BASICS OF INTERNATIONAL TAX & TAX TREATY

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INTERNATIONAL TAX/TAXATION

Study of

- Taxation of Resident Individuals and corporations on income arising in foreign countries – **Taxation of foreign Income**
- Taxation of Non residents on income arising domestically – **Taxation of Non-Resident**

INTERNATIONAL TAX/TAXATION

In other words

- Taxation of cross-border transactions
- A transaction between two or more persons in two or more tax jurisdictions; or
- A transaction involving a person in one tax jurisdiction with property or income flows in another tax jurisdiction

DTAA – WHY REQUIRED

Double tax

- Juridical double taxation
- Economic double taxation

Results into high tax outflows

THINGS TO KNOW – DOMESTIC LAW

- Section 6 – Residential Status
- Section 5 – Scope of Total Income
- Section 9 – Income deemed to accrue or arise in India
- Other specific provisions for Non-residents
- Section 91

THINGS TO KNOW - DTAA

- UN Model/OECD Model
- Interpretation Rules of DTAA
- Multilateral Instrument (MLI)

DTAA

- A result of negotiation between government of two states
- Not to be interpreted as an Act is being interpreted
- Factors prevailing on the date of entry into DTAA be kept in mind

DTAA APPLICABILITY

- Over a person
- Resident of <u>atleast</u> 1 contracting state – as per domestic law
- If non-resident of both the states – particular DTAA is not applicable
- If resident of both the states – tie breaker rule to be applied
  - Possibility – NR for DTAA, Resident for Domestic Law
  - ITR to be filed – under which status?

DTAA APPLICABILITY

Vs Domestic Law

- Beneficial to assessee?
  - For every contracting state separately
  - Beneficial point of view – taxability, income computation mechanism, tax rate
  - Can section 91 be opted for FTC – if beneficial to assessee vis-à-vis DTAA
- Generally domestic law of a state is wider as compared to DTAA – in respect of coverage of incomes taxable in that state
  - Exceptions – 10(38), agricultural income

BENEFITS OF DTAA

- Avoidance of double taxation
- Benefit under TP regulations
  - Income increased in one country vs decrease in one country
  - Is decrease allowed under TP regulations

MODEL/CONVENTIONS

- OECD Model
  - Favourable for developed countries
- UN Model
  - Favourable for developing countries

KINDS OF DTAA

- Comprehensive Agreements
- Limited Agreements e.g. Pakistan
  - Applicability of S. 91 for incomes not covered up by DTAA
- Tax Information Exchange Agreements (TIEA)

COMPREHENSIVE DTAA

- Permanent Establishment
- Business Profits
- Dividend
- Interest
- Royalty/FTS
- Immovable Property
- Dependent Personal Services
- Independent Personal Services

SCOPE PROVISIONS

- Article 1 - Personal Scope
- Article 2 - Taxes covered
- Article 29 - Entry into force
- Article 30 - Termination

DEFINITIVE PROVISIONS

- Article 3 - General definitions
- Article 4 - Residence
- Article 5 - Permanent establishment

SUBTANTIVE PROVISIONS

- Article 6 – Immovable property
- Article 7 – Business Profits
- Article 8 – Shipping, etc
- Article 10 - Dividends
- Article 11 - Interest
- Article 12 – Royalties & FTS
- Article 13 – Capital gains
- Article 14 – Independent personal services
- Article 15 – Dependent personal services
- Article 16 - Directors
- Article 17 – Artistes and Sports persons
- Article 18 - Pensions
- Article 19 – Government service
- Article 20 - Students
- Article 21 – Other income
- Article 22 - Capital

ANTI - AVOIDANCE

- Article 9 - Associated enterprise
- Article 26 - Exchange of Information

ELIMIONATION OF DOUBLE TAXATION

- Article 23 - Elimination of double taxation
- Article 25 - Mutual agreement

MISCELLANEOUS PROVISIONS

- Article 24 - Non-discrimination
- Article 27 - Diplomats
- Article 28 - Terminal extension

SOME TERMINOLOGIES

Make available clause in case of Royalty

- Relevance of “Make Available Clause” explained in the case of Raymond Ltd. vs. DCIT [86 ITD 791] (Mum)
  - Does not mean mere rendering of services
  - Person utilising the service is able to make use of technical knowledge independently, without recourse to the performer of services in future
  - Transmission of technical knowledge, skill, etc. from person rendering the services to the person utilising the services
  - Technical knowledge, skill, must remain with the person utilising the service even after rendering of services has come to an end

SOME TERMINOLOGIES

Rolling period concept

- DPS
- 183 days or more in 12 months' period ending or starting in year concerned
- S. 10(6)(vi)
  - 90 days allowed

SOME TERMINOLOGIES

Most Favoured Nation (MFN) Clause

- Extends similar benefits to one country as extended to certain other countries
- Ensures non-discrimination between a subset of countries
- Examples of MFN-in terms of
  - Rates of taxes
  - Liability to tax
  - Deductions permissible

SOME TERMINOLOGIES

- Most Favoured Nation (MFN) Clause
  - India-Switzerland

  “In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services), if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD signed after the signature of this Amending Protocol, India limits its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower than the rate provided for in this Agreement on the said items of income, the same rate as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply between both Contracting States under this Agreement as from the date on which such Convention, Agreement or Protocol enters into force.”

SOME TERMINOLOGIES

- Treaty Shopping & Limitation of Benefit Clause
  - India-Mauritius DTAA
  - Taxation of Capital Gains vs Notification vs Hon’ble SC Judgement in the case of Azadi Bachao Andolan v. Union of India

LOB CLAUSE

- Article 27A
  - A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.
  - A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

LOB CLAUSE

- Article 27A
  - 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 Rs. 1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.
  - A resident of a Contracting State is deemed not to be a shell/conduit company if:
    - it is listed on a recognized stock exchange of the Contracting State; or
    - its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

SOME TERMINOLOGIES

- Thin Capitalisation vs S. 94B
- Loan vs capital
- Interest more than 1 cr
- Interest more than 30% of EBITA
- Carry forward for 8 years and claim

ARTICLE 6

- Income from immovable property
  - Primary right to tax has been provided to the state where the property is situated.

ARTICLE 13 – CAPITAL GAINS

Sr No	Nature of property alienated	Right of taxation
1	Immovable property	Country in which property is situated
2	Capital stock/ shares of company, interest in firm, trust estate property of which principally consists of immovable property	County in which property is situated -Principally - > 50% Certain treaties – specifically exclude listed companies
3	Shares (other than those in 2 above) of a company resident in other state	Country in which company is resident
4	Any property forming part of business property of a PE (including on disposal of PE)	Country in which PE is situated
5	Any other property	Country in which alienator is resident

ARTICLE 14 - IPS

- Deals with taxation of income in respect of professional services or other activities of independent character
- Taxable in source state
  - If regular fixed base available in that state or
  - Stay exceeds 183 days in any 12 months period
  - Amount taxable – only amount attributable to fixed base or activities carried out in source state

ARTICLE 21 – OTHER INCOMES

- Income not dealt with any of articles of the treaty
    - Taxable in state in which assessee is resident
- Such income could also be taxed in other State
    - If the Income is effectively connected with right/ property of the PE or fixed base is the other state
    - If the income arises in the other state

RELIEF FROM DOUBLE TAXATION

- Exemption Method
- Credit Method
  - Full credit
  - Partial credit
- Tax sparing

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THANK YOU