan 8 covers transfer pricing issues relating to transactions involving intangibles, as well as cost contribution arrangements (CCAs).
9	Action Plan 9 addresses the contractual allocation of risks and the resulting allocation of profits to those risks, which may not correspond with the activities actually carried out. The scope of this action includes the transfer pricing considerations in respect of the level of returns to funding provided by a capital-rich group company.
10	Action Plan 10 focuses on other high-risk areas, such as the characterization of transactions, the use of transfer pricing methods in certain abusive situations, and management fees, among other things.

8.9. Action Plan 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it

A final report on Action Plan 11 was released by the OECD as part of its 5th October, 2015 package of final reports. The Action Plan 11 report assessed available data and concluded that there were significant limitations that constrained the analysis of the scale and economic impact of BEPS, but nevertheless concluded that the impact was significant. Despite the limitations in the data, the report sets out a dashboard of six indicators of BEPS. The report also presents a toolkit to assist countries in evaluating the fiscal effects of BEPS countermeasures and makes recommendations regarding data and tools for future analysis, including a recommendation that the OECD should work with governments to report and analyse more corporate tax statistics and present them in an internationally consistent way.

Six indicators of BEPS activity highlight BEPS behavior using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate -** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.
ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations -** This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.
iii) **Foreign direct investment (FDI) is increasingly concentrated -** FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.
iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly -** For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.
v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties -** This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.
vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries -** The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

8.10. Action Plan 12: Framework for the design of mandatory disclosure rules

Tax authorities around the world faces a significant challenge of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations.

BEPS Action Plan 12 recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and timelier information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

8.11. Action Plan 13: Re-examine and develop rules on transfer pricing documentation

A final report on Action Plan 13 was released by the OECD as part of its 5th October, 2015 package of final reports. To achieve the objective of providing tax authorities with useful information to assess transfer pricing and other BEPS risks, the OECD Action Plan 13 report put forward a three-tiered structure consisting of the following:

I. **Master file:** Document containing standardized information relevant for all members of a multinational enterprise (MNE) group;

II. **Local file:** A document referring specifically to material transactions of the local taxpayer; and

III. **Country-by-country (CBC) report:** A document containing certain information relating to the MNE group's income and taxes, together with certain indicators of the location of economic activity within the MNE group.

8.12. Action Plan 14: Making dispute resolution mechanisms more effective

A final report on Action Plan 14 was released by the OECD as part of its 5th October, 2015 package of final reports. The Action Plan 14 report includes measures that form part of a BEPS minimum standard and that aim to strengthen the effectiveness and efficiency of the MAP process and ensure timely, effective, and efficient resolution of treaty related disputes. In addition, the Action Plan 14 report sets out a number of best practices. Two consequences of the report were a peer review process to evaluate the implementation of the minimum standard and the reporting of MAP statistics under a newly developed reporting framework, MAP Statistics Reporting Framework.

Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

8.13. Action Plan 15: Developing a Multilateral Instrument

A final report on Action Plan 15 was released by the OECD as part of its 5th October, 2015 package of final reports. The report sets out the key elements to be addressed by the MLI, and the text of the MLI was agreed in November 2016. The MLI covers tax treaty related measures arising from the BEPS project, namely, recommendations in respect of hybrid mismatches (Action 2), preventing tax treaty abuse (Action 6), changes to the definition of PEs (Action 7), and dispute resolution (Action 14).

Action Plan 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

9. <u>Multilateral Instruments</u>

Analysis of the tax and public international law issues related to development of Multilateral Instruments (hereinafter referred to as "MLI") are provided by Action Plan 15 of the BEPS Action Plan.

Abuse of tax treaties is one the important sources of BEPS. With the help of MLIs, implementation of tax treaty measures developed through the BEPS project in existing bilateral tax treaties, can be undertaken in a synchronized and efficient manner. These measures will help in prevention of treaty abuse and artificial avoidance of PE status, improve dispute resolution and help neutralize effects of hybrid mismatch arrangements.

9.1. Meaning of MLI

The role of MLI is to implement the BEPS work into the existing treaty network and it will provide a standard language for modification of all existing DTAAs entered between countries. It is prominent to note that MLIs are enabler to the existing treaties by modifying the application of a provision under the DTAA and that it does not replace existing treaties. MLIs enable contracting states to eliminate disputes arising on account of different terms being used in each of the DTAA thereby acting as deterrence for tax abuse.

9.2. Features of MLIs

The Multilateral Convention, an outcome of the OECD/ G-20 Project, tackles BEPS by providing tax planning strategies that looks for the gaps and mismatches in tax rules that artificially shifts profits to low tax or no tax locations, resulting into no or low taxes being paid by corporate entities.

Moreover, the MLIs modify tax treaties that are "Covered Tax Agreements". These agreements are for the avoidance of double taxation that is in force between parties to the MLI and for which both the parties have notified that they intend to modify the agreement using MLI.

MLI is a flexible instrument that will enable modification of tax treaties in accordance with jurisdiction's policy preferences as regards to the implementation of the tax treaty related BEPS measures.

MLIs provide for various types of flexibility to jurisdictions such as:

i) To choose amongst alternative provisions in certain MLI articles;
ii) To choose to apply for optional provisions;

iii) To reserve the right not to apply MLI provisions as regards to their Covered Tax Agreements. However, jurisdictions may be able to only opt out of the provisions that do not reflect a BEPS minimum standard with an option to withdraw their reservations later.

9.3. Structure of MLI

Interpretation of MLIs will be governed by the principles laid down by Vienna Convention on the Law of Treaties (herein after referred to as VCLT). There are in all 7 parts and 39 articles in the MLI listed as below:

a. Part I, Article 1 and 2: Scope and Interpretation of terms
b. Part II, Article 3 to 5: Hybrid Mismatches
c. Part III, Article 6 to 11: Treaty Abuse
d. Part IV, Article 12 to 15: Avoidance of PE status
e. Part V, Article 16 and 17: Improving Dispute Resolution
f. Part VI, Article 18 to 26: Arbitration
g. Part VII, Article 27 to 39: Final Provisions

9.4. Organs of the MLI

There are four key organs of the MLI instrument that acts as center point for its operation. The key organs are enumerated below:

1. **Covered Tax Agreements (CTA):** Definition of CTA has been covered by Article 2 of MLI which can be read as: "An agreement for avoidance of double taxation with respect to taxes on income that is in force between two or more parties and/ or jurisdictions with respect to which each party has notified to the Depository as a listed agreement under the MLI." Hence, to make the MLI operational between two parties or jurisdictions or countries, it is important that each country must notify their bilateral tax treaty while becoming a signatory to the MLI. India has notified 93 jurisdictions.

2. **Compatibility Clause:** One of the core objectives of the MLI is to ensure consistency amongst the nations to incorporate the BEPS solutions in their treaty network. Further, the objective of MLI is to only modify the application of certain provisions in the existing DTAA. Therefore, parties to the MLI are given the flexibility to choose the relevant provisions of the MLI that needs to be transposed to their existing DTAA.

3. **Reservation Clauses:** The reserved provisions of MLI shall not apply to a CTA if either of the parties makes a reservation. A reservation is defined in the VCLT as a "unilateral statement made by a State, when signing, ratifying, accepting, approving or acceding to a multilateral instrument, whereby it purports to exclude or to modify the legal effect of certain provisions of the Convention".

   Hence, reservations under treaties, introduce flexibility in treaty negotiations, so that States come forward to be a signatory to such multilateral conventions. The general rule of multilateral instrument is that its parties are bound by the entire instrument unless the parties make a reservation. The MLI enables states to opt-out of the provisions, either entirely or partially, by introducing a mechanism of reservations.

4. **Minimum Standard:** The mandatory minimum standards form the genesis of MLI and without which the object of MLI may not be fulfilled. One of the core objectives of developing the MLI is to ensure consistency amongst the 3,000 odd tax treaties that are currently in existence. As we have seen earlier, the MLI also gives flexibility to the parties through compatibility and reservation clause; however, to ensure there is some consistency, the parties have to adhere to incorporating mandatory minimum standard provisions in the MLI.

9.5. Application of MLI

MLI would be applicable on the satisfaction of the following conditions:

i) Both the Contracting States to the DTAA should be signatories to the MLI and the MLI has entered into force.
ii) Both the Contracting States should have duly notified their DTAA as a Covered Tax Agreement (CTA).
iii) The substantive provision and choice of the Contracting States is to be analyzed through the compatibility clause and notification clause.
iv) Identifying whether any reservation are made on the application of any provision of the MLI by any of the contracting states.

10. Synthesized Treaty Text

Synthesized texts would take the form of a single document or webpage. It would reproduce -

a) the text of each Covered Tax Agreement (including the texts of any amending protocols or similar instruments), and

b) the provisions of the MLI that will modify that Covered Tax Agreement in the light of the interaction of the MLI positions the Parties have taken.

Synthesized texts would also include explanatory information, including information on the entry into effect of the relevant provisions of the MLI. Synthesized texts would thereby make it much simpler to understand the effects of the MLI and the way it modifies each Covered Tax Agreement.

The purpose of synthesized texts is primarily intended to facilitate the understanding of the MLI. For legal purposes, the provisions of the MLI must be read alongside Covered Tax Agreements as they remain the only legal instruments to be applied, in light of the interaction of the MLI positions of the Contracting Jurisdictions.

10.1. Challenges in Preparing Synthesized Texts

Challenges in preparing synthesised texts include:

I. The MLI is not an amending protocol or an amending instrument in the traditional sense. It applies alongside Covered Tax Agreements modifying their application.

II. Synthesised texts would ideally be prepared when the parties to each Covered Tax Agreement have submitted a definitive version of their MLI positions.

III. The effects of the MLI on the application of a Covered Tax Agreement can change over time as the MLI is a living instrument and Parties can partially modify their MLI positions in the future:

  (i) Signatories can modify the choices, reservations and notifications contained in their MLI position before they deposit their instrument of ratification, acceptance or approval;

  (ii) Parties can withdraw, or in certain instances replace, a reservation made in their MLI position, after the deposit of their instrument of ratification, acceptance or approval;

  (iii) Parties can make additional notifications and opt to apply alternative or optional provisions, after the deposit of their instrument of ratification, acceptance or approval. For instance, a Party could decide to apply the provisions on arbitration to its Covered Tax Agreements after the deposit of its instrument of ratification, acceptance or approval; and, the numbers of Signatories, Parties and Covered Tax Agreements are expected to increase over time.

IV. The provisions of the MLI do not have effect on the same date for all Covered Tax Agreements:

  (i) The moment the provisions of the MLI have effect on Covered Tax Agreements may differ for each Covered Tax Agreement;

  (ii) The moment the provisions of the MLI have effect differs according to the types of taxes involved;

  (iii) The MLI provides several exceptions to the general rules on the entry into effect in Article 35; and

  (iv) The MLI provides rules for the entry into effect of the provisions of the MLI that will apply if a Party modifies its positions after the deposit of its instrument of ratification, acceptance or approval.

V. Synthesised texts should include information on the date on which the provisions of the MLI enter into effect and, at a minimum, should indicate that the modifications made to the application of a Covered Tax Agreement may not have effect at the same time.

VI. Synthesised texts could be produced by different stakeholders:
There is no assurance of uniformity amongst different versions of synthesised texts; and in the event of any discrepancy between synthesised texts and the legal instruments, the stakeholders bear no responsibility as synthesised texts are provided for information purposes only.

11. <u>International Tax Arbitration</u>

Mutual Agreement Procedure provides a generally effective and efficient method of resolving international tax disputes. The Article 25 of UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which was introduced in 2011.

- **Alternative A**

As per **paragraph 1** of the article, where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

Paragraph 2 of the article states the competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case 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 Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

Paragraph 3 of the article provides the competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

Paragraph 4 of the article provides that the competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedures provided for in this article.

- **Alternative B**

Alternative B is provided in paragraph 5 of the article which states, where:

(a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

(b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within three years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

The above alternatives are provided in UN Model whereas OECD does not provide such alternatives. Paragraph 5 of the UN MC reproduces paragraph 5 of Article 25 of the OECD MC with four differences:

(1) **Period for initiation of arbitration** – Para 5 of UN MC provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD MC.
(2) **Person entitled to make a request for arbitration** - While the OECD MC provides that arbitration must be requested by the person who initiated the case, paragraph 5 of Alternative B provides that arbitration must be requested by the competent authority of one of the Contracting States (this means that a case shall not be submitted to arbitration if the competent authorities of both Contracting States consider that such a case is not suitable for arbitration and neither of them make a request).
(3) **Departure from the arbitration decision** - Paragraph 5 of Alternative B of UN MC, unlike the corresponding provision of the OECD MC, allows the competent authorities to depart from the arbitration decision if they agree on a different solution within six months after the decision has been communicated to them.
(4) **Point of time from which period for initiation of arbitration is to be reckoned** - While the OECD MC provides that the two-year period begins when all the information required by the competent authorities in order to address the MAP case has been provided, paragraph 5 of alternative B of UN MC provides that the three-year period begins with the presentation of the MAP case to the competent authority of the State that did not initially relate it.

11.1. Difficulties which can be resolved by mutual agreement

This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention.

12. Unified Framework Pillars

There are two pillars of Unified Framework of OECD which focus on nexus and profit allocations, in addition to base erosion and profit shifting (BEPS) challenges. It examines the goals that the OECD hopes to achieve with regulatory changes, what is still to be determined in the proposed solutions and the implications for transfer pricing and tax strategies.

Two pillars of Unified Framework of OECD are mentioned as under:

- **OECD Pillar 1:** According to the OECD, Pillar 1 a person should "adhere to the concept of net taxation of income, avoid double taxation, and be as simple and administrable as possible." In layman's terms, the OECD has determined that companies aren't paying enough tax in jurisdictions where they have market-facing activities.

  For example: While Facebook has users in every country, it doesn't have physical operations in every country. A country like Egypt might have millions of Facebook users; advertisers are targeting those users, and Facebook is earning revenue and profit from those advertisers. However, since Facebook has no physical presence in Egypt, the company pays no tax there. The OECD's contention is that significant value is being created by Facebook's operations in Egypt, so it should pay some amount of tax there. Pillar 1 would give Egypt a share of Facebook's profits for its revenue-generating activities in the country.

  While Pillar 1 is primarily focused on digital companies, it would also potentially apply to consumer-facing businesses in which a company that does not have a physical presence in the jurisdiction sells products directly to consumers. This could include companies such as Amazon and others that sell and/or deliver their products directly to consumers.

- **OECD Pillar 2:** Under the proposed framework, Pillar 2 would allow a "right to 'tax back' where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation," according to the OECD. Essentially, Pillar 2 seeks to establish a minimum level of taxation on multinational companies doing business around the world.

  Under Pillar 2, thresholds for effective tax rates would be established, and if companies fell below those thresholds, they would owe additional tax. Effectively, Pillar 2 would require companies to "top up" the tax paid to bring the amount to a minimum effective tax rate.

  OECD Pillar 2 would be applied after Pillar 1, rather than concurrently. Companies would first allocate the tax due to jurisdictions where they generate revenue under Pillar 1 OECD guidelines; then, if they were still below the minimum effective tax rate, Pillar 2 guidelines would be applied.

Test Your Knowledge

QUESTIONS	
1.	Explain the meaning and types of DTAA.
2.	Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.
3.	Describe the three-tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.
4.	Explain whether MLI provisions will apply in the following scenarios: **(i)** Country X and Country Y are signatories to the MLI. Both countries have ratified the MLI agreement as per their domestic legislative process. Country X has notified DTAA with Country Y as a CTA, however, Country Y has not notified DTAA with Country X. **(ii)** Country X - Country Y DTAA is a CTA under Article 2 of the MLI as both the countries have notified the concerned DTAA. Country X has ratified the MLI under their domestic laws and has deposited the ratification instrument. Country Y has not ratified the MLI owing to political instability in their country. In this regard, Country A wishes to invoke the MLI provisions while accessing the Country X – Country Y DTAA. Is the action of Country X valid?
5.	Explain the two important pillars of Unified Framework of OECD.

SOLUTIONS	
1.	DTAA means a Tax Treaty between two or more countries to avoid taxing the same income twice. When a person is residing in one country and earning income in some other country they are covered under DTAA. This means that involved countries have agreed upon tax rates and jurisdictions for income arising from their country. **Types of DTAA** Relief from Double Taxation can be provided in two ways: **(a) Bilateral Treaties:** When there is an agreement of DTAA between the two countries relief is calculated according to mutual agreement between such two countries. Bilateral relief can be granted by either of the following methods: i) Exemption method: Under this method, income is taxed in only one country. ii) Tax credit: Income is taxed in both countries. Relief is granted in the country in which the taxpayer is the resident. **(b) Unilateral Relief:** The home nation provides relief when there is no mutual agreement between the countries.
2.	In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible. The provision is applicable to an Indian company or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender. The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the

	head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure. In order to target only large interest payments, it provides for a threshold of interest expenditure of ` 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses. Also, section 94B would not be attracted on interest paid in respect of debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.
3.	Action Plan 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of: **(a)** **Master file:** Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations. **(b)** **Local file:** Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations. **(c)** **Country-by-country (CBC) report:** CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.
4.	**(i)** Since Country Y has not notified DTAA with Country X as CTA, the MLI provisions will not apply with regard to the Country X - Country Y DTAA, as per Article 2 of the MLI. **(ii)** Under Article 34 - Entry into Force of the MLI, only when a Country deposits its

	instrument of ratification, the MLI will enter into force according to the timelines stipulated in the mentioned Article. In the given scenario, since Country Y has not ratified the MLI, consequently, the MLI with regards to Country Y has not entered into force yet. Hence, Country X - Country Y CTA under MLI is not in force yet and hence provisions of the MLI are not applicable. The action of Country X is therefore invalid.
5.	Two pillars of Unified Framework of OECD are mentioned as under: **OECD Pillar 1:** According to the OECD, Pillar 1 a person should "adhere to the concept of net taxation of income, avoid double taxation, and be as simple and administrable as possible." In layman's terms, the OECD has determined that companies aren't paying enough tax in jurisdictions where they have market-facing activities. **OECD Pillar 2:** Under the proposed framework, Pillar 2 would allow a "right to 'tax back' where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation," according to the OECD. Essentially, Pillar 2 seeks to establish a minimum level of taxation on multinational companies doing business around the world.

Understanding International Tax Treaties and its Implications on Domestic Tax Laws

Module III – Problematizing International Taxation

1. Introduction

International tax issues have risen to prominence in public debate and are now attracting considerable attention from policymakers. The *Lough Erne Declaration* from the G-8 summit of June 17–18, 2013 set out a number of commitments and objectives in this area, including for instance, the aspirations that – the tax authorities around the world should automatically share information to fight the scourge of tax evasion and that the countries should change rules that let companies shift their profits across borders to avoid taxes.

There are, broadly speaking, two sets of issues on which current actions are focused:
(i) tax avoidance by multinationals, and
(ii) tax evasion by rich individuals.

The overarching problem, however, is in each case the fundamental difficulty that national tax policies create cross-country spill overs. The opportunities for avoidance and evasion are now a concern and are a very visible manifestation of such spill overs. They exploit gaps and inconsistencies in the international tax framework that arise from combining national tax systems but the setting of national tax policies without considering the spill overs on other countries can generate distortions even in the absence of erosion and evasion phenomena. These can arise instead in the less visible but perhaps even more damaging form of either a dislocation of economic activity purely to exploit differences in national tax policies or an overall level of taxation.

A variety of measures addressed to these issues have been adopted at national and regional levels. Many countries, for instance, have adopted voluntary disclosure programs to encourage taxpayers to report undeclared assets offshore; the European Union requires members to provide information or levy withholding taxes on deposits held by residents of other member states; and some countries have cancelled some of their tax treaties because of the perception that they were being abused.

2. History of OECD

The OECD was initially called the Organization for European Economic Cooperation, or OEEC. It was started in 1948, after World War II, to run the Marshall Plan to reconstruct Europe. Its goal was to help European governments recognize their economic interdependence. In this way, it was one of the roots of the European Union. Once the Marshall Plan was complete, Canada and the United States joined the OEEC nations, which created the OECD on December 14, 1960. The OECD went into full force on September 30, 1961.

OECD Members

- Most of the 38 OECD members are from Europe. They are:

  Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom.

- There are five countries from America:

  Canada, Chile, Colombia, Mexico, and the United States.

- The four Pacific members are:

  Australia, Japan, Korea, and New Zealand.

- The two member countries from the Middle East are:

  Israel and Turkey.

- Also, Costa Rica has recently entered into membership with OECD.

2.1. Evolution of OECD

The OECD has been expanding its membership continuously. Especially around the mid-1990s, when Korea joined the OECD, Mexico and some Eastern European transition countries joined. In 2010, four countries; Chile, Estonia, Israel, and Slovenia acceded to the OECD, increasing the number of members to 34. After Latvia in 2016, Lithuania in 2018, Colombia joined in 2020, Costa Rica joined in 2021, bringing the total to 38.

Aside from the expansion of its number of members, the OECD has recently been using various external-relations tool such as Key Partner programs, country programs, and regional programs to enhance its global influence. To engage further with big players such as Brazil, China, India, Indonesia, and South Africa, in 2007 the OECD started Enhanced Engagement programs, whose name was later changed to Key Partners. With these different programs, the

OECD currently works in some capacity with over 120 governments and jurisdictions across the globe.

In addition to working with governments, the OECD has close working relationships with other international organisations such as the IMF, the WB, and the World Trade Organisation (WTO), and it contributes substantially to the G7 and G20. It also collaborates with major regional banks, as well as many other international banks and organisations. Increasingly, the OECD works with a wide range of policy shapers that go beyond governments, including a network of parliamentarians and legislators, business and a labor-advisory bodies (the Business Industry Advisory Committee, BIAC, and the Trade Union Advisory Committee, TUAC), and partnerships with numerous civil-society organisations.

The OECD has more than 20 Part II programs, in which some or all members or non-members may participate. Under the larger name of the OECD family, some Part II organisations have a very strong independency. The International Transport Forum (ITF), Financial Action Task Force (FATF), and Sahel and West Africa Club (SWAC) are not OECD bodies, though the OECD might have some fiduciary duties as they share the OECD Secretariat. In case of the International Energy Agency (IEA), the Nuclear Energy Agency (NEA), and the Development Center (DEV), they are referred as autonomous organisations, although they were established within the framework of OECD. The level of independence of these organisations varies. The IEA is more independently operated than, for example, the NEA, DEV, or the Global Forum on Tax Transparency and Exchange of Information for Tax Purposes (GFTEI).

2.2. Functions of OECD

Four major functions of OECD are mentioned below:

(i) Statics:

The OECD collects, analyses, and reports on economic growth data for its members. This gives them the knowledge to further their prosperity and fight poverty. It also balances the impact of economic growth on the environment. Committees within the OECD analyse the data and make policy recommendations. It's up to each member country to decide how to use OECD recommendations.

Members have used OECD recommendations in many ways. They've created formal "rule of the game" agreements for international cooperation. These rules include prohibitions against bribery as well as arrangements for export credits and the treatment of capital movements.

OECD agreements have resulted in standards in bilateral tax treaties. They've also increased cross-border cooperation on outlawing spam emails. These agreements have also improved corporate governance guidelines.

(ii) Economic Outlook

Twice a year, the OECD publishes its economic outlook. The OECD Economic Outlook analyses the economic prospects for the 37 members and major non-member countries. The Outlook provides in-depth coverage of the economic policies needed for each member, as well as an overview for the total OECD area. The report is updated twice per year with the significant shifting trends. The OECD updates the report in March of each year.

(iii) Reports

The OECD Economic Surveys are done for each member country every one to two years. They discuss each country's leading economic challenges and provide policy recommendations. The OECD recommended austerity measures to solve the Greek debt crisis. It said the proposals would make Greece more competitive in the global economy. The "Going for Growth" report helped members recover from the 2008 financial crisis. It highlighted the most significant changes to enhance long-term growth.

(iv) Education

Every three years, the OECD conducts the Programme for International Student Assessment. It evaluates education systems around the world by testing the knowledge of 15-year-old students. The OECD uses the data to recommend ways to improve equity in education.

Fig. Functions of OECD

2.3. Aims of OECD

The aims are clearly stated in the OECD Convention. The aims of OECD are provided in Article 1 of the OECD Convention which is as follows:

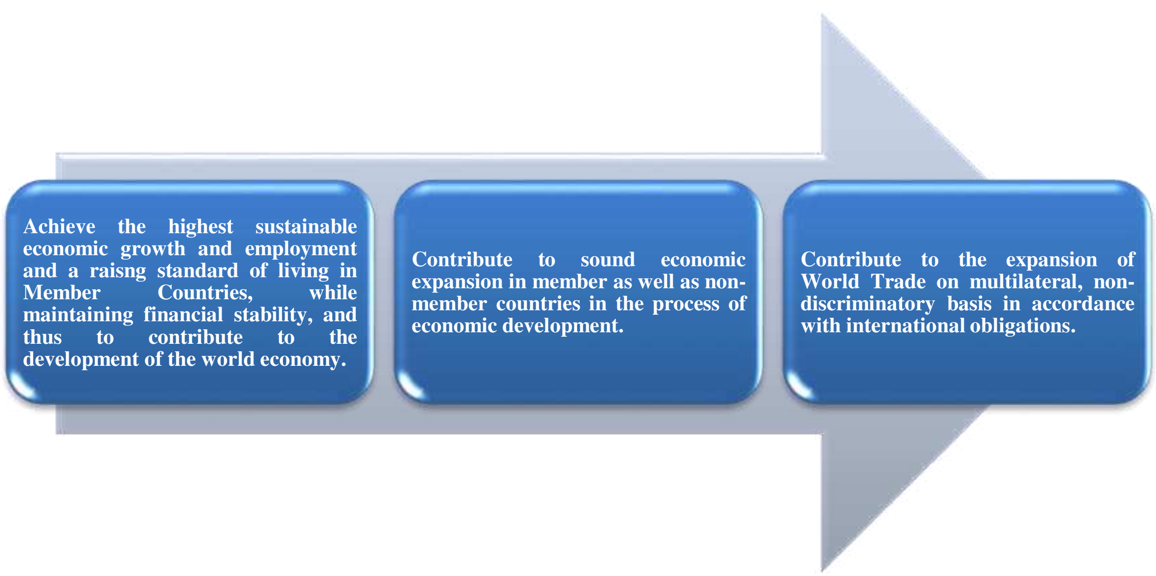


Fig. Aims of OECD

2.4. Structure of OECD

The Council is the highest body of the OECD, entrusted by the Convention to be the body from which all acts of the organisation derive. It provides oversight and strategic direction. The Council is made up of one representative from each member country and the European Commission. It is chaired by the OECD Secretary-General, currently Mathias Cormann of Australia. The Council mandates the OECD’s work and has final decision-making power. Its meetings usually take place in Room C of the OECD Château de la Muette every month.

The Meeting of the OECD Council at the Ministerial Level (MCM) takes place once a year, around late May or early June. The OECD Forum is held in conjunction with the MCM, comprising part of OECD Week, the biggest OECD event of the year. The MCM is chaired by one of the member countries, assisted by two or three vice-chair countries. In 2021, Korea is a vice-chair along with Luxembourg, supporting the United States as chair.

The OECD bodies are composed of the Council and subsidiary bodies. The latter are categorized into three divisions:

- standing committees,
- special bodies, and
- substantive committees.

In the case of substantive committees, the OECD has 37 Level 1 committees. Many of these have sub-committees, designated Level 2, Level 3, or even level 4. The number of committees totals more than 250.

The Council is chaired by the Secretary-General, as mandated by Convention Article 10.2. It is supported mainly by three standing committees:

- the Executive Committee (Ex Co),
- the Budget Committee (BC), and
- the External Relations Committee (ERC).

The OECD Secretariat carries out work in response to the Council's mandates. It measures global performance, analyses data, compares policies, and issues recommendations. The Secretary-General plays a key role in the decision-making process. Mr. Mathias is the sixth Secretary-General of the OECD. He manages the organisation, leads the Secretariat, manages the budget, assists all bodies, and represents the organisation.

The third pole is the committees. More than 250 committees made up of more than 40,000 international experts from around the world exchange information and ideas, and monitor progress in their policy areas.

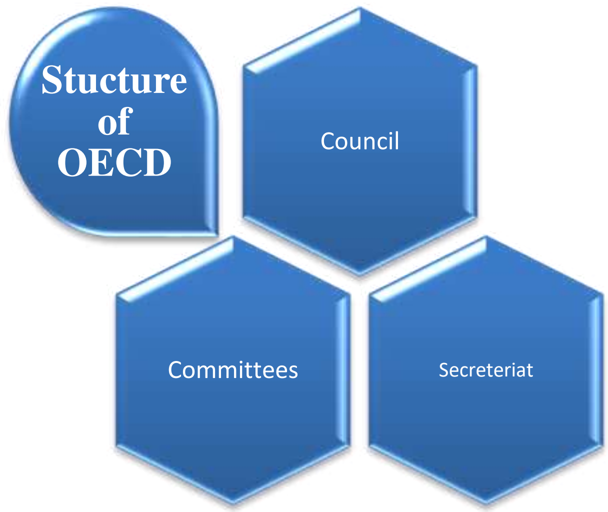


Fig. Structure of OECD

3. Global Tax Governance

Governance can be defined as the activity of 'organizing collective action'. It covers the creation or development of institutions. Such governance may be exercised by state and non-state, public and private actors. Governance is global governance if the reach of the principles, norms, rules, and procedures is global or at least international. "**Global tax governance" consists of the set of institutions governing issues of taxation that involve cross-border transactions or have other international implications**. This definition implies that global tax governance need not, but could, involve a full or partial shift of the power to tax, that is, the right to impose taxes on citizens, to the international level. Currently, the right to tax is firmly tied to the nation-state. While global tax governance circumscribes and shapes a nation's power to tax in various ways, it exclusively consists of institutions governing the interaction among national tax systems.

Today, global tax governance is very high on the international and various national political agendas. There are two main reasons for this.

- First, in the wake of the 2008 financial crisis, many states have seen their public debt rise to high levels and, hence, can no longer afford to forgo tax revenues currently lost to international tax evasion and avoidance.
- Second, political initiatives are fuelled by recent tax scandals (such as Starbucks, Apple, Offshore Leaks and LuxLeaks) that have raised public awareness and guaranteed media attention.

Taxation is the most direct interface between the market and the state, it is the perfect policy area in which to observe the relation between, and relative power of the two spheres. Moreover, taxation represents one of the core functions of the modern nation-state. Therefore, it should be a key to understand how economic globalisation affects state sovereignty and the choice and development of international institutions, as well as the effectiveness and legitimacy of both national and international institutions; these are, of course, the major themes of the literature on global governance.

Politically, the governments and international institutions involved in designing global tax governance claim that they are on track to tackle the problems created by tax competition. Soon after the financial crisis hit, the G20 and OECD revived their ‘black’ and ‘grey’ lists of uncooperative tax havens and forced them to sign bilateral tax information-exchange agreements (TIEAs). Recently, the OECD has even forged an agreement that foresees multilateral automatic information-exchange (AEI) as the new global norm. In addition, the G20 and the OECD are taking steps to control the practices of base-erosion and profit-shifting (BEPS) of multinational corporations. All that being said, most experts, while admitting that these initiatives represent real progress, are less optimistic about their effectiveness.

The objectives of Global Tax Governance include:

(i) identifying the problems that globalisation creates in the area of taxation, through tax competition in particular;
(ii) explaining the institutions, structures, and processes of global tax governance as well as analysing their shortcomings;
(iii) developing the normative foundations for an appropriate regulatory response and building on these foundations; and
(iv) deriving proposals for the reform of institutions and policies.

Global governance aims at the cooperative regulation of globalisation. The basic assumption is that in an age of globalisation, an ever-increasing number of issues cannot be adequately governed within the nation-state. If societal interactions cross borders and create interdependencies and externalities among national societies and polities, there is a need for global governance. In taxation, globalisation has entered the debate as tax competition, that is, national governments competing for mobile tax bases. Political scientists and economists have asked: Does tax competition lead to a race to the bottom in terms of tax rates and, consequently, in terms of revenues and public-goods provision? Does it constrain the political capacity to maintain the welfare state?

A set of influential papers in political science has shown that tax revenues in industrialised countries have remained constant and concluded that, therefore, the autonomy of national tax and welfare state policy was still intact. Others, building on empirical findings in economics, disagreed. They have argued that the focus on tax revenues alone was misguided and masked important changes in the structure of tax systems. In particular, they have made the case that tax competition has undesirable distributive implications in developed countries and leads to significant revenue losses in the developing world. According to this view, tax competition seriously constrains the autonomy of national policy. Therefore, tax governance is one of the important concepts in international taxation which lays down the foundation for guarding the policies of taxation framed by various countries.

4. International Tax Justice

As per 'The State of Tax Justice Report, 2020' published by the Tax Justice Institute, the annual global loss due to tax abuse (Tax abuse: Tax Evasion and avoidance) is nearly $427 billion. Of this, nearly $245 billion is lost to "multinational corporations (MNCs) shifting profit into tax havens. The other $182 billion is lost to wealthy individuals hiding undeclared assets and incomes offshore. The impact of tax evasion is more on the lower-income countries; they lose a much larger equivalent proportion than higher-income countries. Though they suffer a loss of $382 billion in tax revenue annually, they are responsible for facilitating 98% of all global tax losses. The Corporate Tax Haven Index 2021 published by the Tax Justice Institute finds that countries that are members of the Organisation for Economic Co-operation and Development (OECD) are together responsible for 68% of the world's corporate tax abuse risks.

As per the Tax Justice Network, India is ranked 47 in the 2020 Financial Secrecy Index published by the Tax Justice Institute, based on a low secrecy score of 47.84. India loses $10 billion annually in tax due to global tax abuse. This is equivalent to 0.41% of annual GDP of India. The main countries through which maximum tax abuse happens are Mauritius, Singapore and the Netherlands. On the plus side, India does not figure as a corporate tax haven in any of the global index. Thus, India causes no tax loss to any other country.

4.1. Steps Taken to Control Tax Evasion

The steps taken to control the tax evasion at global level includes OECD's Inclusive Framework's Statement. The Inclusive Framework's Statement adopts a two-pillar solution.

Pillar 1: It applies to about 100 of the biggest and most profitable MNCs and re-allocates part of their profit to the countries where they sell their products and provide their services.
Pillar 2: Under pillar two, any company with over EUR 750 million of annual revenue would now be subject to an effective minimum rate of 15 per cent.

As per OECD, the global minimum tax may generate around $150 billion in additional global tax revenues per year.

Steps taken by India to control the tax evasion are mentioned below:

(i) Legislative Action:

a) The Fugitive Economic Offenders Act, 2018

The Act seeks to confiscate properties of economic offenders who have left the country to avoid facing criminal prosecution or refuse to return to the country to face prosecution.

b) The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 is an Act of the Parliament of India. It aims to curb black money, or undisclosed foreign assets and income and imposes tax and penalty on such income.

c) Prevention of Money Laundering Act, 2002 [PMLA]

The PMLA seeks to combat money laundering in India and has three main objectives:

- To prevent and control money laundering;
- To confiscate and seize the property obtained from the laundered money; and
- To deal with any other issue connected with money laundering in India.

(ii) International Cooperation:

Double Taxation Avoidance Agreements (DTAAs): India is proactively engaging with foreign governments on Double Taxation Avoidance Agreements (DTAAs)/Tax Information Exchange Agreements (TIEAs)/Multilateral Conventions.

(iii) Automatic Exchange of Information:

India has entered into an information sharing agreement with the USA under the US Act. It will greatly assist the global efforts to combat tax evasion by proactive sharing of financial information.

4.2. Alternative Frameworks Proposed

4.2.1. ABC's of Tax Justice

The ABCs of tax justice are three transparency measures designed tackle corporate and private tax abuse and other corruption:

a) Automatic exchange of information,
b) Beneficial ownership registration and
c) Country-by-country reporting

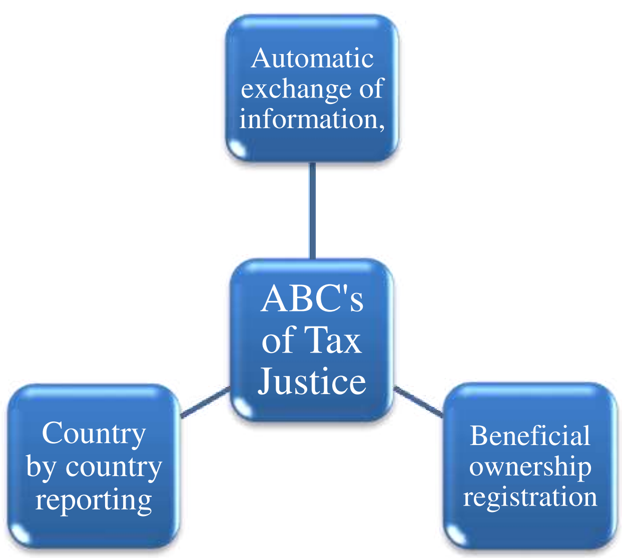


Fig. ABC's of Tax Justice

a) Automatic Exchange of Information

Automatic exchange of information is a data sharing practice that prevents corporations and individuals from abusing bank accounts they hold abroad to hide the true value of their wealth for and to pay less tax than they should at home.

b) Beneficial Ownership Registration

Beneficial ownership registration is the practice of registering the identity of companies and other legal vehicles' beneficial owners. A beneficial owner is the real person, made of flesh and blood, which ultimately owns, controls or receives profits from a company or legal vehicle, even when the company, on paper, legally belongs to another person, like an accountant or a shell company.

c) Country-by-country Reporting

Public country-by-country reporting is an accounting practice designed to expose multinational corporations that are shifting profit into tax havens for the purpose of paying less tax than they should.

4.2.2. Unitary Taxation

The alternative approach is unitary taxation, which treats multinational corporations as one single enterprise, dividing the right to tax their total global profits between the nations where they operate based on a formula. This formula could be based on sales and employees, for example, ensuring that companies only face tax liabilities in countries where they have substantial operations. The system already exists in the US, where it is used to divide taxable profit between different state governments which levy their own corporation tax rates. The Labour party have announced they will implement a unitary system as part of their platform in the 2019 election.

As a matter of pure principle, the unitary principle must surely be the correct approach. As set out long ago by Lord Carnwath LJ, tax statutes 'draw their life-blood from real world transactions with real world economic effects'. In the real world, multinational groups are single businesses rather than a set of loosely affiliated, separate entities.

However, there are many who still stick to the individual entity myth. Furthermore, it cannot go unnoticed that the individual entity approach generates mountains of paperwork for each multinational corporation, as each individual subsidiary must file its own accounts and justify the transactions it makes with companies within the group. This creates large amounts of work for accountants and tax advisors, all of whom are paid hefty fees for their work. These firms of accountants are often the same people acting as the voice of business when it comes to international tax reform.

As discussed, a unitary approach to international taxation means recognizing that a Multinational corporation's profits accrue at the group level; not individually; they, therefore, need to be taxed on the same basis; as a group, and not individually. This is the opposite of the fundamental principle of separate legal entities under international taxation. The Multinational Corporation under unitary taxation has to submit consolidated accounts of all of its subsidiaries for deciding their tax liability. The Carroll Report had reached the conclusion that the unitary taxation approach was the more superior one, but due to its complex nature and political considerations, it was decided that the 'Arm's length pricing' method would be adopted.

'Arm's length pricing' assumes that every company in a group is separate and independent, and therefore should be taxed as such. However, in reality, the only reason these companies are even in a group is that they make more profit in working under common ownership. This excess profit cannot be taxed because the prices charged to each company in the group is adjusted such that only the level that would be earned if they were separate and independent is taxed.

Unitary taxation has **two** important elements to it:

(a) Combined report and;

(b) Formulary apportionment.

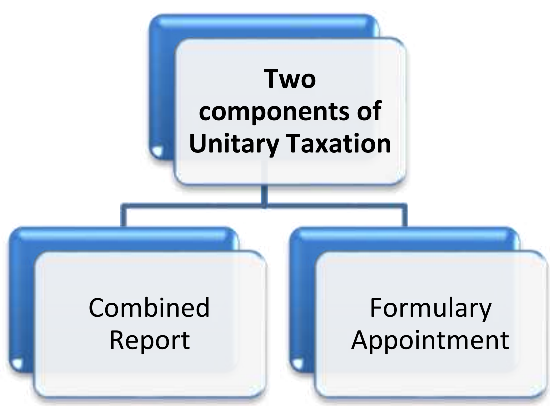


Fig. Components of Unitary Taxation

(a) Combined report

A multinational corporation would be required to produce consolidated accounts in every country it does its business. Along with consolidated accounts, the Transnational Corporations (TNC) also would need to provide details of all related entities in the particular corporate group based on the assets, sales, and employees. The advantage of access to consolidated accounts is that the local governments can see if the multinational corporation is using internal transfers to shift their profit to offshore accounts.

(b) Formulary apportionment

This means enabling every country to tax the global profits of multinational corporations, by apportioning the profits according to a formula based on assets, sales, and employees, with a global minimum effective tax rate. This would eliminate any incentive for multinational corporations to shift their profits around different jurisdictions and would lead to massive increases in tax revenues for the national governments.

The United States has been successfully using the unitary tax approach to tax the various multinational tech giants in its jurisdiction. The pressure from many other countries has also prompted the OECD to come up with a uniform system of taxation. One downside of the entire scheme may be that the tax havens, which in reality are relatively poorer states, might suffer from the new shift in global taxes.

4.2.3. A UN Convention on Tax

Establishing a UN Tax Convention would allow international tax rules to be determined through a genuinely representative process at the UN that reflects the needs of countries around the world. UN convention on tax can hold countries to legally binding, equitable standards on corporate taxation, financial transparency and tax justice.

4.2.4. Global Asset Register

A global asset register is a proposal to create a comprehensive international registry of all wealth and assets in order give policy-makers and the public the data needed to tackle global tax abuse and redress inequality.

5. Global South in Global Tax Policy

The phrase **"Global South"** refers broadly to the regions of Latin America, Asia, Africa, and Oceania. It is one of a family of terms, including "Third World" and "Periphery," that denote regions outside Europe and North America, mostly (though not all) low-income and often politically or culturally marginalized. The global South represents mainly agrarian economies in Africa, India, China, Latin America and others that are not as economically sound and politically stable as their global North counterparts and tend to be characterized by turmoil, war, conflict, poverty, anarchy and tyranny.

5.1. Characteristics of Tax Incentives by Global South

The characteristics of the tax incentives introduced by the Global South are mentioned below:

(i) Incentives must be consistent with national economic policy: For tax incentives to be effective at delivering the desired economic and social outcomes, they must support the economic and development strategies of the country. Governments that offer concessions often see tax as one of their best bargaining chips to secure commitments for investment, but without a clear link to an economic strategy and development plans – including the SDGs – it is unlikely that the incentive will be as effective as it could be. For example, a government seeking to increase employment and stimulate the creation of better jobs may wish to use tax incentives as a means of attracting investment to catalyze job creation. However, whilst some tax incentives catalyze investment that leads to new jobs, this is not always the case. Therefore, it is important that tax policy is strongly aligned with wider economic plans.

(ii) Incentives must be underpinned by a transparent and clear legal process with democratic oversight and political scrutiny: Well-designed incentives, which are administered in a way that ensures they meet their original policy intentions, are important to a well-functioning tax system which supports investment and economic growth. To bring more confidence to the use of tax incentives in developing countries it is incumbent on government and business to be transparent about their existence and take-up. Greater oversight and scrutiny of public finances also helps to enhance the accountability of policymakers and their use of public sector resources. It also reduces opportunities for corruption. Tax incentives should be clearly defined in legislation, after having gone through the appropriate legislative process. This process is important to businesses, society and taxpayers alike in ensuring fairness. It also adds legitimacy to the development of the incentive design and is therefore less likely to be removed because of political pressure in the future. A lack of such legitimacy could create uncertainty for business and undermine investor confidence.

(iii) Incentives should only be granted following clear, evidence-based economic, social and environmental impact assessments: Offering incentives should be about achieving the long-term ambitions of a country, to support sustainable and inclusive economic growth. Businesses and civil society want to see tax incentives offered when there is clear economic and social need to build a lasting presence in a country, which will contribute to prosperity long after the initial project or investment. Impact assessments can help to provide accountability and sufficient evidence that the incentive will deliver a net benefit to the economy by seeking to account for all potential economic, social and environmental impacts. By determining the costs and benefits of an incentive, impact assessments can also help to inform the design of the incentive to ensure the associated costs are minimised.

(iv) Incentives should be subject to on-going monitoring and evaluation by the government to ensure they continue to serve their original purpose: Maintaining the efficiency and effectiveness of tax incentives requires that they are subject to on-going, robust monitoring and evaluation. Specific incentives and reliefs should be audited on a regular basis to ensure they are delivering their intended outcomes. More broadly, incentive regimes should be subject to long term evaluation within the context of wider tax strategies, to ensure they remain appropriate and well aligned with broader economic and development plans, and to understand any indirect impacts of the incentive. This regulatory scrutiny is in the interests of both civil society organisations and businesses. For the former, monitoring and evaluation helps to ensure that incentives are not being granted or maintained unnecessarily, thus depriving countries in the Global South of much needed revenue. For the latter, evidence-based analysis is a tool to demonstrate that incentives used by businesses are contributing to investment, jobs or growth. Furthermore, a clearly defined process of monitoring and evaluation will promote the sort of stable political and economic environment that businesses seek, so they are better able to forecast returns on investment decisions, making them more likely to invest in the future.

(v) Incentives should be available on a level playing field to all similar companies: It is never appropriate for governments to introduce tax incentives for specific company needs, so striving for a level playing field is vital. This is because company-specific tax incentives can distort investment patterns and create the potential for corruption. However, it is important to recognise that it might be part of a country's economic plan to help a particular sector or industry. For example, where an industry is critical to a country's security or citizens' welfare then tax incentives might be appropriate, so long as they are granted on the basis of robust evidence-based analysis. There are also examples where industry focussed incentives can be used to attract the first mover or innovator, to stimulate wider investment and growth in the sector. A good starting point for considering this trade-off is the introduction of State Aid principles, where any advantage provided must be justified against pre-determined rules and where it has been clearly identified as beneficial to the economy.

Test Your Knowledge

QUESTIONS	
1.	The only function of OECD is to collect, analyse and publish reports on economic growth data of its members. State whether the above statement is correct.
2.	Ram is preparing a presentation on the topic Global Tax Governance. Help him identify the objectives of Global Tax Governance.
3.	Explain the concept of ABC’s of Tax Justice.
4.	What are the two important elements of Unitary Taxation?

SOLUTIONS	
1.	There are four functions of OECD which include the following: **(i) Statics:** The OECD collects, analyses, and reports on economic growth data for its members. This gives them the knowledge to further their prosperity and fight poverty. It also balances the impact of economic growth on the environment. Committees within the OECD analyse the data and make policy recommendations. It's up to each member country to decide how to use OECD recommendations. **(ii) Economic Outlook** Twice a year, the OECD publishes its economic outlook. The OECD Economic Outlook analyses the economic prospects for the 37 members and major non-member countries. The Outlook provides in-depth coverage of the economic policies needed for each member, as well as an overview for the total OECD area. The report is updated twice per year

	with the significant shifting trends. The OECD updates the report in March of each year. **(iii) Reports** The OECD Economic Surveys are done for each member country every one to two years. They discuss each country's leading economic challenges and provide policy recommendations. The OECD recommended austerity measures to solve the Greek debt crisis. It said the proposals would make Greece more competitive in the global economy. The "Going for Growth" report helped members recover from the 2008 financial crisis. It highlighted the most significant changes to enhance long-term growth. **(iv) Education** Every three years, the OECD conducts the Programme for International Student Assessment. It evaluates education systems around the world by testing the knowledge of 15-year-old students. The OECD uses the data to recommend ways to improve equity in education. Therefore, from above its clear that OECD has various other functions other than collecting, analysing and publishing reports on economic growth data of its members.
2.	The objectives of Global Tax Governance include: • identifying the problems that globalisation creates in the area of taxation, through tax competition in particular; • explaining the institutions, structures, and processes of global tax governance as well as analysing their shortcomings; • developing the normative foundations for an appropriate regulatory response and building on these foundations; • deriving proposals for the reform of institutions and policies.
3.	The ABC's of tax justice are three transparency measures designed tackle corporate and private tax abuse and other corruption: a) Automatic exchange of information, b) Beneficial ownership registration and c) Country-by-country reporting **a) Automatic Exchange of Information** Automatic exchange of information is a data sharing practice that prevents corporations and individuals from abusing bank accounts they hold abroad to hide the true value of their wealth

	for and to pay less tax than they should at home. **b) Beneficial Ownership Registration** Beneficial ownership registration is the practice of registering the identity of companies and other legal vehicles' beneficial owners. A beneficial owner is the real person, made of flesh and blood, which ultimately owns, controls or receives profits from a company or legal vehicle, even when the company, on paper, legally belongs to another person, like an accountant or a shell company. **c) Country-by-country reporting** Public country by country reporting is an accounting practice designed to expose multinational corporations that are shifting profit into tax havens for the purpose of paying less tax than they should.
4.	Unitary taxation has **two** important elements to it: a) Combined report and; b) Formulary apportionment. **a) Combined report** A multinational corporation would be required to produce consolidated accounts in every country it does its business. Along with consolidated accounts, the Transnational Corporations (TNC) also would need to provide details of all related entities in the particular corporate group based on the assets, sales, and employees. The advantage of access to consolidated accounts is that the local governments can see if the multinational corporation is using internal transfers to shift their profit to offshore accounts. **b) Formulary apportionment** This means enabling every country to tax the global profits of multinational corporations, by apportioning the profits according to a formula based on assets, sales, and employees, with a global minimum effective tax rate. This would eliminate any incentive for multinational corporations to shift their profits around different jurisdictions and would lead to massive increases in tax revenues for the national governments.