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OBJECTIVES
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RESEARCH METHODOLOGY
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INDIA & TAX TREATIES

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ABSTRACT

The purpose of this seminar paper is to highlight the influence of DTAA (Double Taxation Avoidance Agreement) on foreign investments in India. India had recently amended its DTAA with Singapore, Belgium and Cyprus so as to plug certain loopholes and this paper focuses on its impact on cross border transactions. Double taxation is considered as one of the major obstacles to the development of international economic relations since the fiscal jurisdiction will be always heavily guarded. Nations are often force to discuss and settle the claims of other means of double taxation avoidance agreements, I order to bring down the barriers of international trade.

KEYWORDS

Indian taxing, tax treaties, Double Taxation Avoidance Agreement.

JEL CODES

F38, K34

1. INTRODUCTION

A DTAA is an agreement entered into between two countries in order to avoid taxing the same income twice. Commonly, the two legal criteria for taxability under any tax law are "residence" and "source". As a result of this whenever the resident of a country derives income from a source in another country, he is likely to get taxed in both the countries, i.e. the source country and the country of residence. The double liability is often mitigated by providing bilateral relief which is granted through the aforesaid tax agreements known as tax treaties.

With the advent of globalization and increased growth in international trade and commerce, residents of countries are concentrating on doing business not only in their own countries but also extending their area of operations to other countries. In such a situation the major impact will be on the countries' domestic taxation policy on the economy of another. This has led to assessing and amending a country's tax policies time and again according to the change in other countries. Double Tax Agreements are also known as Double Tax Treaty or Double Tax convention. India had recently amended its' DTAA with Mauritius, Cyprus and Singapore so as to eradicate various inconsistencies existing between these nations.

2. OBJECTIVES OF THE STUDY

1. To identify the growing relevance for tax avoidance treaties with the advent of globalisation and increase in international trade
2. To determine the operation of double tax treaties by identifying and applying their main rules on allocation of taxing rights and thresholds for source taxation
3. To note the key features of double tax relief under double tax treaties and model tax conventions
4. To identify the key stages of double tax treaty negotiations
5. To delineate the scope of tax treaties

3. RESEARCH METHODOLOGY

The study is based on secondary data. Published and unpublished article, ongoing academic working paper and internet are used extensively as a source of information.

4. STRUCTURE OF DTAA

Normally, the articles of DTAA are structured in a standardized manner, although all DTAAs are not identical in nature. Some DTAAs, the OECD model is followed while in some, the Un model is adopted with or without modifications. Articles 1 & 2 and 30 & 31 explain the scope of DTAA determining the persons eligible to access DTAA, taxes covered, period for which the agreement is in operation and termination. Definitions are covered in the Article 3 including general terms used in DTAA such as person, company, national etc., are defined. Article 4 defines resident and lays down tie breaker rule. Article 5 covers the meaning of permanent establishment. Article 24 provides conditions for relief from double taxation to the tax payer. Articles 25 to 29 are miscellaneous provisions dealing with double taxation relief, non-discrimination, EOI, collection of taxes and other related aspects.

4.1 PERMANENT ESTABLISHMENT

Article 5 of every DTAA specifically defines a permanent establishment. It means a fixed place of business of an enterprise is wholly or partly carried down. Article 5 (2) stipulates various instances pf PE. PE includes (i) place of management; (ii) a branch; (iii) An office; (iv) a factory; (v) a workshop; (vi) a sales outlet; (vii) a warehouse; (viii) a mine, an oil or gas well; (ix) a quarry or any other place of extraction of natural resources. If business activities involve insufficient economic activity like preparatory or auxiliary activities within the country in which they occur, it will not constitute PE. A place to be considered as a PE needs to fulfil the following criterion:

i. The physical criterion
ii. The subjective criterion
iii. Functional criterion

4.2 TIE BREAKER RULE

The status of a person as a resident or otherwise shall be determined in accordance with Article 4 of the DTAA. It is possible that a person is resident in two contracting states in a year as per the domestic law of either country. In such a case, an issue arises as to which country shall be entitle to treat the person as a resident for the purpose of levying tax on income. In such situations the tie breaker rule shall apply on the basis of following criterion in a sequential manner:

i. The place of permanent home
ii. The centre of vital interest – economic and personal interest
iii. The place of habitual abode
iv. Nationality
v. Mutual agreement between contracting states

Only if the tie is not resolved by the first criterion then the second shall be applied. Again, only if the second criteria does not resolve, then the third shall apply and so on.

5. CROSS BORDER INVESTMENTS

Cross border investments are happening on a large scale since the implementation of new economic reforms, in terms of inbound investments, non-residents comprising of individuals, various entities including MNCs channelize their investments into India in the form of FDI, FII, FPI, QFI and FVCI. Residents of India making investments outside India by acquiring business or assets form part of outbound investments. On the basis of above mentioned facts, there is a possibility for double taxation of the same income in two jurisdictions.

6. TRENDS IN TAX TREATIES

DTTs are aimed at not only avoiding double taxation but it also paves a way for the exchange of tax information between treaty countries. Treaties also serve the purpose of gaining international economic recognition. Thus bilateral treaties prevent double taxation and tax evasion of residence of one country who earn income in another country. There are several merits and demerits pertaining to tax treaties. On the positive side, DTTs serves to standardize taxable income definitions and jurisdiction between treaty countries, where they are useful in clarifying actual income taxability for multinationals and reducing relating ambiguities. On the negative side there may be a cost associated in negotiating and ratifying the treaties. Some treaty provisions might conflict with domestic tax laws, curtailing national fiscal sovereignty. On the controversial side DTTs help in exchange of tax information between authorities. Such transparency may compromise privacy and trade secret protection apart from the desirable consequence of preventing tax avoidance and tax rate shopping. However, it also suggests that countries and governance with lower tax rates may lose their advantage in attracting foreign business after signing a tax treaty.

6.1 INDIA AND TAX TREATIES

India has signed DTAAs with 93 countries and limited agreements with 8 countries. It provides for the income that would be taxable in either of the contracting states, depending on the understanding of the nations and conditions for taxing and the exemptions from tax. The Union Government has set a key priority area for fighting the menace of black money stashed in offshore accounts. To further this goal India has either signed or amended International agreements, declarations or conventions for the DTAA and prevention of fiscal evasion with respect to taxes in income and EOI with Mauritius, Cyprus and Singapore during the financial year 2016-17.

6.2 TAX RESIDENCY CERTIFICATE

For the purpose of claiming a tax treaty benefit, it is necessary for a person no resident in India to obtain a certificate of it being resident of the other country or specified territory. In this connection, as an additional requirement, the Government of India has notified Form 10F, where in the person has to self-declare prescribed details.

7. KEY HIGHLIGHTS OF TAX TREATIES ENTERED INTO BY INDIA DURING THE FINANCIAL YEAR 2017-18

7.1 CYPRUS

- The new DTAA provides for source based taxation instead of resident based taxation with respect to capital gains arising from alienation of shares with effect from 1st April 2017.
- Revision of provisions regarding the exchange of information between the two countries in order to bring information exchange in line with international standards
- Tax rate on royalty payments has been reduced from the existing rate of 15% to 10% thereby bringing the tax rate I line with that under Indian tax law
- Declassification of Cyprus as a non-cooperative jurisdiction ratifying previous classification made in November 2013 due to its failure to provide information to the Indian tax authorities
- Scope of the term PE has been broadened under the new amendment

7.2 MAURITIUS

- India gets taxation rights on capital gains arising from alienation of shares in accompany resident in India acquired on or after 1st April 2017 and protection of investments made prior to 1st April 2017.
- Tax rates for the transition period from 1st April 2017 to 31st March 2019 will be limited to 50% of India's domestic tax rate. Taxation in India at full domestic rate will take place from financial year 2019-20
- Interest arising in India to Mauritian resident banks will be subject to the withholding tax in India at the rate of 7.5% with respect to debt claims or loans made after 31st March 2017
- Update of EOI, a tool for prevention of fraud or evasion of taxes and assistance in collection in taxes and source based taxation of other income

7.3 SINGAPORE

- Source based taxation of capital gains in DTAA will help to curve revenue lose prevent double no-taxation and streamline the flow of investments
- Two year transition period from April 1st 2017 to March 31st 2019 during which capital gains on shares will be taxed in source country at half the normal rate
- Facilitates relieving of economic double taxation in transfer pricing cases as it is tax payer friendly measure and is in line with India's commitments under BEPS action plan
- Enables application of domestic law and measures concerning prevention of tax avoidance or tax evasion

8. CONCLUSION

A key motivation for entering into DTTs is the elimination of double taxation so as to increase the flow of FDIs flows. Developing economies that are in need of foreign investments may however be exposed to significant cost from the tax exemptions that are made by entering inti DTAAs. Complementing the Governments effort to plug tax evasion ant tax avoidance and its fight against the black money the recent amendments will help curve revenue laws emerging due to round tripping funds and treaty abuse; prevent double non taxation; streamline the flow of investment and stimulate the flow of EOI. It will also help in increasing transparency in tax matters.

Since the implementation of the amendment in a prospective basis, the economy will soak in short term tremors in the foreign investor community looking at India. Considering the certainty attached to the amended tax regime, India will continue to receive good FDI inflows despite the amendments. The Indian economy is now strong enough to depend on any tax incentivized route and will attract more foreign investments in the long run. Stable environments will auger well for the Indian rupee which would make the tax cost look insignificant.

Lastly, although the amendments may have closed few windows for tax exemptions and black money, impish investors will sooner or later find new routes to counter the steps undertaken by the government. Policymakers would therefore need to reassess the competitiveness of India's taxation system periodically.

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