# INDIA'S INTERNATIONAL TAXATION REGIME

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**This dissertation is submitted in partial fulfillment of the degree of B.A., LL.B. (Hons.)**

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# DECLARATION

I declare that the dissertation entitled **"India's Regime for International Taxation"** is the outcome of my own work conducted under the supervision of Mr. **Sujith P. Surendran**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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## CERTIFICATE

This is to certify that the research work entitled **"India's Regime for International Taxation"** is the work done by **Mudit Latoriya** under my guidance and supervision for the partial fulfillment of the requirement of B.A., LL.B. (Hons.) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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## ABSTRACT

Amidst a deteriorating economic environment due to multiple factors, certain direct tax related developments during 2012 led to an outcry among the international investor community. US multinational enterprises (MNEs), by virtue of their large presence, joined this chorus, fearing major adverse consequences for the cost of doing business in India. While issues of permanent establishment and transfer pricing under international tax regimes have been a sore point for MNEs for some time, the introduction of the General Anti-Avoidance Rules (GAAR) and retrospective amendments of tax law in 2012 were seen as unprecedented and adversarial for business and industry. Although India's tax policy and law is generally in line with that in other tax jurisdictions, its implementation is not in tune with the international best practices followed by successful tax administrations globally. The Indian government has since taken certain steps to soothe investor sentiment but a lot more needs to be done for India to become an attractive destination for investors in a highly competitive international environment.

With the advent of era of globalization, India has undergone a series of changes in the context of foreign participation and investment. Subsequent to the economic reforms of 1991, which was followed by removal of regulatory and trade restrictions and barriers, India emerged as a pleasing pivot for foreign direct investment. This led to the extension of sphere of business operations giving rise to increase in cross-border transactions.

Among the developing economies, India has adopted liberal mechanism for foreign investment so as to become an attractive hub for FDI. However, the opening of national economy and widening of integration of trade with other nations, have paved way for new obstacles to the current tax regime. The balance between the domestic tax regime and international standards is required in order to promote investment in the financial system of the country.

One of the mechanisms to encourage foreign investment is International Taxation. International Taxation addresses the international features and aspects of income tax laws and regulations of a specific country. Though, India has made significant achievement in lowering its tax structure for foreign investors, yet, there are wide number of issues that are yet to be resolved. They range from aspects of foreign investors engaged in business in India through permanent establishment, the various facets of Double Taxation Agreements, Transfer Pricing, taxing royalties for technical services, and the nature of income accrued. The various aspects of these issues affect the foreign investment and taxation regime in India.

Another issue that affects the international taxation regime of India is the redressal of disputes arising in the context of above-mentioned issues. These disputes take years to resolve owing to the uncertainty of grievance forums, litigation costs, and compliance costs which affects the international growth of the country.

The Income Tax Act, 1961 contains provisions that addresses the transactions that have extra-jurisdictional effect like the incomes that are earned abroad by resident tax payers or incomes that are earned in India by NRI's and foreigners which are taxable in India under specific circumstances.

Therefore, an attempt has been made in the dissertation to address analytically the laws and legislations that govern the taxation regime of foreign investors in India in order to reflect the major consequences, challenges and drawbacks of various issues involved in various components of International Taxation in Indian regime and propose suggestions.

**Key Words**: GARR, Double Taxation Agreements, Transfer Pricing, Taxing Royalties for Technical Services, International Taxation, Tax Avoidance and Evasion

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I sincerely convey my deepest gratitude to my mentor Mr. Sujith P Surendran, who has actively & consistently helped me in the preparation of this Dissertation. He has been the source of motivation and encouragement and the one who generated interest in the specific field.

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## ABBREVIATIONS

AAR – Authority for Advance Ruling

ALP – Arm's Length Price

AMP – Advertising, Marketing and Promotions

AO – Assessing Officer

APA – Advance Pricing Agreement

BC – Business Connection

BEPS – Base Erosion and Profit Shifting

BPO – Business Process Outsourcing

BRIC – Brazil, Russia, India and China

CA – Competent Authority

CBDT – Central Board for Direct Taxes

CFC – Controlled Foreign Company

CIT (A) – Commissioner of Income Tax (Appeals)

CPM – Cost Plus Method

DIT – Directorate of Income Tax

DRP – Dispute Resolution Panel

DTAA – Double Taxation Avoidance Agreement

DTC – Direct Tax Code

FDI – Foreign Direct Investment

FII – Foreign Institutional Investment

FTS – Fee for Technical Services

G20 – Group of 20

GAAR – General Anti-Avoidance Rules

GoI – Government of India

GST – Goods and Services Tax

HMRC – Her Majesty’s Revenue and Customs

IT – Information Technology

ITAT – Income Tax Appellate Tribunal

ITD – Income Tax Department

ITeS – Information Technology

KPO – Knowledge Processing Outsourcing

LO – Liaison Office

LoB – Limitation of Benefits

MAM – Most Appropriate Method

MAP - Mutual Agreement Procedure

MNEs – Multi National Enterprises

OECD - Organisation for Economic Co-operation and Development

PE – Permanent Establishment

R&D – Research and Development

SAAR – Special Anti-Avoidance Rules

TNMM – Transactional Net Margin Method

TP – Transfer Pricing

TRC – Tax Residency Certificate

UN – United Nations

USIBC – United States-India Business Council

## INTRODUCTION

Post the Economic Reforms of 1991; the consequent deduction of rigid trade hindrances, the emergence of India as key player in the universal arena, growing as, a striking venture place for the outside players to invest and foreign institutional investment (FII) and among the top countries in respect of exporting the services. Within the period of two decades, roughly every principal MNC's have their establishment in India, with engagement of qualified Indian workers and employees in working in their companies. However, with the liberalization done in Indian economy, along with further assimilation within the international commerce, has resulted into many challenges faced by the present taxation framework of the country. In addition to it, the legislature and executive, in order to generate fair revenue, also faces difficulty in balancing the parameters of national taxation framework with that of the international principles. This issue is crucial in the sense, that such minimizes the gaps in the taxation system along with promotion of investment in the country.

Although, India has taken significant measures in reducing the taxing rates, thus, making the taxation framework friendlier, many problems still exists to be resolved. These problems have been intensified with establishment of intricate corporate frameworks, and introduction of complex policies in trade and commerce. These problems ranges from the issue whether any foreign corporate entity is operating in the country via temporary establishment, or the nature of profits accrued via these operations, or the issue of characterizing such profits as royalty or sum paid for providing technical facilities, to the issue of application of rules of transfer pricing on the products purchased or sold. Such problems arisen have affected roughly every MNEs, which also involves foreign occupant entities. Such problems has resulted into various taxation conflicts whereby such conflicts take long time to get resolved, thus, increasing the litigation expenses incurred by enterprises. Furthermore, the large number of unresolved conflicts has resulted into uncertainty in the taxation structure of int. enterprises, thereby portraying

India as non-friendly venture place which severely affect its competitive rank in global marketplace. [1]

“While the Government of India has repetitively promised a stable and non-adversarial tax system on public platforms, frequent legal changes as well as varied and inconsistent interpretation of laws by the taxation administration have proved to be deterrent for business entities looking to invest in India. From retrospective changes in tax laws to an aggressive stand on transfer pricing (TP) and the hasty introduction of the General Anti-Avoidance Rules (GAAR), the Indian government and tax administration has been on an overdrive to increase revenue collection to meet its annual targets. This tough pro-revenue positioning by the government has created ambiguity and volatility for a foreign investor looking to invest and capitalise on the high growth potential of the Indian market comprising more than 1.2 billion people; the need is to design stout taxation systems attractive to international investors while at the same time meeting their own revenue goals.”

Many developed economies attempts to confine the taxation related conflicts by introducing unambiguous policies and schemes in the field of taxation legislations. In addition to it, to curb litigation expenses, the tax authorities are empowered with more power so as to resolve the taxation conflicts as soon as possible. In order to make the dispute resolution framework to work effectively, other developing economies base their taxation framework on the standards and customs which are adopted by developed economies. Countries like Brazil, Indonesia have successfully achieved the aims and targets of an efficient taxation framework by conquering the taxation related obstacles attached with dispute resolution. While on the other hand, the taxation regime of India, though by introducing various considerable alterations in its dispute resolution framework with the global standards have not succeeded in achieving the desired key outcomes.

Many a times, it is brought to notice that, a subjective loom is adopted by taxation authorities. This includes the subjective construction, implementation and application of

[1] R.R. Singh, *India’s Investment Climate: Addressing Concerns about Tax Policy,* (2014) available at http://icrier.org/ICRIER_Wadhwani/Index_files/India's_Investment_Climate.pdf”, (March 01, 2016)

taxation related legislations, which creates challenges in decision-making procedure. The authorities are often said to be unfavourable towards the taxpayers and frequently introduce schemes without taking any suggestions from the sector. This results into difficulty for various enterprises and as such creates a cut off in the enforcement of taxation provisions and the schemes formulated by govt.

Furthermore, it is often the notion that taxation authorities are not trustworthy towards the taxpayers. “The World Bank study report on Doing Business (2014) ranks India at a dismal low of 158 in 'ease of paying taxes' parameter out of 189 countries. India ranks well below other BRICS countries – China (91), Russia (112), and Brazil (130) – and also below many OECD countries like South Korea (8), Sweden (13) and Mexico (48).”

In its report of 2008, Ernst & Young notes that India's current policy on international tax treaty mirrors positions that were considered apposite when it was an importer of capital, with limited cross-border trade. But gradually this image is in its phase of changeover. India is now budding as both an importer and exporter of the capital. This in result has rendered the current models of tax treaties as obsolete.[2]

There in doubt that India need to change its tax laws and administrative procedure for cross border transaction in order to bring in equity, transparency and fairness. Such fairness and transparency may be attained through installation of modern automated techniques, speedy dispute resolution mechanism and quality of information provided. A technology-driven tax administration will reduce the complication of doing business and will also reduce the cost of compliance to taxpayers as well as the administrative cost of and to the administration.

The USIBC, in the US as well as in India, has many times pointed out the tax related concerns of US MNCs. Most US-resident companies with operations and businesses in India face scrutiny and audit by tax authorities. US companies have raised their voice against the Indian tax authorities and the makers of the schemes whereby it was brought to notice that such prolongation of the issues, often leads to hampering of investments.

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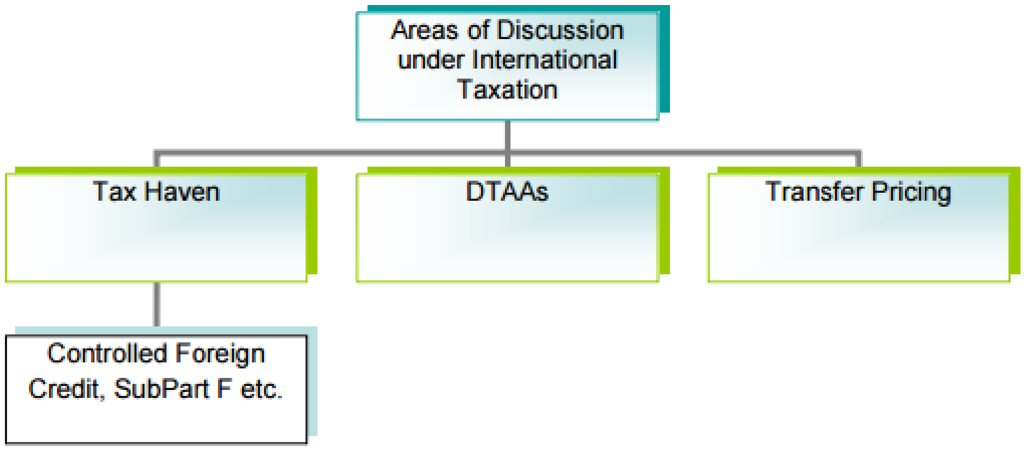
[2] OECD Report, *Action Plan on Base Erosion and Profit Shifting*, (2013), available at http://dx.doi.org/10.1787/9789264202719-en accessed on 01.03.2016

Aligned with these conditions, this dissertation elucidates five critical concerns in respect of Indian taxation environment which needs to be resolved.[3]




This dissertation is set accordingly in the given way: Chapter II attempts to give explanation on concept of DTAA in context with International Taxation in India and issued related therewith; Chapter III discusses the various facets of transfer pricing, which acts as a component of International taxation regime in India. The salient features, provisions related with it, penalties and other controversial issues in context of transfer pricing along with the recent developments have been analytically dealt with; Chapter IV examines the contentious aspect of international taxation, i.e., taxing royalties and fees for technical services. The laws and regulations under the Income Tax Act, OECD, DTAAS, and UN conventions have been analyzed in detail.; Chapter V addressed the issue of Tax Evasion and avoidance by means of tax havens in Indian taxation regime.; Chapter VI addresses the benefits and problems of such wide scope, this chapter deals with the different modes and mechanism adopted to tackle with the various disputes arising in context of international taxation in India.  ; And Chapter VII addresses the challenges and drawbacks of different components of laws and regulations that govern the taxation of foreign companies in India.

[3]supra note. 1

# RESEARCH METHODOLOGY

## STATEMENT OF PROBLEM

India is the second most populous country in the world which has an increasing rate of domestic consumption making it an important market for investors. India's market is an important target for foreign investors but because of several factors including the fiscal regime that regulates and governs the taxation for foreign investors is not adequate, the investors are reluctant to invest in India.

India needs foreign investment for infrastructure and overall development. The taxation regime of a country is an important factor in attracting foreign investment; in India, it is not adequate enough to make it an investor friendly nation. The research would focus on the lacunas in the existing regime and would propose suggestions to make India's market an investor hub.

## OBJECTIVES

The purpose of this dissertation is to identify and study the laws that regulate the taxation regime for the foreign companies that want to trade or do business in India. This dissertation would also focus on the lacunas in the existing taxation regime in India and would propose suggestions to make it more investor friendly.

The dissertation would explain the different types of taxes imposed on a foreign company trading in India and the modes of taxation with the help of few case studies and the relevant treaties that India had signed.

## SCOPE AND SIGNIFICANCE OF STUDY

- Domestic Legal Framework for International Taxation in India.
- Practical Issues and Challenges in International Taxation In India with special focus on:
    - ❖ Double Taxation and Related Treaties
    - ❖ Transfer Pricing and Relevant laws in India
    - ❖ International Taxation for Royalty and Fees for Technical Services and related laws in India.

- ❖ International Tax Avoidance and Evasion and related domestic laws and treaties.
- Relevant Treaties pertaining to International Taxation India and Dispute Resolution Mechanism pertaining to International Taxation in India
- Analyse the lacunas in the existing legal framework and Propose suggestion to make it more investor friendly.

**RESEARCH QUESTIONS**

Whether the national laws in India and the relevant treaties that regulate the International Taxation in India are investor friendly?

a. Whether the national laws in India that regulates or govern the taxation regime for foreign companies that want to trade or do business in India are investor friendly?
b. Whether the treaties that India had signed for regulation of taxation for foreign companies trading or willing to do business in India would promote investment in India?
c. What are the lacunas in the existing taxation regime for foreign companies in India keeping in view to attract investors?

The Dissertation would focus on the study of the taxation regime for foreign companies in India, understand the lacunas in the existing regime and propose suggestions to make it more investor friendly.

**HYPOTHESIS**

India lacks foreign investment for its Infrastructural and overall development because of India's taxation regime since it is one of the factor to attract foreign investment in India.

**METHODOLOGY**

The nature of research is purely doctrinal which involve analysis of existing statutory provisions and cases laws as well as analytical methodology is opted to carry out study relying mainly on secondary data which includes journals, articles, commentaries, textbooks, reference books, internet sources, e-books, committee and law commission reports. Citation method used is Bluebook 19$^{th}$ Edition.

The methodology is adopted, as there are already voluminous literatures and research works available on the particular topic that could come handy in bringing reforms in capital market vis-à-vis investor protection regime. Further, the research methodology is futile because the objective of this dissertation is to analyse the existing legal framework pertaining to investor protection in Indian Capital Market (both primary and secondary market) and to analyse the challenges faced by the investor protection regime therein.

For the mentioned purpose, the Researcher will analyse the existing legislative provisions, decided judgment, scholarly articles and comments on various areas connected with the issue. Researcher has collected materials from various sources i.e. primary as well as secondary sources available at the UPES Library and UPES online e-resources database.

**LITERATURE REVIEW**

1. **R.R. Singh & Neetika Kaushal Nagpal, *Report on India's Investment Climate : Addressing Concerns about Tax Policy*, Indian Council for Research on International Economic Relations(2014)**

   India's taxation regime is in consonance with of other taxing countries yet, its execution is not in line with the international best practices which are adopted by other booming tax administrations at international level. In light of this, the report examines the existing Indian laws and regulations that govern the foreign companies in India. The authors have analysed the different components of international tax regimes embodying DTAAs, Transfer pricing, GAAR along with its challenges and drawbacks.

2. **Ray, Sarbapriya, *A Close Look into Double Taxation Avoidance Agreements with India: Some Relevant Issues in International Taxation,* 2 International Affairs and Global Strategy(2011)**

   With the increase in cross-border transactions, the scope of trade and investments via interaction among nations has increased. The domain of business operations has increased, not limiting itself to the domestic nation but encompassing in itself the international trade and commerce. In light of this, this paper has examines the different components of bilateral Double taxation Avoidance Agreements (DTAAs) taking in special consideration of India's network of DTAAs. It has also analysed the different issues and controversies that has arisen in context of double taxation avoidance agreements with India.

3. **Gupta, Sayantan, *'Transfer Pricing' - An International Taxation Issue Concerning the Balance of Interest Between the Tax Payer and Tax Administrator*, Company Law Journal,(2009)**

   Transfer pricing (TP) is a mechanism used to restrain tax avoidance by controlling prices issued on intra-group cross-border transactions in order to elevate the taxable profits in low tax countries and decrease such profits in high tax jurisdictions. The author has examined the salient features of this mechanism along with its different facets. The paper also addresses the disputes, issues and the challenges faced in context of Transfer pricing along with the recent developments made in this mechanism.

4. **Victor Thuronyi, *Tax Law Design and Drafting* 1 (1996)**

   The book addresses the growth of tax laws and legislations in context of different countries. It emphasizes on the development of tax legislation in various developing countries with the aid of IMF Legal Department's and also throws light on the growth of practical guidelines that have evolved with time from the experience of IMF legal department and its officials and their advisors. The author has addressed a broad number of topics, ranging from the legal structure for taxation to Value Added Tax, and also emphasizing on specialized topics such as inflation adjustment, amortization, fiscal transparency.

5. **G.V.Satya Sekhar, *Modus operandi of double taxation avoidance: a select country wise analysis*, 1 SPC ERA International Journal of Law and Governance (2013).**

   The author has addressed the various facets of the double tax avoidance agreements taking in special consideration of India's tax regime considering

DTAA as one of the most important tool of tax coordination. The chapter further throws light on the different issues, challenges and drawbacks that arises in context of double taxation avoidance agreements with India. The article has been analysed in the light of guidelines of the Organization for Economic Co-operation and Development (OECD) adopted in various countries and the current scenario that prevails in India.

6. **Michael S. Lebovitz & Theodore P. Seto,** ***Preface: The Fundamental Problem of International Taxation,*** **23 Loy. L.A. Int'l & Comp. L.Rev. 529 (2001).**
   The article reflects the different perspective of International Law in comparative law perspective. Further, the authors have analyzed the different legislations that govern international taxation in different countries. The authors have addressed the challenges, and drawbacks that arise in context of International Taxation in many developing and transition countries. The article attempts to provide an insight to the complexities and intricacies that are attached with the concept of International Taxation.

7. **William B. Baker,** ***An International Tax System for Emerging Economies, Tax Sparing , And Development : It is all about Source*****, 29 U. Pa.J.Int'l L (2007).**
   The article emphasizes on the source tax system for emerging economies showcasing the growth and development of capital and technologies along with the proposal for tackling with the issue of tax avoidance and evasion. The concept of Free trade has removed the barriers of trade and commerce among different countries, thus, widening the interaction among nations and rendering territorial notion of source taxation outdated. In the light of this, the author has addressed the interplay of tax systems of developed and emerging economies.

8. **Aaron S. Edlin & Stefan Reichelstein,** ***Specific Investment Under Negotiated Transfer Pricing: An Efficiency Result,*** **70 Accounting Review (1995)**
   The article discusses the various facets of international business tax base. Emphasizing on the structural flaws that is attached with the transfer pricing rules,

the article throws light on the problems and challenges that arise in the context of international division of business income tax base. The authors have further analysed the possible solutions that could be adopted in order to curb tax evasion taking is special consideration of transfer pricing tax avoidance.

9. **Ansari Jamshed,** ***Approach of Supreme Court in Double Taxation Relief in India. Researcher*** **2014 (ISSN: 1553-9865)**
The author has critically examined the perspective of Supreme Court in Double Taxation Relief in India. The different aspects of Double Taxation Regime have been addressed in light of changing approaches of the Supreme Court before and after the liberalization era. The author has also discussed in length, the challenges and drawbacks to Double Taxation Avoidance agreement taking in special consideration of DTAA signed between India and Mauritius in context of its abuse by the "treaty shopping" for the purpose of tax evasion.

10. **Abhinav Kumar & Devanshu Sajlan,** ***The limitation of Benefits Clause in Double Taxation Avoidance Agreements*****, Tax R. Int'L (2013)**
The author has analytically examined the issue of 'Limitation of Benefits' clause in the context of Double Taxation Avoidance Agreement. The article throws light on the necessity of Limitation of Benefits Clause in DTAA's in order to limt revenue loss. The author has attempted to address the drawbacks and challenges that a country may face in adoption of a 'limitation of benefits' clause in a Double Taxation Avoidance Agreement. The author has further dealt in length the arguments that favour the concept of 'treaty shopping' and the arguments that are against it.

# CHAPTER I

## 1. INTERNATIONAL TAXATION: CONCEPT OF DTAA

### 1.1. INTRODUCTION

In the present period of cross-border exchanges over the globe, the impact of tax collection is one of the imperative contemplations for any exchange and investment choice in different nations. A standout amongst the most after effects of globalization is the obvious effect of one nation's local assessment arrangements on the economy of another nation. This has prompted the requirement for persistently surveying the assessment administrations of different nations and achieving fundamental changes. Therefore, the result of taxation is one of the essential contemplations for any exchange and venture choice in other nations.

Fiscal authority is one of the most protected spheres of jurisdiction in India. Hence, even in times when economies are progressing worldwide and fringes are vanishing, prompting speedy development of merchandise, administrations and finance, double taxation is one of the real hindrances to the advancement of nation's monetary prospects. India is mostly compelled to arrange and negotiate the cases of different countries inside of their vigorously shielded fiscal authority by the medium for double taxation avoidance agreements, keeping in mind the end goal of cutting down the obstacles to worldwide trade.[4]

International double taxation happens when the same subject matter is charged upon the same citizen by two or more states. Generally, double taxation emerges in light of the fact that states charge not just residential resources and exchanges yet, likewise resources and exchanges in different states which give advantage to occupant citizens, bringing about the overlapping of the country's tax claims. Respective double tax bargains or treaties address and decrease the degree of this double taxation. The adequacy of this treaty approach, be that as it may, relies on upon regular and workable construction of the settlement terms.

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[4]C. Devarajan, Direct Tax Laws (2nd ed.,2009), available at http://dl4a.org/uploads/pdf/dt2.pdf, accessed on 01.03.2016

Where an assessee is inhabitant in different country yet has a pay emerging in different country it offers rise to possible tax assessment at two distinct wards. These outcomes from two essential standards which offer power to two states to tax likewise, the country where the wellspring of wage exists to push tax, to be specific (i) the source rule and (ii) the home principle or the tenet of habitation.[5]

The rule of origin states that the profit or gain is to be assessed and taxed in the nation where such profit emerges inspite of the fact that the profit accumulate to an habitant or a non-inhabitant while the principle of residence prescribes that the ability to assess and taxation ought to rest with the nation where assessee lives. If the two standards are to be applied at the same time to a business element and it were to endure charge at both closures, the expense of working on a worldwide scale would amount to be restrictive which leads to hinder the pace of globalization. It is from this perspective that (DTAA) turn out to be exceptionally critical. [6]

Accordingly, International double taxation adversely affects the exchange and benefits and on development of capital and individuals. Tax assessment on the same incidence of profit by the more than two nations puts restrictive load on the citizen.

The domestic legislation of many nations, India being no exception, alleviates such trouble through the application unilateral remedy in appreciation of this pay which is taxed twice. In any case as such cannot be an acceptable arrangement with regard to the divergence in the principles and rules for ascertaining incomes in different nations, the tax assessment treaties attempt to evacuate charge impediments that restrain exchange and benefits and development of economy and citizens of the nations affected. This would assist in enhancing the sphere of investment. [7]

The double taxation (additionally known as Double Taxation Avoidance Agreements) came under the sphere of public international law and represented by the standards

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[5]Rahul Ranjan, *Critical Analysis of The Concept of Double Taxation Avoidance Agreement under The Income Tax Act, 1961,* 2 NDIAN JOURNAL OF LEGAL PHILOSOPHY, (2014),available at http://www.ijlp.in/ijlp/imageS/Volume-%202%20Issue-3%20Sep-14.pdf accessed on 01.03.2016.

[6]R. Santhanam, Handbook on Double Taxation Avoidance Agreements & Tax Planning for Collaborations, (5th Edn. 2001).

[7]Sec. 91 of Income Tax Act, 1961.

provided under VCLT, 1969. This has been a legitimate concern for all nations to guarantee that undue taxation rate is not cast on persons taxing so as to tax them twice, once in the nation of residence and again in the nation where the pay is determined. In the meantime adequate safety measures are additionally expected to be made to prevent evasion of tax and to encourage tax collection and recoveries.

In perspective of the above discourse, the chapter endeavours to assess different aspects of bilateral Double Tax Avoidance Agreements (DTAAs) with specific reference to India's system of DTAAs as a tax organization device utilized by countries to disseminate rights to assess diverse bases in the worldwide monetary commons.

Double Assessment of Taxation is imposition of taxation on the same income for two more than two times. It alludes to common incidence of taxation by more than one nation on the same wage, resource or exchange, for instance wage granted by an element of one nation to an inhabitant of an alternate nation. The double risk is regularly moderated by tax arrangements or treaties between countries. [8]

DTAA represent contracts or treaties signed by two sovereign nations. These Agreements can be signed by two nations that are not "sovereign" nations in the complete legitimate meaning. It is valuable to come up with a model agreement for double taxation. The League of Nations interestingly initiated effort for such benefit in the year 1921 and developed in the year 1928 the primary Model Convention for double taxation.

This makes it one of rare situation for a company or an individual who is inhabitant in different nation to make an income assessable in different. At times, it contemplates that taxes should be paid nation of residence of assesse rather than nation where the income is generated. In the other cases where the tax has been deducted at source by the nation where the income is generated such income may be exempted from taxation in the nation of residence. [9]

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[8]"E.L. Guruli, *International Taxation: Application of Source Rules to Income from Intangible Property*, 5 HOUS. BUS. & TAX L.J. 204 (2005)."

[9]"Sarbapriya Ray,*Close Look into Double Taxation Avoidance Agreements withIndia: Some Relevant Issues in International Taxation*, (2011), available at www.iiste.org/Journals/index.php/IAGS/article/download/1064/984, accessed on 01.03.2016."

Double Taxation is not particularly prohibited either under treaties or the residential law. Bilateral double taxation bargains in the way of treaties have a tendency to dodge taxation on same incidence more than once, yet in case, tax break conceded by one state are wiped out by the other without a particular clause or provision in the agreement in this regard, there is a monetary burden, which is not forbidden generally, a rule which has been generally acknowledged.

With respect to the modern setting, an exchange is not generally limited to two nations, in view of addition of value in two or more nations, common or in view of arrangements. DTAA does not take care of the problems of taxation that arises in cross border transactions in more than two nations.[10]

The idea of double taxation has been one of the fiscal issue in the consideration of the courts not only in India and but also in abroad. In *Laxmipat Singhnia v. CIT*[11], the Supreme Court has explicitly stated that this is a fundamental guideline of the tax laws that except when the generally stated income can't be assessed more than once. Further, the Income Tax Officer cannot avoid the accumulation, in the event, where such profit or gain of the assessee is subjected to be included in the aggregate profits or gains of a specific year, and thereafter to be assessed and taxed as the income of one more year on the premise of receipt.

This guideline articulated by the Supreme Court has likewise been given statutory acknowledgment in the Income Tax Act by way of the provisions ‘Explanation 2 to Section 5’ of the Income Tax Act.

A different branch in the law of taxation has been developed in India after various DTAAs signed between India and few outside nations. The explanation behind these Agreements to originate and to be entered into was because of situations where a man having origin of income in India was the inhabitant of another nation.[12]

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[10]"Government of India, Ministry of External Affairs, *Report on India in Business: Investment: Other taxes: Double Taxation in India*,(2010), available at http://www.indiainbusiness.nic.in/investment/double_tax.htm, , accessed on 01.03.2016."
[11](1969) 72 ITR 291 (SC)
[12]"Government of India, Income Tax Department (no date) Income Tax Department web page at

These agreements accommodate remedy from the double taxation with regard to incomes by providing exclusion and furthermore by giving credits for duties paid in one of the nations. These treaties rests on the general standards set down in the model draft of the Association for Economic Cooperation and Development (OECD) with suitable changes as consented to by the other contracting nations. If there should arise an occurrence of nations with which India has double taxation evasion agreements, the expense rates are dictated by such agreements.[13]

Distinctive methods of maintaining a strategic distance from/limitation double taxation have been developed on account of various sorts of income. Certain incomes, for instance, income by means of interest might be assessed in both states. While the general principle is that the nation of which the assessee is an occupant has the privilege to demand assess, the source or Origin State would likewise also have the privilege to require charge yet at a greatest allowable proportion.

For each situation of collaboration agreement subsequent to the exchanges between the entities which include dealings in more than one nation, the assessment laws of both the nations must be taken into record to decide the effect of the levy of tax in one nation on the assess or tax payable in the other nation in admiration of the income, benefits or gains. The strategy of double taxation alleviation is most noteworthy in the connection of appropriate tax schemes in connection to collaboration agreements and arrangements as the absence of appropriate consideration to secure that the same income does not draw burden of tax in more than one nation may put the citizens at extensive limitation.[14]

Further, the tax laws in the vast majority of the developing nations, every now and then, experience considerable changes and furthermore, it turns out to be to a great degree troublesome for the taxpayers to adjust the terms of the collaboration agreements to get the same understanding with the adjustments in the monetary laws. One of the unavoidable thing confronted by taxpayers, is the retrospective amendments, the tax burden emerging from these amendments to the law puts the assessee in either nation at

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http://law.incometaxindia.gov.in/DIT/File_opener.aspx?fn=http://law.incometaxindia.gov.in/Directtaxlaws/dtrr2005/R10.htm accessed on 01.03.2016."

[13]"http://www.itatonline.org/interpretation/interpretation17.php, visited on 01.03.2016."

[14]*Id*

significant burden other than making it impracticable for them to recover the situation. The constitution of India has given the sovereign energy to impose taxes and to authorize gathering and recuperation thereof on the State under Article 265 by obligatorily giving that no tax should be imposed or gathered with the exception of by power of law. In like manner, the Union of India is engaged to go into treaties and agreements with remote nations and in this falls the extension of the force of the Union of India to go into Double Taxation Avoidance Agreements.[15]

With the end goal of DTAA, the sourced income is the income generated at the place of residence of assesse. Both the nations might want to assess the income of a man emerging from the same exchange, on the grounds that the craving of a nation for taxation can never be fulfilled. That is the place where the DTAA becomes an integral factor. It might vest right to charge a specific sort of income in one of the challenging States. A privilege to impose a specific income under the DTAA might rely on upon specific conditions. For instance, business income is for the most part assessable in the source state if the undertaking has a permanent foundation therein.[16]

### 1.2. HISTORICAL DEVELOPMENT

Origin of Double Tax Avoidance Agreement is, maybe, the initial move towards a law, which might at last prompt a global society. Agreements between neighbourly States more often take place in the sphere of non-aggression, exchanging and trade of data among them.

Public international law is the law by assent. The objective of public international law is to regulate or control the behavior of nation state as it has been the aim of academician to bring peace in the world through international law. In any case, international law has, by far, been signifying an arrangement of standards and, customary principles of behaviour, which are relied upon to control the relations between cultured nations.

[15] "R. Santhanam, Handbook on *Double Taxation Avoidance Agreements & Tax Planning for Collaborations*, (5th Edn. 2001), at p. 464."
[16] *I*d., at 14

JagarmadhaRao, J., in an exemplary judgment in *C.I. T. v. Vishakhapatnam Port Trust*,[17]had alluded to the significant advancements in the sphere of tax treaties. In this situation, the assesse was itself a Government undertaking involved in trading business with a non-inhabitant German Company. It had attempted to setup a plant in India and the issue identified related to the degree of non-inhabitants' Indian income accountable to Indian tax and the ramifications of the Double Tax Avoidance Agreement as in the middle of India and Germany. The judgment, by the way, alludes to the improvement of law on DTAA, which have themselves experienced different changes. Model structures appropriate to all nations were initially arranged by the monetary advisory group of the League of Nations in 1927. Later the said group directed gatherings at Mexico amid 1943 and in London in 1946, and projected a few minor variations.

Although the OECD conventions is applicable on contracting parties but it has been looked up by non-members for connected matters. There is UN Model Convention in addition to the OECD convention. A resolution was passed by Economic and Social Council of the U.N. in August 1967 which was thereafter published as Model Double Taxation Convention in 1980, among developing and developed nations. Like all laws, global taxation laws, advancing through way of relief from DTAA, with some of them either joined or generally incorporated in local law, is progressive, and is quickly experiencing changes with improvements in exchange, new strategies for correspondence, particularly the laws identifying with contract and sales of merchandise.[18]

The DTAA has been altered each time such agreements have been entered into between different nations. Recently India has loosen its barriers related to trade, as an after-effect of its universal responsibilities, so that international taxation has turned out to be more significant than it turned out for Indian exchange, not just for the individuals as exporters or shippers but also as a result of the effect of universal exchange and international business on domestic cost of services and products, since tax is an expense and a huge

[17]144 ITR 146

[18] "Das-Gupta, Arindam, *Economic Analysis of India's Double Avoidance of taxation Agreements*, (2010),available at http://dx.doi.org/10.2139/ssrn.16329 , accessed on 05.03.2016."

expense at that. Elucidation of DTAA has an impact on evaluating strategy as well as on the business choices of occupants in undertaking international exchanges. [19]

Double taxation treaties alongside alternate laws identifying with company law and movement arrangement, strategy identifying with outside ventures assume a noteworthy part in globalization. Double tax settlements falls under taxation regime of international law, however a huge part of the same the length of both nations have their own arrangement of taxation, whether limited to the income emerging within its jurisdiction or on worldwide income of its residents. There are concurred rates of tax and jurisdiction on determined sorts of income emerging in a nation to a tax inhabitant of another country. There are provisions under Income Tax Act which provides remedy to the taxpayer from double taxation under section 91 and section 91 of the Act. Section 90 deals with taxes paid by an assessed in nation with India has marked DTAA, while Section 91 gives alleviation to assesses who have discharge tax liability to a nation with which India has not marked a DTAA. Subsequently, India offers help to both sorts of payers.

### 1.2.1. ANALYSIS OF THE PROVISIONS RELATING TO DTAA UNDER THE INCOME TAX ACT, 1961

**Section 90:-** This provision engages the Central Government to enter in to concurrence with foreign nations for providing remedy from double taxation or for the evasion of double taxation. Within the limits of the powers by the corresponding section in the 1922 Act and by this provision, agreements with numerous nations have been gone into for alleviation against or evasion of double taxation. As respects income which accumulates to an inhabitant of India, in a nation with which there is no such understanding or agreement, remedy is given by section 91 of the Act."

Extent of sub-section (1): The four provisions in sub-section (1) set out the extent of force of the Central Government to enter in to concurrence with another nation.

[19]"Dianna Lane, *Australia's Double Taxation Avoidance Agreements: Gains from the sale of shares by Nonresidents, 2* Journal of Australian Taxation,(1999)."

Clause (a) considers circumstances where tax has as of now been paid on the same income in both nations and it authorizes the Central to concede remedy in cases of such double taxation.

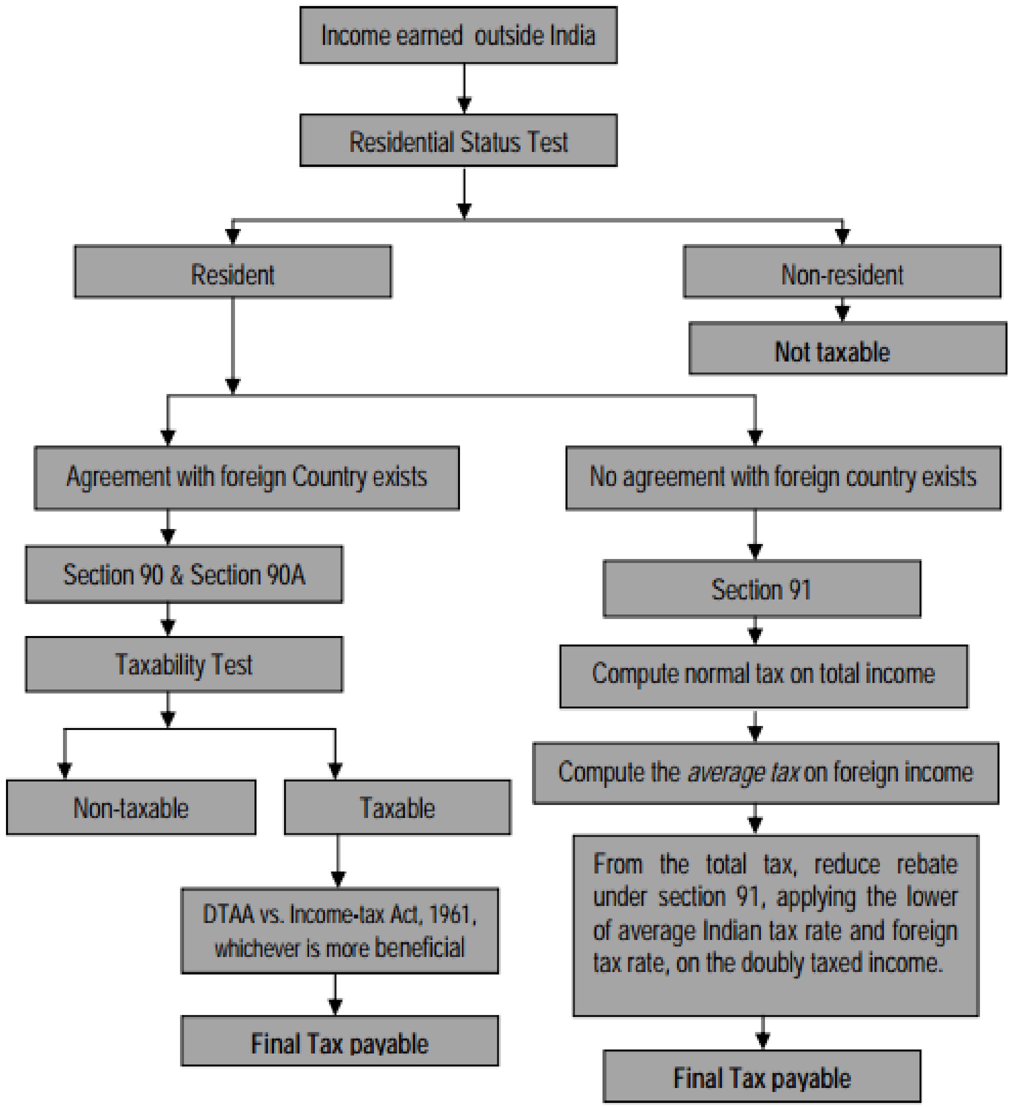
Clause (b), which is more extensive than provision (a), gives that an understanding i.e., agreement might be made for the 'evasion of double taxation of income under this Act and under the corresponding law, in force in that nation'. This proviso can't be stretched out to make provisions in agreements for circumstances not relating to double taxation.

Clause (a) has been substituted, with effect from April 2004, to give that an agreement might likewise be gone into for providing of alleviation in admiration of income tax chargeable under this Act and under the corresponding law in force in that nation; to advance shared financial relations, exchange and investment.

The central government is now empowered under the new amendment to sign the agreements for evasion of double taxation and exempt certain Incomes from taxation.

In can be inferred from the statement that such power shall be exercised to grant alleviation as a part of appreciation of income tax, and not to make any crisp taxes, commitment or responsibility. [20]

[20] Sec.90, Income Tax Act, 1961




**Taxing Foreign Income**

**Source: The Institute of Chartered Accountants of India**

### 1.2.2. IMPACT OF AGREEMENT

The agreement's effect made according to this section as in under -

i. If no tax obligation is levied under this Act, the issue of availing the agreement would not emerge. No provision of the understanding can secure A tax obligation under the agreement would not arise when there is no liability under the Act.

ii. If a tax obligation is levied by this Act, the agreement might be turned to for mitigating or eliminating it.

iii. If there arises an occurrence of contrast between the provisions of the Act and the agreement made according to section 90, the provisions of the agreement beat the provisions of the Act and can thereby, the courts and appellate authorities can enforce as such. However, as per sub-section (2), whichever provisions are more advantageous to the assesse ill apply.

It is fundamental principle of law to look into the laws of taxation in case the agreement does not set out any specific provision. If the DTAA sets out specific method for computation of income, it shall be taken into account, independent of the provisions of the Taxation statute. Hence, the proviso has been added under section 4 and section 5 of the Act, which defines the 'all out income' for residents and non-residents, and the proviso is not only applicable to these sections but on the agreements made thereunder.

### 1.2.3. RELIEF AGAINST EVASION

On the off chance that the concurrence with the foreign nation is under condition:

(a) for remedy against double taxation and not fall under provision,

(b) for the evasion of double taxation,

The assesse must be able to establish that he has been taxed more than once on the same income in two different nations. The assesse would not qualify for the relief of double taxation, if he has not paid taxes but the royalty fee in the foreign nation. If the tax has been overpaid in the remote nation and the abundance is reimbursed to the assessee later when the rate of currency exchange has been modified in computing the double taxation alleviation, the department can't consider such adjustment in the exchange rate. [21]

[21]"United Nations, *United Nations Model Double Taxation Convention Between Developed and Developing Countries, Articles and Commentary,* (2009) available at http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002084.pdf , accessed on 06.03.2016."

### 1.2.4. ISSUE OF VALIDITY OF AGREEMENTS MADE UNDER THIS SECTION

India is a sovereign republic as perceived by the preamble to the Constitution of India and this influence is passionately ensured by keeping the sovereign power concerning entering into agreement with remote countries under this authority granted by the constitution. Under section 14 to the Union List, the matter included is 'entering into arrangements and agreements with remote nations and usage of bargains, traditions and agreements with outside countries'.[22]

In like manner, the unique power of the Parliament to make laws concerning going into agreements and understandings is extensive and impressively, incorporates the power to control in such way in the field of tax collection and income. This specific power has been exercised by the Parliament by instituting section 90 of the IT Act, 1961. Under section 90, the Parliament has selected to the Central Government the capacity to go into an "agreement" with the Government of whatever other country, and by notice in the Official Gazette make such procurements as may be crucial for executing the Agreement.

The power under this section is to be exercised with the deciding objective of 'evasion of double taxation' or for granting alleviation where double taxation has successfully happened. The Central Government in this way, needs to sit tight inside of the parameters of the powers granted to it, and can't overlook them. The degree of clause (a) of sub-section (1) has now been stretched out with effect from April 2004, and questions in regards to the authenticity of an understanding which relate to a period after that date must be seen, in the association of the new more broad power introduced upon the Central Government.

In *U.O.I v. Azadi Bachao Andolan*[23], the Supreme Court, comprehensively considered this section, and, has made, inter alia, the following perceptions:

i. An agent (in this situation, the Central Government) of the law making body can practice the power of exception in a monetary statute.

[22]CIT V. Burmah Oil 47 ITR 25
[23]263 ITR 706

ii. The legitimacy of the agreement falling under this section is to be determined by ascertaining whether it is within the parameters of the authoritative procurement.
iii. The principles governing the interpretation of settlements are not the same as those governing the interpretation of statutory language.

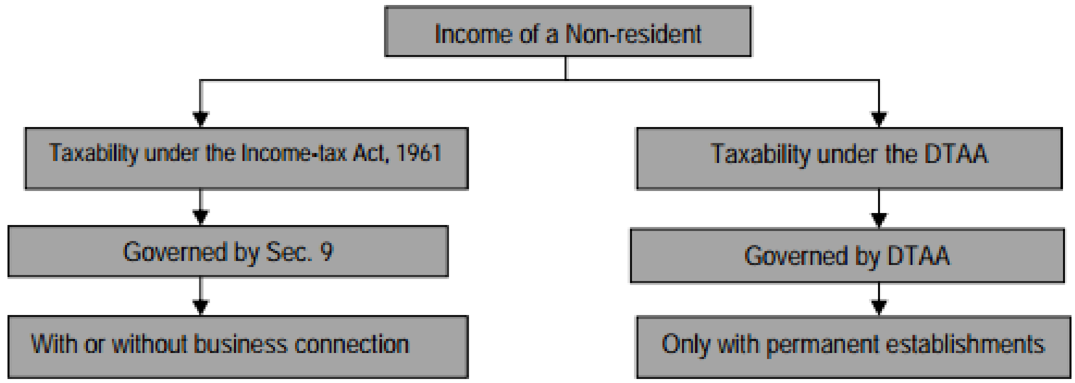
This provision has not authorized the Central Government to go into a concurrence with retrospective effect. The Bombay High Court in *CIT v. Tata Iron*[24] maintained the perspective that an agreement for the evasion of double taxation can't make a difference retrospectively nor would it be able to apply to contracts executed before the date of the agreement.

**"Section 91: Unilateral Relief in respect of Foreign Income Taxed Abroad":-**

"Sub-section (1) of this section grants unilateral relief in cases-where section 90 does not apply, subject to the fulfilment of the following conditions:

a) The assesse should be the resident in India in the previous year;
b) The income should have accrued in fact outside India and should not be deemed under any provision of this Act to accrue in India;
c) The income should be taxed both in India and in a foreign country with which India has no agreement for relief against or avoidance of double taxation;
d) The assesse should have in fact paid the tax in such foreign country by deduction or otherwise."[25]

[24]62 ITJ 17
[25]Sec.91, Income Tax Act, 1961




**Source: The Institute of Chartered Accountants of India**

In *Gamman India v. CIT*[26], the Bombay High Court held that alleviation under Sec. 91 couldn't be guaranteed in correction proceedings under section154; however the Calcutta High Court took a contrasting perspective in *CIT v. United Commercial Bank*[27]

**Who can tax the Income?**

An issue which regularly emerges in implementing a DTAA concerns determination of the issue as to which nation is qualified to tax a specific income. The capacity of a DTAA is really to determine the purview of the contracting parties with the end goal of taxing a specific income, i.e. whether a specific income must be taxed in the source nation or in the nation of residence. For instance, it might be given in a DTAA that the income from an immovable property ―perhaps be taxed in the contracting state in which such property is located. The issue emerges in respect to whether the nation of residence of the proprietor of the property can likewise tax the income. In such a case the proprietor of the property would need to claim credit in the nation of residence for the tax paid in the nation where the property is located.

If there should be an occurrence of business benefits, the benefits of a business element might be taxed just by the nation of residence unless it carries on business in the other contracting state (source state) while having a perpetual foundation located therein. In

[26](1995) 214 ITR 50, (March 07, 2016)
[27]240 ITR 355

such a case, the benefits of the venture might be taxed in the other contracting state to degree owing to that foundation.[28]

The Madras and Karnataka High Courts in *CIT v. V.R.S.R.M. Firmand Others*[29]and *CIT v. R.M. Muthaiah*[30] held that when it is given that tax might be charged in a specific state in appreciation of the predefined income it is suggested that tax won't be charged by the other state. Be that as it may, in the *Azadi Bachao Andolan*[31]case, the Supreme Court has endorsed of not just the choice for Muthaiah's situation (involving not only immovable property but business income) but also the High Court's reasoning.

The Supreme Court in *CIT versus Kulandagan Chettiar and Other Appeals*[32], decided appeals arising from various High Courts's decisions (including of the Madras and Karnataka High Courts alluded to above) wherein it was held that if the concerned assessee was occupant in India and, had a permanent foundation or possessed relentless property in Malaysia it was Malaysia alone which had the privilege to tax such business or enduring property income.

In a judgment which is not the most unmistakably landmark case, the Supreme Court seems to have taken the perspective that the concerned assessees were to be viewed as occupants in Malaysia with no permanent establishment in India and, in this manner, not chargeable to Indian tax. "The Supreme Court, in this manner, did not particularly endorse nor at all oppose the perspective of the High Courts that where it was given that the source state ―may tax the predetermined income, without stating that the country of residence might likewise tax such income, it was the previous alone which could tax such income. Notwithstanding, in *Azadi Bachao Andolan*[33], the Supreme Court obviously held that it endorsed of the conclusion as well as the reasoning for reaching such conclusion."

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[28]Supra note.1
[29][1994] 208 ITR 400
[30][1993] 202 ITR 508
[31](2003) 263 ITR 706 at 721
[32]267 ITR 654
[33] (2003) 263 ITR 706 at 721

For instance, by and large both states are enabled to tax income by method for profit, interest and royalty. The privilege of taxation is presented on the country of residence yet it is particularly given that such income might ―also be taxed in the country of source.

### 1.2.5. ENTITLEMENT OF BENEFIT UNDER TREATY

"According to the *Article 124 of the OECD Model Convention*, the procurements of a DTAA apply to an assessee who is an inhabitant of either or both the contracting parties. In this manner, to be liable to the provision of the arrangement or treaty a man needs to demonstrate that he is an inhabitant of no less than one of the contracting states. For the most part, a man is considered as an inhabitant of a nation in the event that he is obligated to taxation therein by reason of certain endorsed tests, for instance, living arrangement, home, spot of administration, and so forth."[34]

The interpretation of the expression ―liable to tax is subjected to a few contentions. There are four conceivable cases which might emerge:

1. No law on taxing the income in the concerned state.
2. The law levying tax on income in the concerned state may not make a difference to a specific class of persons, i.e., individuals and firms however just to corporate substances
3. Under the law of the concerned state, a tax might be leviable just if reached out to the specific individual or exchange by a Government notification or
4. A specific sort of income may not taxable in the concerned state; e.g., specialized administration expenses, capital gains, and so on.

Likewise as the main case is concerned, one can't say that this is risky to tax in that state and, as needs be would not be seen as an occupant of that state met all requirements for case points of interest of the Double Taxation Avoidance Agreement. The same result may stream in the second case also seeing that the law imagines tax assessment of only a class of assessees, say, corporate assessees and there is no law under which non-corporate assessees could be subjected to charge.

[34] "Ryan Deloitte, *Action plan on base erosion and profit shifting*,(2013), available at http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/us_tax_globaltaxdevelopmentsquarterly_131018.pdf , 07.03.2016."

As for third case, where the law accommodates tax collection of a particular individual yet it has been, so to speak, held in temporary discontinuance pending issue of a notification. In such a case the individual ought to be seen as a tenant of that state met all requirements for claiming advantages under the treaty. The fourth case is definitely one where the individual is at risk to be overviewed however the state has picked not to request charge on a particular kind of pay. "In the *Azadi Bachao Andolan*[35], the Supreme Court held that even so the concerned element was an inhabitant of Mauritius. This Convention should apply to persons who are inhabitants of one or both of the Contracting States."

**Life of Treaty**

The Central Government in India is authorized by virtue of Section 90 to go into DTAA along with making provisions for the usage of the same by issuing notification in the Official Gazette. Such Agreements, subsequently, turn out to be a section of the Income Tax Act itself. The Supreme Court in *CIT versus Kulangadan Chettiar*[36], held that such a DTAA goes about as an exemption to or adjustment on Section 4[37] and Section 5 of the Income Tax Act. Entry 14 in List I of Schedule VII to the Constitution vests control

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[35] (2003) 263 ITR 706 at 721

[36][2004] 267 ITR 654 (SC)

[37]"(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person : Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly. (2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act. 16 (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which - (a) Is received or is deemed to be received in India in such year by or on behalf of such person; or (b) Accrues or arises or is deemed to accrue or arise to him in India during such year; or (c) Accrues or arises to him outside India during such year : Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) 127a of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India. (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which - (a) Is received or is deemed to be received in India in such year by or on behalf of such person; or (b) Accrues or arises or is deemed to accrue or arise to him in India during such year. Explanation 1 : Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India. Explanation 2 : For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

solely in the Union to go into settlements. The Supreme Court in *Meganbhai v. Union of India*[38] and *Union of India v. Azadi Bachao Andolan*[39], held that a tax settlement or treaty becomes law with no further enactment having to be sanctioned.

Once a DTAA is gone into, it would keep on being in force in each one of its terms unless the contracting states in these lines execute a convention to reexamine the terms of the DTAA or one of the states pulls out of termination to the following state which ought to be conceivable entirely when the expiry of any base supported period for the operation of the Treaty. The contracting states to a DTAA need to advise each other of their consistence with the measures required by the different laws of the state for getting the settlement power. After a decided time, the Agreement comes into power. Likewise as India is concerned, the procurements of the Agreement generally apply in appreciation of Income emerging in any financial year starting on or after the 1st April.

An issue emerges where occupants of the two contracting parties have gone into a private contract at the point when a specific DTAA was in force and in this manner there is an amending protocol or another Agreement which influences the assessee unfavorably.

The issue that emerges is that whether an assessee can ask that, the terms of the protocol as existing when the private contract was entered into, ought to administer the taxation in appreciation of income under the said private contract and not the amending protocol or the terms of the new Agreement? The general perspective is that it is the procurements of the protocol as on the main day of the important appraisal year which would be considered and not the terms of the Convention as in force when the parties went into the private contract. It was held in *CIT v. Isthmian Steamship Lines* [40]that the guideline is the same as when interpreting a revision to the Income Tax Act — the Income Tax Act (as revised) existing on first April, of the evaluation year will apply.

[38]AIR 1969 SC 783
[39] (2003) 263 ITR 706 at 721
[40]20 ITR 572, 577 (SC)

### 1.3. DOUBLE NON-TAXATION

After reflecting on double taxation, the position is all that much clear that if a specific income is assessed and taxed in the source country, and then the country of residence can't tax the same. In the same way, there might emerge a circumstance of double non-taxation' where a specific income is definitely not taxed in the source country, in light of an incentive, exception or prevailing in that specific state.

For instance, if an inhabitant of India possesses immovable property in nation 'A' where income from such property might be taxed according to the DTAA yet the laws of nation 'A' for some reason don't accommodate taxation of the income from such undaunted property, then, such income would go totally untaxed as nation 'A' in which the purview to tax that income has been presented with option to not tax it.

These days, a perspective is developing internationally that a DTAA might not to be interpreted in order to offer ascent to double non-taxation since its aim is simply to dodge double taxation. The underlying theory in this perspective is that the country of residence dependably keeps an inherent right to tax the income of the occupant. Thus, regardless of the possibility that, in the above sample, nation ‘A' does not tax income from enduring property, India being the country of residence can assess and tax it. However this perspective may not be acknowledged effortlessly. [41]

A DTTA must be interpreted entirely on its own terms regardless of the fact that it amounts to double non-taxation. The Supreme Court has additionally unmistakably confirmed the perspective that a probability of double non-taxation is of no consequence. In *Azadi Bachao Andolan*[42], the Mauritian investors had asserted that according to article 13 of the Indo-Mauritius DTAA, capital gains arising to them were taxable just in Mauritius. In spite of the fact that it was noticed that the capital gain was not taxable according to Mauritian law, yet the Supreme Court maintained the case of the Mauritian investors.

[41] “S. Goradia, 2012. “GAAR Impact on Cross-Border Structuring”, BMR Insights published by BMR Advisors.”
[42] (2003) 263 ITR 706

## CHAPTER II

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# 2. INTERNATIONAL TAXATION: TRANSFER PRICING

### 2.1. INTRODUCTION

The increase in the economic participation by the multi-national entities in India has offered ascend to new and complex issues rising up out of exchanges entered between two or more undertakings fitting in with the same group. Consequently, there was a need to present a uniform and universally acknowledged mechanism of deciding sensible, reasonable and impartial benefits and tax assessment in India on account of such multinational endeavors. Likewise, the Finance Act, 2001 presented law of transfer pricing in India by means of Sections 92A to 92F of the Indian Income Tax Act, 1961 which facilitated calculation of the transfer price and Suggests comprehensive documentation strategies.[43]

### 2.2. MEANING

Business exchanges between the distinctive parts of the multinational groups may not be subjected to the same business sector which strengthens the relations between two independent entities. The transfer of services or goods by one party to another for an amount. This mechanism is known as transfer pricing and the amount is known as 'transfer price'. This might be subjective and arbitrary, with no connection to cost and added value. Transfer price is, accordingly, a price which reflects the value of good; or services between autonomous entities of an association. Yet, the term "transfer pricing" by and large alludes to prices of exchanges between related undertakings which might occur under conditions varying from those occurring between autonomous ventures. It alludes to the value linked to the transfer of merchandise, technologies, and the services

[43] "Girish Ahuja, Advance Law Tax and Practice in India,(4th ed.,2012) available at http://www.icsi.edu/Webmodules/Publications/FULL%20BOOK-PP-ATLP-PDF%20FILE.pdf, accessed on 09.03.2016."

between related parties. It likewise alludes to the price connected to the transfers taking place between unrelated parties that the common entity controls.[44]

Let's take a scenario where an organization B buys merchandise for 100 rupees and offers it to its related organization A in another nation for 200 rupees, who thus offers in the open business sector for 400 rupees. Had B sold it direct, it would have made a benefit of 300 rupees. In any case, by directing it through A, it confined it to 100 rupees, allowing A to appropriate the amount. The exchange in the middle of A and B is arranged and not influenced by the market forces. The benefit of 200 rupees is, along these lines, shifted to the nation of A. The merchandise is thereby transferred on a cost (transfer price) which is subjective or arbitrary (200 hundred rupees), and not on the price which is driven by market forces(400 rupees).

Along these lines, the impact of transfer pricing is that the parent organization or a particular subsidiary tends to create inadequate taxable pay or inordinate misfortune on a transaction. For example, benefits arising to the parent can be increased by raising the transfer prices higher so as to siphon benefits in terms of profits from subsidiaries domiciled in high tax nations, and to lower transfer prices to shift benefits to the subsidiaries situated in low tax countries. For example, groups which make items in high tax nations might choose to offer them at a lower profit to its subsidiary deals organization situated in a tax haven nation. That organization would thusly offer the item at an arm's length price and the subsequent (inflated) benefit would be subjected to very less or zero tax in that nation. The outcome in such cases would be loss of revenue and drain on reserves of foreign exchange.

### 2.3. SCOPE & APPLICABILITY

All the parties that enter into an 'International Transaction' with an 'Associated Enterprise' are subjected to the application of Transfer Pricing Regulations ("TPR"). Thus, all the transactions related to cross border are subjected to its application where such transactions are entered between the associated entities. The transactions that involve merely a book entry with no clear financial effect are also subjected to its application. The goal is to reach at a comparable price, for instance, the price which is available in

[44] "C. Devarajan, Direct Tax Laws (2nd ed.,2009), available at http://dl4a.org/uploads/pdf/dt2.pdf , 09.03.2016."

open market situations to any unrelated party and this is called as the Arm's Length Price ('ALP'). [45]

### 2.3.1. ASSOCIATED ENTERPRISES ('AES')- HOW IDENTIFIED?

The general basis to ascertain an AE is the contribution in administration, control or capital (ownership) of one entity by the other entity. This participation might be direct, indirect or by means of any intermediaries. This mechanism of control embodied in the statutes not only covers the control by way of acquiring and holding shared or by means of voting power or by the means of power to appoint the administration of an entity, but also by means of any debt, or blood relationships, and control over different elements of any business transaction done by a taxpayer like the control over sales. It seems that one might go to any level of management, control or ownership so as to ascertain (a) Direct Control (b) Through Intermediary.[46]

### 2.3.2. WHAT IS AN INTERNATIONAL TRANSACTION?

Any kind of transaction that is mainly a cross-border transaction dealing with any kind of property or goods or services, etc can be referred as international transaction. The minimum requirement is that in such transaction at least there is a party who is non-resident that has entered into the given transactions (a) Purchase, sale or lease of Tangible or Intangible Property (b) Provision of services (c) Lending or borrowing of money (d) Any transaction having a bearing on profits, income, losses or assets (e) Mutual agreement between AEs for allocation/apportionment of any cost, contribution or expense. An example dealing with 'International Transaction' could be where one resident entity exports merchandise to an unrelated person abroad, whereby, there is a and there is separate agreement entered between that unrelated person and the AE which affects the amount at which such merchandise are to be exported. In that case also, the transaction with unrelated entity will be subjected to the TPR.**[47]**

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[45]"Sunil Arora Manager, Law of Transfer Pricing in India, available at http://www.cci.in/pdfs/articles/Law-of-Transfer-Pricing-in-India.pdf, accessed on 09.03.2016"

[46] "John Neighbour, *Transfer pricing: Keeping it at arm's length*,(2002) available at: http://www.oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html , accessed on 09.03.2016."

[47] "Anshuman Kothari,*International Transfer Pricing*,(2013),available at http://www.pwc.com/gx/en/international-transfer-pricing/assets/india.pdf , accessed on 11.03.2016."

### 2.4. METHODS OF DETERMINING THE ALP

ALP is the price or amount that would be charged in an international transaction owing to any income that arises in such transaction entered between AEs and would be computed in the same manners if the transaction has been entered by two unrelated parties in same circumstances. This has been provided in the TPR subjected to the internationally acknowledged principles. Any of the given means can be used to ascertain the. It is on the discretion of the taxpayer to select any of the appropriate means to be applied on any transaction, but such decision should be made taking into consideration of various elements provided in the TPR. In order to promote flexibility in imbibing the ALP, the TPR provides for 5 percent of variance allowance. The methods provided in the TPR are (a) Comparable Uncontrolled Price Method ('CUPM') (b) Resale Price Method (''RPM') (c) Cost plus method ('CPM') (d) Profit Split Method ('PSM') (e) Transactional Net Margin Method ('TNMM').[48]

#### 2.4.1. DOCUMENTATION

The provisions of the TPR are comprehensive to the extent of issue of maintenance of documentation is concerned. This incorporates the background data relating to the commercial environment in which the exchange has been entered by the parties, data with respect to the international transactions, the examination done by the party to choose the most proper technique and to recognize comparable transactions and the practical application of the transaction related to ALP. This additionally incorporates report held by the accountant ensuring that the ALP has been made as per the TPR and that recommended documentation has been kept up. This documentation ought to be held for a base time of 8 years. In any case, it might be noticed that in the event that the transaction's value is underneath INR 10 million, it would be adequate for the taxpayer to keep up documentation and data which promotes his case for the ALP by him.[49]

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[48] *Id.*

[49] supra note. 46

### 2.4.2. BURDEN OF PROOF - TAXPAYER OR TAX OFFICER?

The essential onus is on the taxpayer to decide an ALP as per the TPR and to substantiate the same with the recommended documentation. When this onus is released by the taxpayer and the information utilized for deciding the ALP is solid and right there can be no interference by the tax officer. In different cases, where the tax officer is of the perspective that the (a) value charged in an international transaction has not been made as per the strategies provided, (b) or data and reports with respect to the international transaction have not been kept and kept up by the assessee as per the TPR, (c) or the data or information utilized as a part of calculation of the ALP is not right, (d) or the assessee has neglected to provide any data or archive which he was required to provide under the TPR the tax officer might dismiss the ALP chosen by the assesse and decide the ALP as per the TPR. For this reason, he would then allude the matter to a Transfer Pricing Officer ('TPO') (an special post made for evaluation of ALP) who might decide the ALP in the wake of listening to the contentions of the taxpayer.

### 2.4.3. EFFECTS OF ADJUSTMENT TO THE ALP

The following consequences might happen if the ALP ascertained by the TPO reflects the understatement of income of the taxpayer, (a) Adjustment to reported income of the taxpayer (b) Levy of penalty

**Adjustment to the Reported Income**

The tax officer will undoubtedly change the taxpayer’s reported income with the measure of alteration proposed by the TPO. This would have an impact of expanding the evaluated income or then again diminishing the loss that is assessed. Besides, deductions under Section 80 cannot also be taken into account on the increased income. In any case, those taxpayers who are qualified for deductions falling under section 10A and 10B stay unaffected as these deductions stay accessible on the increased income

### 2.5. ADVANCE PRICING AGREEMENTS (APAS)

The various unilateral, bilateral and multilateral APAs have been introduced by the Indian authorities with effect from 1 July 2012. No prerequisites or any monetary condition is provided in the rules under Indian APA that makes a taxpayer to qualified for applying for an APA. But this mechanism of APA is not applicable in particular domestic transactions. The legitimacy of an APA (once went into) should not surpass five back to back years and would be binding on the taxpayer and also on the Revenue authorities under the purview of international transactions for which the mechanism of APA has been adopted.. APA charges would fall between INR 1 million to 2 million, on the basis of value with respect to the international transactions[50]. There are four stages in an APA which is in accordance with worldwide practice, which are:

- **Pre filing phase:** The procedure of an APA would begin with a pre-filing discussion meeting. This meeting will be held to decide the coverage of the agreement entered, comprehend the issues with respect to transfer pricing and to decide the suitability of the agreement falling under international transaction. No charge is to be paid in this stage.
- **Formal submission phase:** Subsequent to pre-filing meeting, if the taxpayer wants to apply for APA, an application in the manner of format provided would be made inculcating the particulars of data. The APA documenting charge is payable at this stage. In the application, the taxpayer must portray critical or fundamental presumptions. Fundamental assumptions allude to an arrangement of taxpayer incidental facts and macroeconomic basis(such as industry, business, monetary conditions, and so on.), the continuance of conditions that are fundamental to reflect the position under an APA. A fundamental alteration in any of the basic suppositions might bring about modification of the APA or even end in other circumstances.
- **Negotiation phase:** Subsequent to the phase of accepting the application, meetings will be held by the APA team with the applicant and necessary inquiries will be undertaken as such that relates to the case. After the necessary meetings and inquiries, a draft report will be prepared by the APA team which will be given to the Competent Authority in India (for unilateral/multilateral APA) or to the

[50] "KPMG, *Advance Pricing Agreement Considerations for India,*(2011), available at http://www.kpmg.com/IN/en/services/Tax/FlashNews/KPMG-Advance-Pricing-Agreement-Considerations-for-India.pdf , accessed on 11.03.2016."

Director General of Income Tax (International Tax and Transfer Pricing) (for Unilateral APA).

- **Finalisation phase:** This stage is about the exchange of remarks on draft of APA, the APA's finalization, and giving effect to the original years falling within the APA term that were elapsed.[51]

An annual compliance report (ACR) has to be prepared by the taxpayer which for each year of the APA, mentioning the requisite data to ascertain the actual outcome for the year and to reflect that the terms of APA has been complied with.

### 2.5.1. PENALTIES

Penalties have been prescribed as a deterrent for not complying with the procedural requisites and such penalties are stated as (a) Penalty for Concealment of Income - 100 to 300 percent on tax evaded (b) Failure to Maintain/Furnish Prescribed Documentation - 2 percent of the value of the international transaction (c) Penalty for non-furnishing of accountants report - INR 100,000 (fixed). The taxpayer can be absolved of the above mentioned penalties if he proves that reasonable cause persist for the failures.

## 2.6. LEGAL CASES

Following the time when the sanctioning of the transfer pricing regulations produced results from April 01, 2001, Indian tax Authorities have finished eleven rounds of transfer pricing reviews. There have been couple of exceptional legal cases, which have set up certain imperative transfer pricing standards, for example, inclination for transaction by transaction examination over the collection of transactions methodology, significance of practical similitude between tried gathering and comparables and nonchalance of comparables having controlled transactions. Likewise, while the regular issues, for example, accessibility of concurrent information and utilization of mystery comparables stay unsolved, the duty powers have expanded their attention on complex issues including intangibles, acquirement models and cost portions. Few newly closed imperative judgements that have denoted the move evaluating scene in India are compressed underneath:

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[51]"C. Devarajan, Direct Tax Laws (2nd ed.,2009), available at http://dl4a.org/uploads/pdf/dt2.pdf , accessed on 11.03.2016."

### 2.6.1. SKODA AUTO INDIA PRIVATE LIMITED

In this case the main international transactions by and of the taxpayer involved the payment of royalties and purchase of kits, the arm's-length pricings of which were reasonable using TNMM as the most suitable method. Additionally, CUP data was taken help of for the corroborative analysis for the transaction of purchase of kits. The application of the CUP was rejected by the TPO and TPO made a modification by discounting the comparables which were selected by the taxpayer. The grounds, on which the taxpayer argued at the Appellate Tribunal level, are as following:

- The low-capacity utilization of the taxpayer, taking into consideration the fact that it was in the start-up phase.
- Differences in mode of commerce of comparable companies and business models.

The Appellate Tribunal held that:

- The taxpayer is not expected to obtain information in detail, which does not exist in the general public domain.
- In the case of deficiency of information existing in the public domain for making the adjustments, assumptions and approximations can be relied upon.
- Economic adjustments should be made wherever necessary (for unusual high start-up costs, capacity utilization).
- The approved benefit of the 5 % range (-/+) should be allowed to taxpayer.

The principle of adjustment for high start-up costs well-defined in the judgment still holds importance for companies that are in their early stage of operations and establishment. The ruling underlined the fact that a comparison must be made after economic adjustments, wherever necessary.

### 2.6.2. IL JIN ELECTRONICS (I) (P) LTD.

In the present case, the taxpayer was engaged in the manufacturing of printed circuit boards for one of its group companies in India. 45.51 % of its required raw materials were imported by the taxpayer from its AE in Korea, while the rest 54.49 % was procured in India. These raw materials were purchased by the AE in Korea from unrelated vendors and accordingly, a charge was added for its services of procurement.

The taxpayer took the use of TNMM and the operating margin results of various comparable companies to display the arm's-length character of the transactions of import. The TPO, during the audit, rejected some high-loss-making comparable companies which were identified by the taxpayer and consequently, TPO by applying a higher arm's-length operating margin not to the 45.51 %, but rather to the total turnover of taxpayer, made an uphill adjustment to the taxpayer's import prices.

Before the Appellate Tribunal, the taxpayer pleaded that in arriving at the arm's-length price for the import transactions, it is imperative to take into consideration the mark-up charged by its AE for its procurement services and the real purchase price paid by its AE to the separate vendors. Another argument raised by the taxpayer was that working capital differences between the comparable companies and the taxpayer needs to be taken into consideration in finishing the arm's-length operating margin by the TNMM. So, the central argument of the taxpayer was that since only 45.51 % of the total raw materials were imported from its AE, upward adjustment, if any, shall be applicable not on the total turnover but only on the 45.51 % of the taxpayer's turnover.

The Appellate Tribunal held that a substitute methodology for TP analysis taking a 'foreign AE' as an established party by applying the CPM or resale price method would have been the perfect approach to determine the arm's-length price in the present case. Nonetheless, in the absence of any supporting information and analysis undertaken with respect to the details of prices of the raw material purchased by the AEs from the third-party vendors, the Appellate Tribunal observed that the adoption of alternative methodology is not correct in the present case and therefore, only TNMM could be used as the most suitable method in the present case.

Consequently, the Appellate Tribunal was satisfied with the argument of the taxpayer that the transfer pricing adjustment shall be made not on the total turnover, but merely on 45.51% of the turnover.

This decision is significant in the context of applicability of the TNMM, when the method has been applied in cases where segmented financial data is not available with the taxpayer for transactions with its AEs, and TNMM has been applied on an entity-level basis. In such type of cases, any transfer pricing adjustment is to be made not on the basis of the total turnover of the taxpayer but only on a proportionate basis. This decision also highlighted the use of foreign AEs as an established party for the calculation of the arm's-length price.

### 2.6.3. GEMPLUS INDIA PVT. LTD.

In the present case the taxpayer was a part of the Gemplus group, which was engaged in providing smart card solutions for the telecommunications industry, financial services industry, and other e-businesses. The taxpayer entered into an agreement with its AE for receipt of services in finance, accounting, legal support, sales and marketing support, customer service support, and administration support.

TPO in the present case held that there was no apparent proof that whether such services have actually been rendered by the AE or not. There was no clear benefit accrued to the Indian entity. The taxpayer in the present case had not established the obligation for availing these services from the AE and had already incurred expenses towards consultancy and professional services and employed qualified personnel in India for the endearment of similar type of services. The quality and volume of services were highly unbalanced to the amount paid, and the charge was based not on the basis of actual services rendered but rather on cost-sharing amongst the group entities on a mutually agreed basis.

The Appellate Tribunal held the case in favour of Revenue. This ruling laid down some serious principles applicable for and to service transactions, which would in fact be applicable to any transactions involving intra group intangibles or services. Simply speaking, in order to satisfy the arm's-length standard, a charge for intra group intangibles or services, these three conditions must be satisfied:

- The intra group intangibles or services have in fact actually been received.
- The need for intra group intangibles or services is established.
- The benefit from the intra group intangibles or services is proportionate with the charge incurred.

It is pertinent to note here that in the case of *Dresser Rand India Private Limited*, the Tribunal observed that the commercial wisdom of the taxpayer cannot be questioned in calculating the need for availing such services. A few principles that are common in both the decisions are that there must be documentary evidences to establish actual receiving of services and that the cost incurred must be in proportion with expected benefits which will be received.

### 2.6.4. LOGIX MICRO SYSTEMS LTD.

The Appellate Tribunal has held that the concept of charging interest only on the overflowing interest-free period is the proper course of action and observed that any interest loss on non-receipt of funds on time should form the foundation of calculating the notional income."

"It is pertinent to note here that in the explanation added to definition of 'International transactions' by the Finance Act 2012, any debts arising in passage of business or receivables are considered as international transactions.

## CHAPTER III

# 3. INTERNATIONAL TAXATION: ROYALTY AND FEES FOR TECHNICAL SERVICES

### 3.1. INTRODUCTION

Income arising from the utilization of elusive property has essentially expanded after some time with the development of innovation and the quickly developing volume of business transactions between multinational endeavors[52]. Quick changes in science and innovation, combined with development of legitimate insurance, have made another sort of profitable impalpable corporate resource.

The intellectual property is attached with asset[53], which incorporates different protection like trademarks[54], patents, copyrights, trade secrets. The arena of intellectual property today has turned out to be so tremendously critical that the legal safeguards and enforcing the rights under arena of intellectual property involve a focal part in worldwide exchange and relations. These impalpable resources create a higher rate of return since intangible resources have more noteworthy universal mobility. Installments made to proprietors of these intangible resources for the utilization of such resources are for the most part known as royalties. Legislatures of most nations have taken exceptional enthusiasm for the tax assessment of royalties as the regularly higher rate of return makes royalties a significant revenue source. Additionally, the development of universal exchange has likewise made giving technical and specialized services much less complex and the tax assessment of the fees paid for these provisions of services has attracted the focus of the policy makers.[55]

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[52]E.L. Guruli, *International Taxation: Application of Source Rules to Income from Intangible Property*, 5 HOUS. BUS. & TAX L.J. 204 (2005).

[53]See, J.M. Manak, *The Law of Written Description in Pharmaceutical and Biotechnology Patents*, 23 BIOTECH. L. REP. 30, 31 (2004).

[54]See, R.P. Merges, *A New Dynamism in the Public Domain*, 71 U. CHI. L. REV. 183, 200 (2004).

[55]A.J. Cockfield, *Designing Tax Policy for the Digital Biosphere: How the Internet is Changing Tax Laws*, 34 CONN. L. REV. 333, 382 (2002).

The goal of the chapter is to reflect some particular concerns which originate in cases of royalties taxation in the sphere of international taxation. The debate restricted to three main concerns: (A) fees charged for technical services and particular disputes in this area with respect to its taxation; (B) the connection between computer, software e-commerce, and the royalties; and (C) the mechanism of taxation of income that arises from such utilization of satellites. Further, the chapter reflects the various issues and rising concerns arising in the taxation of royalties and in the area of charging fees for technical services, at both the level of domestic and international arena.

## 3.2. ROYALTIES AND FEES FOR TECHNICAL SERVICES – EXISTING LAW

The taxation of Royalties and fees for the technical services is governed by the provisions provided in the Income Tax Act, 1961. Besides, the DTAAs entered into by each nation likewise impose royalties under a different head. In spite of the fact that the model conventions don't make a particular provision of the tax collection of fees for such technical services, tax assessment of such fees in the different respective settlements is governed by the special provision made under various treaties made by India. Before analyzing the present position in the domestic and international level as to the tax collection of royalties and fees for such technical services, it is critical to comprehend the significance of the expressions "royalties" and 'fees for technical services'.[56]

### 3.2.1. MEANING OF ROYALTIES AND FEES FOR TECHNICAL SERVICES

Royalty is defined as:

"…consideration for transfer of rights in respect of or for use of intellectual property viz., patent, invention, model, design, secret formula, process or trade mark and similar property. It includes consideration for imparting of information concerning the working or use of those properties and also for imparting of information concerning technical, industrial, commercial or scientific knowledge or skill."

[56]See, D.P. MITTAL, *Indian Double Taxation Agreements And Tax Laws* 1ed. (2014)

To put it plainly, it is the sum made to the proprietors of specific sorts of rights by the individuals who are allowed by the proprietors to practice those rights. The payment paid could take the type of a single amount installment or repeating installments. In any case, it doesn't bring inside of its domain the asset transfers as those constitute capital exchanges or transfers.

'Fees for technical services' is "consideration for the rendering of any managerial, technical or consultancy services, whether such consideration is paid in lump sum or in any other manner. It also includes consideration for providing services of technical or other personnel as part of their service contract."

### i. Royalties and Fees for Technical Services: Domestic Law

With the progression of society and the development of intercommunication and collaboration between diverse nations, payments done as royalty under cooperation agreements entered incredibly expanded. As there was already no particular provision in this regard in the Indian taxation regime, the Finance Act, 1976 came up with the clause (vi) in s. 9(1) characterizing the expression royalty and endorsing the circumstances under which such royalty payment might be regarded to gather or emerge in India[57].

Clause (vii) was likewise embedded in s. 9(1) by the Finance Act, 1976, indicating the conditions in which income via fees for technical services shall be esteemed to have collected or emerged in India furthermore characterizing the expression fees for technical services. Royalties is characterized under the Explanation affixed to s. 9(1)(vi) of the Act, while 'fees for technical services' is characterized in the Explanation attached to s.9(1)(vii).[58]

*Taxability under the Income Tax Act*

The Act assesses the tax on the person's aggregate income[59]. This income is not necessary to be actual receipts. At the point when income accumulation originates or is

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[57]OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, (2005) [hereinafter "OECD Model Convention"].
[58]INCOME TAX ACT, (4 of 1961) [hereinafter "the Act"], §9(1)(vi) and 9(1)(vii)
[59]Act, supra n.16, § 4(1) provides that income tax is chargeable on the total income of the assessee.

received, or when it is by fiction esteemed to gather, arises or is regarded to be received, it is incorporated into the total or aggregate income of the assessee and is consequently assessable or taxable. [60]

"S. 9(1)(vi) of the Act expresses that on account of royalties, income is considered to collect or emerge in India, if the payer is the Government or an Indian occupant or establishment of business is in India by the non-inhabitant[61]. The place of accrual is governed by the place of intellectual property where the income is to be paid by person other than Government of India. In situation where the right, property or data on which royalty is to be paid is utilized for the reasons of business or any profession carried in India or to earn income from any source in India, royalty is considered to have gathered in India and is as needs be chargeable to assess."[62]

Thus, fees for technical services are assessable in the hands of non-inhabitants if such is received in India or if those fees accumulate in India. If the income is payable by the Government, It will always be considered that it has accrued in India. In appreciation of installment made by others, it is the spot where the services are used that decides the accumulation of income in India.[63]

In the event that the services are used in a profession or business in India or with the end goal of procuring income from any source in India, the fees accumulate in India paying little mind to some other component. Further, the definition utilizes the expression 'fees for services used' in India and not 'fees for services rendered' in India and appropriately, if the fees are paid for the services used by the Indian organization in its business carried on by it India, independent of the spot where the services are rendered, the measure of fees would be regarded to accumulate or emerge in India.[64]

[60] INCOME TAX DEPARTMENT, DEPARTMENT OF REVENUE, MINISTRY OF FINANCE, GOVERNMENT OF INDIA, Taxation of Income of Non-residents from Transfer of Technology – Tax Treatment of Royalty and Fees for technical Services, available at, http://www.incometaxindia.gov.in/publications/9_Income_Tax_For_NRI/Chapter008.asp, accessed on 11.03.2016.
[61] *See* D.P. MITTAL, supra note.14.; at 433; CIT v. Davy Ashmore, 190 ITR 626
[62] K. Chaturvedi, S.M. Pithisaria, *Income Tax Law*, (5th edn., 1998).
[63] *Id.*
[64] Act, supra n. 16, §9(1) (vi).

Simple utilization of services of technically qualified persons prima facie does not bring the sum paid as 'fees for technical services' inside of the domain of Explanation 2 to s. 9(1)(vii) of the Act. A reasonable qualification must be made between using technical information or expertise so as to render services and charging of fees for such technical services. The explanation behind this qualification is that in numerous cases the innovation or the technical information of the persons is not made accessible to the client.

In such cases, the sum paid is not "fees for technical services". Fees for technical services emerge in situations where the assesse obtain particular rights which can be subsequently utilized as a consequence of technical services that are made accessible.[65]

The main issue is to determine whether a sum paid under the agreement is to be regarded as royalty or fees for technical services that should be determined on the basis of different facts and circumstances of a particular case and the various stipulations of the agreement. It is the determined factor that the facts of the case and circumstances and not the terminology that would decides the nature. The contractual commitment embodied in the agreement should be inspected against the setting contained in the definition to find out the genuine nature of an agreement.[66]

*Tax Deduction at Source or Withholding Taxes on Royalties and fees for Technical Services*

Tax or charge deducted at source or retaining taxes is generally the most common means of obtaining the income tax under the Income Tax Act. Income from various sources involving the income obtained from royalties and the fees for technical services given to the non-residents also fall under the purview of tax deduction at source. Where such income by the payer is not taxed at source, he is therefore considered to be an assessee in default in appreciation of such tax.[67]

It is well known that the liability to deduct charge at source emerges just in the event where the income is to be chargeable to be taxed under the Income Tax Act. Thus the

[65]Skycell Communications, Elkem Technology v. DCIT, [2001] 250 ITR 164.
[66]Aziende v. CIT, [1977]110 ITR 145.
[67]IdAct, supra n. 16, §201.

related inquiry that emerges in such manner is with reference to who is to determine the issue whether such income is income at all in any case. In a recent decision, the High Court of Karnataka Court has looked to resolve this question. A short analysis of this decision is exceptionally illustrative.[68]

The main argument by the assessee presented to the High Court was that the payer can determine the question that whether the income of the recipient would be chargeable under the Income tax Act. In the event that, as a consequence of this determination, it is observed that the income is not chargeable to assess under the taxing provisions of the Act, there is no need to deduct charge from the sum paid to a non-resident recipient. This argument was completely dismissed by the High Court on the observation that s. 195 of the Act that required the payee to deduct expense is not a charging segment, nor it is a provision for assessment and determination of tax liability of non-resident in reference to the issue whether such income is taxable under the Act.

The Court was of the view that such an activity is not to be turned to by the payer while paying sum to non-resident. The Court was of the perspective that a payer must acquire the earlier endorsement of the assessing officer to retain tax at a reduced rate or to not retain any tax at all.

The ramifications of this decision are huge. The judgment given by the High Court has uprooted the component of choice or discretion that was till then was practiced by the payer in choosing whether the sum paid made to the non-inhabitant is income is to be taxed. Consequently, whether the payer can be assuaged from the commitment to retain the tax, completely or halfway, must be chosen by the method visualized under Act[69], after giving the application to the Assessing Officer. The guideline set down by the High Court will make each sum paid which is in the way of income per se to fall under the domain of retaining taxes underlying the provision of s. 195 of the Act and in the event

[68]CIT v. Samsung Electronics Co. Limited &Ors., [2010] 321 ITR 209; *See* Transmission Corporation of A.P. Ltd. v. CIT, [1999] 239 ITR 587

[69]Act, supra n. 16, §195. Where the person responsible for paying any such sum chargeable under this Act (other than salary) to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Assessing Officer to determine, by general or special order , the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable.

where the assesse desires to get exemption in respect to withholding taxes, he should firstly provide an application to the Assessing Officer and acquire a certificate absolving him from withholding or retaining taxes with respect to sum paid. This decision must be taken in consideration of the issue of characterization of income as income in the way of royalties, technical fees or business benefits. [70]

In spite of the fact that the Court did not decided on the kind of income in this specific case, it is yet sensible to trust this decision will bring about noteworthy prosecution later on. There is dependably plausibility that the payer of the income might translate it to signify 'business benefits', rather than royalties and fees for technical services. Thus, it might prompt a circumstance where the resident payer needs to approach the Assessing Officer to elucidate the degree of his liability with regard to taxation.

### ii. Royalties and Fees for Technical Services: Treaty Law

A country's tax mechanism of the multinational income of its occupants is changed by the standards and standards built up by the tax treaties entered by such nation. In any case, assessing the contemplations that influence going into bilateral treaties necessitates an unambiguous comprehension of the source and residence guidelines of tax collection.[71]

The arena of international taxation has depended on the residence guidelines and standards of source since past seventy years.

The source-based methodology allows a "source" nation to impose tax on the income with respect to non-inhabitants that is earned inside of its borders. Interestingly, within the residence based framework, a nation declares its jurisdiction to impose tax the overall income of its occupants, paying little respect to its source. Many nations, and also India, "assert jurisdiction to tax based on principles of both source and residence."[72]

[70]See, National Organic Chemical Industries Ltd. v. DCIT, 96 TTJ 765 (2006).
[71]See R.S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1303-06 (1996).
[72]J.K. Sweet, *Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence Based Taxation in an era of Eroding Traditional Tax Principles*, 146 U. PA. L. REV. 1949, 1953 (1998).

The underlying principle behind tax treaties emerges from the thought that … the strategies of the different nations with respect to source - and taxation on the basis of residence based system might make the potential in the area of the double taxation with respect to particular cross-border flows of income. Bilateral tax conventions reflects an instrument for two nations to reach out ways that takes out or reduces double taxation in the sphere of multinational income, enhancing any unfair duty treatment of foreign organizations, and facilitation of information exchanges with respect to taxation authorities. Henceforth, the riddance of double taxation for people and ventures having income-procuring businesses in more than one nation is the most general justification for going into an international taxation treaty.[73]

DTAAs are entered into under the auspices of s. 90 of the Income Tax Act. As per s. 90(2), the procurements of the DTAA supersede those of the Act and in the case of a dispute between the DTAA and the Income Tax Act; the more gainful procurement will win. Royalties and Fees for Technical Services under Model Tax Conventions: The two famous conventions with respect to taxation that nations take to stay away from double taxation are the UN Model Double Taxation Convention and the OECD Model Tax Convention. The OECD Model Convention is an outline for various bilateral treaties in the field of taxation and practically every treaty negotiations in the area of taxation at international level, today, begin with it[74].

The UN Model Tax Convention came in 1980 to build up a structure for the arrangement of bilateral treaty negotiations in the field of taxation entered between developing and developed nations. With respect to the tax collection of royalties and fees for technical services, the model taxation conventions vary essentially. It must be noticed that model convention do not contains a particular procurement for fees paid for technical services.

Royalties falling under the domain of OECD and the UN Model Tax Conventions are given under Art. 12. The central distinction between the two taxation assessment

[73]"See A.C. Warren Jr., *Income Tax Discrimination Against International Commerce*, 54 TAX L. REV. 131 (2001)."

[74]"Department Of Industrial Policy & Promotion, Ministry Of Commerce And Industry, Taxation In India, http://siadipp.nic.in/publicat/invpub/taxation.htm accessed on 11.03.2016."

conventions is on the taxation assessment of royalty by the source nation. The OECD Model Convention has given special rights to the nation of residence to impose the tax on such income, while the UN Model Convention, perceives the privilege of the source nation to assess the same sources of income, along with the right of taxing the income by the resident nation. The UN Model Convention perceives that jurisdiction to assess the tax ward relies on the nexus between the nations that tax and the activities which are economic in nature creating income on one side and also on the basis of relationship between the nations that taxes and the citizen on the other side.

Despite the fact that the UN Model Convention perceives the privilege of the source nation to charge the tax, it can do as such just at a specific concurred rate of the gross sum. This rate is ordinarily lower than the typical rate that is applied to such income. spite of the fact that India has gone into Tax Evasion treaties with more than 65 nations, the DTAAs entered by India between the four nations which includes USA,UAE, UK and Mauritius are of particular significance as these nations are four of India's most vital exchanging accomplices.

### 3.3. DTAAs BETWEEN INDIA AND USA, UK AND UAE

The DTAA in the middle of India and USA contains procurements concerning royalties and fees for technical services under Art. 12. The DTAA utilizes the term 'fees for included services' which is synonymous with fees for technical services. USA by and large takes after the OECD Model Convention, under which royalties are assessed and thereby taxed just in the country of residence and no jurisdiction is given to a country of source. In any case, the India–USA DTAA deviates from the common model adopted by the USA and gives the country of source the right of taxing income by means of royalties and fees for included services. Thus, it could be seen that in the context of Indian Revenue, the inflows coming from USA are significant sources. As to source tax collection of income, the standards contained in the UN Model Convention accommodate tax assessment at a rate which has been negotiated, and such is valid for the DTAA with

USA too. The advantage of a lower rate is offered just to the beneficial proprietor of a royalty.[75]

This implies the advantage of a lower rate is not accessible where an intermediary interposed in the middle of the payer and the beneficiary such as in the cases of agents. The India-UK DTAA embodies provisions for royalties and fees for technical services in Art. 13. This DTAA at the end of the day takes after the UN Model Convention in consideration in permitting the country of source the privilege to assess and tax 'royalties'. The standards that are followed are very much the same as that of the India-USA DTAA. The India-UAE DTAA at the end of the day permits the nation of source for the tax assessment of royalty income.[76]

The taxation rate in context of royalty by the nation of source with respect to the India-UAE DTAA is the least among all the DTAAs considered here. If royalties are paid to the advantageous proprietor, the taxation rate that is applied is 10%, when contrasted with 15% in alternated DTAAs. The India-UAE DTAA is different from the other DTAA's in a way that a particular exclusion has been given in cases of sum paid as royalty in the area of mines operation, petroleum production and extraction and other natural assets.

These three taxation treaties embody numerous provisions that are common. Like, the article in context of royalty that is not applied in the event where the beneficial proprietor who own royalties carry on, or has continued, its business in the nation of source by means of through any permanent establishment or it has given any type of independent personal services via fixed base in nation of source, and therefore, the royalties are attached to such fixed base or the permanent establishment. In these events, the provisions underlying Art.7 (business benefits), or those of Art. 14 (free individual services) will be applied.

[75]See C. Brown & C. Manolakas, *Trade in Technology within the Free Trade Zone: The Impact of the WTO Agreement, NAFTA, and Tax Treaties on the NAFTA Signatories*, 21 NW. J. INT'L L. & BUS. 71 (2000).
[76]Art.12, Art. 14;DTAA Between INDIA And USA,.

### 3.4. DTAA BETWEEN INDIA AND MAURITIUS:

As expressed above, the FDI inflows coming from Mauritius represents the biggest inflow into India from a solitary nation. This is somewhat because of the advantageous provisions embodied in the DTAA which boost the investment transactions in India. The India-Mauritius DTAA, also take the recourse of following the UN Model Convention in permitting the privilege to the source country in respect to tax assessment of royalties at a reduced rate.

Nonetheless, where the India-Mauritius DTAA contrasts from the other DTAA's is that, the reduced rate with respect to taxation can be taken of regardless of the fact that the beneficial proprietor of royalties is not payee. The outcome of this is the availing of advantage at a lower rate of taxation is given notwithstanding when there is intermediary and it interposes between the payer and the beneficiary. In this manner, the royalty paid to an inhabitant of Mauritius will be subjected to the rate of only 15%, regardless of the fact that royalty is being paid or is not being paid to the beneficial owner.[77]

The income arising from the exchange of right to utilize a thing, which is intangible, is royalty and the opportunity for organizations and entities to go for preferential jurisdictions get a boost owing to the facet of high-mobility of such intangible thing. The advantageous provisions under the India-Mauritius DTAA set Mauritius to fall under the purview of preferential tax jurisdictions in the arena of royalties. The DTAA entered into by India and Mauritius does not have particular provision in context of fees for technical services.

### 3.5. TAXATION OF ROYALTIES AND FEES FOR TECHNICAL SERVICES IN INTERNATIONAL TRANSACTIONS – SPECIFIC ISSUES

#### 3.5.1. FEES FOR TECHNICAL SERVICES AND CERTAIN CONFLICTS

Countless organizations give technical services in India either straightforwardly from abroad or by way of any establishment of an entity in India. It is intriguing to observe that however the OECD and the UN Model Conventions have comprehensive provision in

[77] DTAA Between India And Mauritius, Art. 12(2): However, such royalties may also be taxed in the Contracting State in which they arise, and according to the law of that State, but the tax so charged shall not exceed 15 per cent of the gross amount of the royalties.

connection to tax assessment of royalties, but there is no particular provision for tax assessment of technical fees. The outcome is that when any charge is paid for technical services, then both, the UN Model Convention and OECD Model convention, would apply where this income would be made to fall under the purview of 'business benefits.'

Nonetheless, Art. 7 of the model conventions necessitate the presence of a Permanent Establishment so as to draw attention of liability of taxation. This issue is critical as the various number of the DTAAs went into by India don't particularly impose tax fees in regard to the technical services. Nonetheless, the Act gives a detailed meaning of fees for technical services and an inquiry emerges in the matter that whether without any particular provision with respect to fees for technical services in DTAA, the same can be conveyed to charge as tax fees in the Act for the technical services. This issue is of significance to the source nation as characterization of such fees as business income might bring the outcome of such income being not taxed. “A fascinating decision was conveyed by the Income Tax Appellate Tribunal, Bangalore in Spice *Telecom v. IT*O[78], The issue presented before the ITAT was whether in the event where DTAA is silent, the provisions will be applicable or not? In this case, the classification of the income arising from the advisory and support services as the provision of technical services was not done by the assesse and therefore the tax was not deducted.”

The argument of assesse was that such services that were provided would not come under the DTAA go into by India and Mauritius. Nonetheless, the Assessing Officer continued to assess tax as per s. 9(1)(vii) of the Act. Setting aside the ruling given by Assessing Officer, the ITAT was of the view that since there is no provision for technical service under DTAA, DTAA provision will be applied and thereby, the taxation of income will be assessed as business. This position was emphasized in the case given by the Authority for Advance Ruling (AAR) in the case Worley Parsons Services Pty. Ltd.[79]

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[78]Spice Telecom v. ITO, (2008) 113 TTJ 502
[79]Worley Parsons Services (P) Ltd. v. DIT 313 ITR 74 (AAR)

### 3.5.2. ELECTRONIC COMMERCE, COMPUTER SOFTWARE AND ROYALTIES

The conventional global taxation concepts and the standards are essentially challenged by the introduction of electronic commerce. The buying and selling of the intangible provision of services and items via internet is referred as electronic commerce. The procedure involving distribution, marketing, delivery and payment of the services or goods of intangible nature can be done via computer networks without the requirement for physical conveyance of the item or provision of services.[80]

As indicated by a report by a group of technical advisory in the OECD, of the twenty-eight conceivable types of e-business, just three might create royalty.

i. Classification Problems Associated with E-Commerce Transactions

The international taxation treaties by and large accommodate business benefits of multinational undertakings to be taxed and assessed where the entity has a settled base. Advancements in the arena of technology have added to the crumbling of the taxation base in numerous nations. Computerized advances, for example, the web, challenge global standards that depend upon physical vicinity as the premise for jurisdictional income tax assessment. E-trade offers decisions to buyers that did not exist when governments initially tended to income characterization issues.[81]

Today, for instance, "somebody wishing to buy ten duplicates of a book might basically buy one [electronic] duplicate and obtain the privilege to make nine extra duplicates." Technically, this business transfer would appear to produce "royalty" income. Practically, the business exchange could be seen as "just a replacement for the buy of ten duplicates" in bound structure. Some electronic transactions might likewise obscure the difference between income arising from the offer of merchandise and income arising from the procurement of services[82]. A case of this is given by the Treasury Department of the US,

[80] Forgione, *Clicks and Mortar: Taxing Multinational Business Profits in the Digital Age*, 26 SEATTLE UNIV. L. R. 719, 722 (2003).

[81] Office of Tax Policy, U.S. Dep't Of The Treasury, *Report On Eselected Tax Policy Implications Of Global Electronic Commerce* (1996).

[82] Act, supra n.16, §§9(1)(vi) and 9(1)(vii) state that in the case of Royalties and Fees for Technical Services, "income is deemed to be Indian source, if the payer is the Government or an Indian resident or Indian business establishment of the non resident." Therefore, in the event that the income cannot be characterized in terms of definitions of Section 9(1)(vi) or (vii) of the Income Tax Act, then such income is said to be business income; See D.P. MITTAL, supra n. 9.

which has depicted a circumstance in which a man desirous to buy an encyclopedia may have a decision of either purchasing an arrangement of CD-ROMs, which might bring about offer of products income, or availing the services online, which might create services income. The taxing authorities will, hence, face the concerns raised by the development of utilization of e-business and the free stream of digitized data. Should such business and transactions which bring about the exchange in intangibles, be dealt with as royalty or as business income? Without a perpetual establishment, the revenue in form of tax income generated of the import or source nation might be saved in the case such income is described as royalty.[83]

ii. Classification of Income in case of Computer Software

Characterization of the tax revenue either as general business income or treating as royalty income will bring about altogether distinctive assessment treatment. This distinction makes an issue for transactions which are equipped to fall under both these heads. For instance, the buying or selling deal or licensing of PC systems produces fees that can sensibly be dealt with as either a royalty or as business income. In the event, that product permit fees to be dealt as royalty sum paid to the merchant, which is justifiable as all such sum paid are basically remuneration for the privilege to utilize copyrighted matter, the sum paid, contingent upon the DTAA, would be liable to be taxed in the source nation. Nonetheless, when a license fees is seen as income arising from services earned over the span of a business, the international taxation assessment treatment of such income would be tangibly distinctive. In the event, that the beneficiary of the income is occupant in a nation that has a taxation treaty with the nation of residence of the payer, the source nation might be permitted to impose tax on the business income in the event the recipient which is foreign has a permanent entity established inside of the source nation.

Citizens will have a tendency to classify sum paid emerging out computer programming transactions in a way that in prudent manner minimizes their taxation obligation. In this

[83]OECD Model Convention, supra n. 12. See, Art. 7: Business profits under Art. 7 of the DTAA are taxable only if such business profits are attributable to a PE in India. Therefore, in the absence of a PE, no taxes can be levied on business income.

manner, there is necessity to set down particular principles for the tax collection of such computer software transactions.

iii. OECD guidance on taxation of E Commerce

The report by OECD in 2001 that set down guidelines to the taxing authorities of nations that are its member, in determining questions identifying with e-commerce transactions. The OECD was slanted to describe the licenses sales and the transaction related to computer software as business income arising on the premise that capture and utilization of computerized copyrighted data reflects just a by-result of the e-trade exchange where the genuine reason for such business transactions is to procure income from such business.[84]

iv. Indian Scenario

In 2006, Delhi High Court in 2006 managed to resolve the question of characterization income in situations that are related to computer software. The core of the question was whether the sum paid will fall under the payment for a copyright or under the copyrighted material. In the event that it would come under copyright, it ought to be characterized as royalty in the Act as well as in the DTAA and it would be taxable and assessable by the assesse on that premise. In the event that the sum paid was truly for a copyrighted material, then it would not be characterized as royalty in the act as well as the DTAA owing to the fact that such sum paid reflects the purchase price.[85]

"The Delhi High Court observed in *Motorola Inc. v. Dy. CIT*[86], wherein particular reference was made under Copyright Act, 1957 and held that in the event the payer does not have any right specified in clauses (a) and (b) under s. 14 of the Copyrights Act, 1957; it would imply that they would not have any of the copyright rights"[87]. All things

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[84]OECD Technical Advisory Group on Treaty Characterisation of Electronic Commerce Payments, *Report on Tax Treaty Characterization Issues Arising From Electronic Commerce*, (2001), available at http://www.oecd.org/tax/consumption/1923396.pdf , accessed on 13.03.2016.

[85]Dy. CIT, Non Resident Circle, New Delhi v. Metapath Software International Ltd, [2006] 9 SOT 305.

[86](2005) 96 TTJ Delhi

[87]THE COPYRIGHT ACT, 1957 (Act No. 14 of 1957) §14 (b): "The term copyright, in the case of computer software, means To do any of the acts specified in clause (a) and to sell or give on hire, or offer for sale or hire, any copy of the computer programme, regardless of whether such copy has been sold or

considered, the sum paid made by the payer couldn't be described as royalty either falling under the Act or in the DTAA. Consequently, the exploitation of the copyright can be done commercially by the holder and in the event that he is not allowed to do as such then such acquiring by the holder would not amount to be taken as a copyright. In such case, it must be said that he had obtained a copyrighted material. One can't have a copyright in the absence of the copyrighted material yet in the meantime since one has the copyrighted material, it doesn't take after that one has additionally the obtained a copyright in it. The Court was of the view that the payment got by the assessee on software license ought not to be dealt with as royalty in light of the fact that such sum paid was truly for a copyrighted material reflecting that as purchase price of material and couldn't be taken as royalty in DTAA or under the Act

### 3.5.3. SATELLITES AND ROYALTIES

The connection between income got from the utilization of satellites by cable administrators and the characterization of this income to be royalty has been a debated concern. This concern assumes an essential part in worldwide tax assessment as by and large these satellites are claimed by foreign organizations where they don't have a settled base in India. Additionally, deciding the precise area of the satellites likewise represents a main issue for taxing authorities. With respect to the perspective of royalties, this concern emerges by means of utilization of specific terms in the meaning of royalty in the DTAAs as well as in the Act. The important inquiry which emerges is whether the sums paid are to be taken as royalties or as business income. The word royalty is characterized in the OECD Model Convention as "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including

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given on hire on earlier occasions. Section 14 (a) Copyright means the exclusive right to do or authorize the doing of the following acts:

i. To reproduce the work in any material from including the storing of it in any medium by electronic means;
ii. To issue copies of the work to the public, not being copies already in circulation;
iii. To perform the work in the public, or communicate it to the public;

To make any translation/adaptation of the work;"

cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.”[88]

The interpretation of the definition brings up some vital issues[89]. What constitutes “consideration for the use of, or the right to use, any . . . secret formula or process “? In particular, are fees given for the utilization of space on a satellite, or for providing broadcast into the source nation appropriately is taken as royalties? These questions are determined contrastingly by the OECD and different States when contrasted with the courts in India. The ITAT has these questions in two particular cases.[90] Before going into the international standards and practice, it is critical that Indi’s position be set down unambiguously and in comprehensive manner

I. *Asia Satellite Telecommunications Co. Ltd. v. Chief of Income Tax* [91]

The facts included fees paid by a cable administrator for a down linked satellite signal. The issue was whether such payment of fees by cable administrator for utilization of satellites would be taken as royalties given for utilization of a business "process."

Nonetheless, the question rotated around an organization which was occupant in Hong Kong and as India was not having DTAA with Hong Kong; the Tribunal continued to reflect on whether the alleged fees would have tax liability in the Act. The Act characterizes royalty in Explanation 2 to s. 9(1)(vi). Proviso (iii) of the Explanation expresses that “for the purposes of this clause, “royalty” means consideration for the use of any patent, invention, model, design, secret formula or process or trade-mark or similar property”. “The Tribunal considered three issues: (a) whether property, (b) whether the word secret be connected to the term process and thereby utilized (c) whether the utilization of satellites added up to a procedure where in such case it would be assessable as royalties?”.

[88]See “L. Sheppard, *News Analysis: Revenge Of The Source Countries, Part 2: Royalties*, 2005”, available at http://taxprof.typepad.com/taxprof_blog/files/e59e358c8cf43c.pdf, accessed on 13.03.2016.
[89]Art. 12,OECD Model Convention,2014
[90](2006) 103 TTJ Delhi 861.
[91](2003) 78 TTJ Delhi 489.

With respect to the main question, it was held that the expression "use" alludes to obtain benefit out of properties and in the current situation; the benefit was obtained by using the procedure in the transponder. In that capacity the procedure in the transponder can be said to be "utilized."

“The Tribunal while resolving the question of the expression "secret" observed that since there was no comma after the expression "secret" until end of the Clause (iii). Further, there would have been comma, after term ‘formula’, if the parties intended to utilize such expression before the term ‘processes.” It was further observed that if by natural interpretation it cannot be seen that the term ‘word’ is before ‘trademark’, then such term cannot be prefixed before the term ‘process’. Further, the legislature had intended to restrict the use of such expression only prior to term ‘formula’ rather than for terms ‘process’ or ‘trademark’.

At last, concerning the third question, with respect to application of domestic law of India, it was held that the paid fees given for utilization of satellite were clearly falling under royalties, because of the fact that the sum paid for the utilization of a procedure. The procedure being referred to was the utilization of the transponder for relaying signals of satellites into India. This situation is of prime importance because the ruling by the Tribunal has imperative impact on cases where there is DTAA in respect to India, as there exists a huge contrast with respect to the meaning of the expression "royalty" under the Indian Income Tax Act and DTAA of India.

II. *Deputy Commissioner of Income Tax.v. Panamsat International Systems Inc*.[92]

With regard to the case, the question was mostly similar as in above case, revolving around an assessee who was an inhabitant in the USA. In this way, the DTAA in the middle of India and USA was to be applied. Art. 12(3) under USA DTAA characterizes royalty as significant sum paid of any sort by way of consideration for utilization of, or to acquire right to utilize any copyright with respect to any artistic, scientific work or literary work, which includes cinematograph movies or work in video form, tape, or different method for generation for use in context of radio or TV broadcast of any secret

[92] (2006) 103 TTJ Delhi 861

formula or patent, or model plan, trademark, or for data concerning mechanical, business or scientific knowledge, involving the benefits arising from such alienation or any property which are dependent on its utilization or productivity.

Thus, it was held by the Tribunal held that "secret" complements both terms "formula" or "process" as the utilization of the comma subsequent to the expression "secret formula or process" under Art. 12(3)(a) of treaty uproots "defect" indicated in case of Asia Satellite and reflects that it was expressly intended. Thereby, ignorance of punctuation cannot be done. It is to be noticed that both model conventions, uses the terms "secret formula or process". It was further considered by the Tribunal the issue the carrying of process by the assessee fall under purview of secret process. It was observed by the Tribunal that the relaying of satellite signals by the process of utilization of transponder cannot be said to be a secret process.

Hence, the utilization of the satellite and the sum paid thereby would not fall under the purview of royalty in the Act and therefore, application of source treatment cannot be done. The impact of the ruling is that, income arising from utilization of transponder for relaying of satellite signals into India without a fixed establishment, would not be taxed in India.

*III. New Skies Satellites N.V. v. ADIT*[93]

In the light of the clashing decisions by the Income Tax Appellate Tribunal in the mentioned rulings examined over, the ITAT at Delhi was approached by the Income Tax Department in New Skies Satellites where it was put forward that the two decisions were conflicting and contrasting and in this manner, it was essential that the question of taxation of operators of foreign satellite in India be determined by virtue of Special Bench. In like manner, a Special Bench was made which analyzed the three issues that are as follows:-

a) Whether the services rendered by the assessees through their satellites for the purpose of telecommunications or broadcasting results into a 'secret process' or only a 'process'?

[93](2009) 126 TTJ 1

b) Whether the expression "secret" which is used in the expression ' secret formula or process' in the meaning of the word Royalty under the Act and the significant DTAA qualify "process" also? Provided that this is true, then the issue arises that would only the services provided by means of a secret process would fall under the expression "royalty"?

c) Whether the sum paid to the assesses from their clients add up to royalty and assuming this is the case, are these subjected to tax under s. 9(1)(vi) of the Act read along with the applicable provisions under the DTAA. ?

The Tribunal held, in appreciation of the main issue, that the process of transmission of voice, programs and information which belong to the clients or customers is a "process" utilized in transponder of the satellite and in this manner, services provided by the assesses by means of satellites for telecom or broadcast adds up to a 'process'. As respect to the second issue, the Tribunal observed that the expression "secret" used in the expression 'secret formula or processes' under the Act and the significant Article in the DTAA won't qualify the term 'process'.

Along these lines, to fall within the definition of Royalty as provided in the provisions under the Act and as well as the DTAA, it is not an essential requirement that the services should be provided by way of "secret process". Indeed, if the services would be provided by way of simple procedure or process, it will come under the definition of royalty. With regard to third issue, the Tribunal inferred that the sum paid to the assesses by clients or customers are on the basis of utilization of process which is involved In transponder and hence, it adds up to royalty falling inside the scope of definition under s. 9(1)(vi) of the Act.

### *IV. International practice on the taxation of income from the use of satellite*

The report of OCED with respect to Taxation of Leasing of Industrial, Scientific, and Commercial Equipment opposes grouping of satellite fees as royalties and made it fall under business profits[94]. Nonetheless, a few nations, which include, Brazil, some previous Soviet republics, and Mexico reflect that the sum paid in respect of satellite,

[94]OECD Report, *Taxation Of Leasing Of Industrial, Scientific, And Commercial Equipment* (1983).

cable and other fiber transmission would be taken as royalty income, and this can be shown by their treaties. Australia as of late altered its arrangement or treaty with USA and the treaty as of now explicitly regards satellite fees to come under the ambit of royalties.[95]

Accordingly, it is unambiguous that numerous nations regard satellite fees to come under the ambit of royalties. Hence, the outbound sum paid would be taxed by the source country and hence, it would lead to larger revenue generation, regardless of the vicinity of a Permanent Establishment. With respect to India, there is necessity to make the position clear as to whether such income would be taxed as business profits or royalties. Despite the fact that the opposing perspective taken by various tribunals has, to a specific degree, been resolved by the ITAT, Delhi, and the question should be determined in a conclusive manner to reach an unambiguous position. This is because that the characterization of this income to fall under royalty will undoubtedly impact the revenue making it richer and also in the meantime, this categorization might also result into making the cost of services more costly arising from utilization of satellites more costly. The ruling given in New Skies Satellite will undoubtedly have a major sway on satellite proprietors because of the fact that such income would be treated as royalty and would be taxed as such under the Act.[96]

[95]See, Ministry Of Commerce And Industry, Department Of Commerce, Government Of India, *Report on Foreign Trade Policy*, (2009), available at http://dgftcom.nic.in/exim/2000/policy/plcontents2006.pdf , accessed on 15.03.2016.
[96]See, "Ministry Of Finance And Company Affairs, *Report Of The Working Group On Nonresident Non Resident Taxation*, (2002), available at, http://finmin.nic.in/downloads/reports/NonResTax.pdf. Accessed on 15.03.2016."

## CHAPTER IV

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# 4. TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION

## 4.1. INTRODUCTION

Tax Avoidance, similar to Tax Evasion, genuinely affects the objective of public finance for collection in a fair and equitable manner. Exchanges that give a more noteworthy chance to Tax Evasion have a tendency to distort the allocation of resources. Since the Advantageous segments are more inclined to fall back on such practices, Tax Evasion additionally prompts cross-subsidisation of the rich. In this manner, there is an all-around created general assumption in the finance strategy that all Tax Avoidance is monetarily questionable and biased. On contemplations of financial productivity and equity, a citizen ought not to be permitted to utilize lawful developments or exchanges to damage value.[97]

Prior, the reaction to Tax Avoidance has been the bringing legislative amendments to manage certain transactions relating to Tax Avoidance. Since the liberalization of the Indian economy, more propelled types of Tax Avoidance are being trailed by the citizens and their guides. The issue has been further extended by Tax Avoidance courses of action rotating over a few expense purviews. This has brought about serious issue on jurisdiction of the taxation. Further, investigating authorities and courts have been setting out a substantial weight on the Revenue when managing matters of Tax Evasion despite the fact that the important actualities are in the restrictive area of the citizen which he picks not to uncover.[98]

The decision by Supreme Court on Vodafone case created crisp verbal confrontations on whether India needs to survey its current legal framework regarding overseas tax collection. In this setting, clear qualification between Tax Evasion, Tax Avoidance and planning of taxation are crucial. The Standing Committee on Finance under 49th Report on Direct Taxes Code bill, 2010 prescribed Controlled Foreign Corporations (CFC) rules,

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[97] Jane G Gravelle, *Tax Havens: International Avoidance of taxation and Evasion* ,(2015), available at https://www.fas.org/sgp/crs/misc/R40623.pdf , accessed on 15.03.2016.
[98] *Id.*

Advance Pricing Agreement (APA) alongside General Anti Avoidance Rule (GAAR) procurements to substitute the Income Tax Act, 1961 according to the International Taxation Standard furthermore consistence with the Chinese Corporate Income Tax (CIT) Law in the year 2008 to manage overseas transactions through holding companies. Though presentation of GAAR is fundamental given the confined utilizations of a focused on hostile to shirking control, the Committee additionally recognizes the exigency for a proper Dispute Resolution Panel (DRP) as GAAR may bring about giving a huge discretionary power to the tax authorities. The fitting use of procurements of GARR assumes a critical part in transactions with nations without any Limitations of Benefit (LOB) proviso (e.g. Mauritius) with India. Before falling back on case, it is useful to settle debate relating to tax through arrangement as Mutual Agreement Procedure (MAP), where tax authorities of the particular nations arrange to settle dispute in amicable manner.

### 4.2. THE SUPREME COURT VERDICT ON VODAFONE CASE

The Honourable Supreme Court's guidelines in Vodafone case have huge impact on taxation regime of India for revenue generation. Some are specified herein under:-

The holistic approach of a transaction must be looked into instead of looking at a segregated approach. There is a need to follow the holistic approach to highlight the difference between a genuine transaction and a sham arrangement.

The current Income Tax Act, 1961 under section 9(1)(i) explains that the following income shall be deemed to be accrue or arise in India "all income accruing or arising, whether directly or indirectly through or from any business connection in India , or through or from any property in India , or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India."

Therefore we may conclude that the income that deemed to accrue in India is that which earned from-

- any business which is in India
- any property in any territory of India

- any asset or source in India and
- any transfer of capital asset in India.

In Vodafone case it is extremely hard to trust that the profit has not been created under any of the classifications for this situation. Vodafone organization has its business association CGP Holding and thus Hutchison. Notwithstanding when we consider it as just share transfer and not an asset transfer, it is very clear that the transfer of shares created the benefit from India. The fact of the matter is that whether this profit be taxable, and if yes who should pay the tax? Whether Vodafone or Hutchison? Since the Vodafone is the acquirer of Hutchison (the objective organization), the monetary record of the benefits side of the Vodafone organization itself says that the procurement and takeover by the organization. In any case, on the other side on the off chance that we acknowledge the fiscal increase as an addition by cash the money related addition could be comprehended as the financial increase of the organization. Subsequently the truth of the matter is to be in distinction is that whether a fiscal benefit is to be taxed where the benefit conceded by transfer and buy of shares and whether they can be considered as the assets.[99]

**With reference to tax dept. of India**:

When a fiscal addition occurred for 36 months is called 'long term Asset'. Where , shares of the organization the unit of the trust of India or mutual fund or any security listed in any stock exchange which are to be considered as short term, in the event that they were held for maximum period of 12 months.

By the 49th report[100] of the parliamentary standing board's report equity shares or preference shares like debentures recorded government securities, mutual funds and UTI,

[99]Vodafone International Holdings BV *vs*. UOI, (2012) 6 SCC 613.
[100]Indian Lok Sabha, Committee of Finance, 49th Report and Direct Taxes Code Bill,(2010), available at http://www.prsindia.org/uploads/media/DTC%20Bill/SCR%20DTC%20Bill%202010.pdf , accessed on 17.03.2016.

zero coupon bonds are characterized as a long term capital assets (committee on finance act 2012).[101]

Another significant issue which has been resolved by the benchmark about the passable measure of assets transfer or upper limit of such transfer. S. C. Likewise cleared up that:-

‘ the difficulties has been raised because this case is related to share sale and not assets sale .The hon’ble high court also failed to appreciate about the investment made by the HTIL in India . Thus they have not considered it as a part of such payment for each of the above item.

With this context I can say that the practice of this non-compliance of the taxation is contrary to the soul of the law while it could be attempting to consistent with the letters of the Law. To quote:

*“The principle aim behind Tax Avoidance is that on the on hand it seeks to lower the tax bill whereas on the other hand, it tries to comply with the provisions of taxation law thus, defeating the objectives of taxation legislations. It generally involves establishing sham transactions or business so as to alter the kind, recipient or the time of sum paid. International Tax Avoidance refers to the transactions that take place via a foreign business. To avoid such Tax Avoidance unique complicated policies are framed. The Tax Avoidance involves concealing the material data, where it becomes difficult to establish the intention of guilty parties and hence the wall between Tax Avoidance and Tax Evasion becomes blurry.”*[102]

Very often, it is challenged that CGP Holding is not made during the time of exchange and such is present till 1998. A twisting certainty behind it is due to the presence of various tax havens corporates that is utilized to maintain a strategic distance from tax liability. It would always be difficult to handle such cases of tax liability until such tax havens corporates modify their taxation laws so as to enforce taxes on the transactions that take place in offshores, along with expanding the tax bases. In spite of the fact that

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101 Rihard Murphy, *Tax havens Report UK* Tax Research LLP, (2013), available at http://www.pcs.org.uk/taxhavens , accessed on 17.03.2016.

102 *A Critical Analysis Of Tax Planning, Evasion of taxation And Avoidance of taxation*, available at https://researchersclub.wordpress.com/2014/11/30/a-critical-analysis-of-tax-planning-tax-evasion-and-tax-avoidance/, accessed on 17.03.2016.

OECD has taken such measures, the tax rates and taxation framework in various tax haven nations are very and pointlessly useful for venture purposes. In this regard, the Standing Committee Finance recommendation on Controlled Foreign Corporation (CFC) rule is crucial which would be applicable to Companies located in low tax jurisdictions.[103]

Law should be able to clearly reflect precisely: *Whether Income Tax authorities are entitled to charge capital gains tax where mergers and acquisitions take place outside Indian Territory by foreign companies containing any relation to Indian assets* Or *whether companies (foreign/domestic) have to pay a capital gains tax to Indian tax authority in case of a M&A held outside Indian jurisdictions containing any relation to Indian assets (and under what conditions).*Laws should be clear and mostly inclusive to reflect how to tax *direct and indirect offshore transactions arising from sale of assets*.

Moreover, what should be treated as assets for tax purposes and the related classification of such assets is crucial. It can be mentioned in this context that the proposed Direct Tax Code (DTC) in India suggested that income from transactions in all investment assets will be computed under the head 'Capital gains.' However, more clarity is required whether capital gains tax would be generated on both assets and income since a major controversial area is whether the income generated from capital market transactions should be treated as business income or as capital gains. There is also a need of clear separation of different corporations/companies (for instance, 'offshore companies') to specifically categorise which types of taxes would be applicable on which types of companies and under what circumstances. For instance, in the revised discussion paper of DTC an explicit mention is provided whether capital gains tax would be applicable for Foreign Institutional Investors (FIIs) as The capital gains arising to FIIs shall not be subjected to TDS and they will be required to pay tax by way of advance tax on such gains( CBDT 2010).[104]

[103]*Id.*
[104]*Id.*

### 4.3. WHERE ARE THE TAX HAVENS?

There is no exact definition of a tax haven. The OECD initially defined the following features of tax havens: no or low taxes, lack of effective exchange of information, lack of transparency, and no requirement of substantial activity. Other features have been included in the list through legislation and by researchers. Also, a number of jurisdictions have been identified as possessing the characteristics of tax haven.[105]

### 4.4. OECD PLAN ON BASE EROSION AND PROFIT SHIFTING (BEPS)

As of late, globalization has prompted worldwide joining of economies and organizations at a quick pace. The free development of capital and work combined with evacuation of exchange obstructions, moving of assembling base to ease areas, and mechanical improvements have changed the methods for leading cross-fringe exercises. MNEs have moved from country specific working models to worldwide models taking into account lattice administration associations and incorporated supply chains that bring together a few capacities at a local and worldwide level. These MNEs live, control and oversee operations from one nation (occupant nation) yet lead business in numerous nations (source-nation), at times without building up any office in the last nations.

The spread of web and development of e-trade has likewise made it workable for organizations to find a hefty portion of their exercises in nations far from clients to whom they convey administrations. In the vicinity of various DTAAs spreading over numerous assessment purviews, these improvements have incentivized and exacerbated refined expense arranging exercises by MNEs that recognize and adventure legitimate arbitrage opportunities. By taking forceful duty positions, MNEs can lawfully moderate or abstain from paying charges in either source or inhabitant nation by falsely isolating assessable wage from the action that produces it. This has hurled difficulties of base disintegration and benefit moving in the current duty administration. Governments, both in created and creating nations are confronting challenges from natives and household organizations

[105]"Michael S. Lebovitz,Theodore P. Seto, *Preface: The Fundamental Problem of International Taxation*, 23 Loy. L.A. Int'l & Comp. L.Rev.529 (2001)."

over disparity and injustice in a framework that empowers some profoundly productive enterprises to pay far lower assessments than some of their own representatives. [106]

A standout amongst the most generally referred to cases is of Starbucks, which paid no corporate duty in 2009-2011 by reporting misfortunes in spite of indenting up offers of GBP1.2 billion from more than 700 outlets. Another case is of Apple which, in spite of being the most productive American innovation organization, abstained from paying billions in charges in the US as well as around the globe through an intricate web of backups and duty shirking plans. Organizations more often than not go settlement shopping, incorporating putting copyrights in seaward shell organizations, and afterward paying sovereignties to those shell substances as a method for lessening the expressed assessable benefits earned in higher-charge nations. In the wake of such methodologies, organizations that lead cross border business have favorable position over the individuals who don't have abroad operations or are not inhabitant in expense safe houses. In spite of the fact that assessment arranging offers MNEs to decrease their expense some assistance with outgoing, this base disintegration is negative to different areas of society. Against this setting, at the case of the G20, OECD distributed an Action Plan posting fifteen new assessment standards on BEPS in 2013 with the target of tending to saw blemishes in universal expense rules in a period bound and co-ordinated way. [107]

BEPS Action Plan identifies with occasions where DTAA and duty rules lead to twofold non-tax collection, or not as much as single tax assessment. On the off chance that embraced generally, it will move a portion of the worldwide taxation rate from little ventures and people towards substantial organizations. If not acknowledged, it is expected that nations will fall back on one-sided activities that will in the end lead to twofold tax assessment and in this manner, hamper ventures. The activity arrangement expresses that central changes are required for successful tax collection and new universal gauges must be intended to guarantee consistency of corporate salary charge at the worldwide level. It perceives that activities actualized to counter BEPS can't succeed

[106] *See* OECD Report, *Harmful Tax Practices: Update on Progress In Member Countries,*2006, available at http://www.oecd.org/dataoecd/1/17/37446434.pdf , accessed on 17.03.2016 .

[107] M. Bhutani, *BEPS & India: In search for a solution,* Business Standard,(August 18, 2013), available at http://www.business-standard.com/article/opinion/beps-india-in-search-of-a-solution-113081800704_1.html , accessed on 17.03.2016.

without further straightforwardness or sureness and consistency of business. One of the basic focuses said in the activity arrangement is the test of exhausting an advanced economy.[108]

E-trade and online organizations posture challenges in applying existing global duty rules. The move arrangement makes a comprehensive way to deal with this issue and considers both immediate and aberrant tax assessment. The other issue is to create model arrangement procurements and suggestions to plan residential guidelines to kill the impact (e.g. twofold non-tax assessment, twofold derivation, long haul deferral) of mixture instruments and elements. OECD in its report expresses that there is critical need to reinforce controlled outside organization (CFC) rules through co-ordinated endeavors alongside redoing the work on hurtful expense hones with accentuation on enhancing straightforwardness, including mandatory unconstrained trade on decisions identified with special administrations, and on requiring generous action for any particular administration. OECD likewise understands that there is an inclination amongst corporates to depend on simulated shirking of PE status.

The activity arrangement expects to create changes in the meaning of PE and benefit attribution. It additionally expresses that MNEs have in a few occurrences utilized or twisted guidelines to separate income from the relating economic activity with the reason for moving the applicable pay to a low tax segment. This regularly comes about because of exchanges of intangibles and other portable resources. The arrangement sets down activities for each of the three distinguished regions. What's more, the OECD report records suggestions with respect to the outline of compulsory exposure rules for forceful or harsh exchanges, courses of action, or structures, contemplating the authoritative cost suggestions for tax administration. The report utilizes a measured outline considering most extreme consistency, remembering nation particular needs and risks. One zone of center is universal tax plans, where further work will investigate utilizing a wide meaning

108 OECD Report, *Action Plan on Base Erosion and Profit Shifting*, (2013), available at http://dx.doi.org/10.1787/9789264202719-en, accessed on 17.03.2016.

of "tax benefit" to catch such exchanges. This will be blended with work on co-agent consistence.[109]

Another vital center region of BEPS is exchange evaluating documentation to upgrade straight forwardness in tax administration, keeping in perspective the expense of consistence to organizations. The OECD activity arrange additionally focuses on making question determination systems compelling and adding to a multilateral instrument for determining universal assessment debate The OECD activity arrangement has set clear parameters for every activity thing. In the meantime, it leaves extensive degree for the Working Groups 39 to figure its own suggestions. The moves set forward will make near two years for fulfillment and maybe extensively more to be completely connected therewith.

There are signs that BEPS related advancements have as of now prompted a material movement in the conduct of duty organizations. By and large, the activity arrangement introduces an adjusted methodology where, from one viewpoint, it obviously distinguishes the "holes" in the present framework and puts a guide to address these through shaping devoted Working Groups, and then again, sets a mindful tone, focusing on the requirement for planning controlling standards on straightforwardness, consistency and responsibility for both the legislature and the citizen. Price Waterhouse Coopers, in its Tax Policy Bulletin (July 2013), expresses that it respects this methodology of expanding on, as opposed to surrendering, long standing principles on global tax collection and invites, specifically, the announcement disheartening one-sided measures to maintain a strategic distance from re-rise of twofold tax collection. Be that as it may, a few concerns emerge over multilateral execution and harmonization of differing tax frameworks. It ought to endeavour to lead the pack wherever conceivable in different Working Groups to defend its own particular interest as well as those of other creating economies. Nonattendance from such multilateral consultations would just hurt India more over the long haul.[110]

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[109] *Id.*

[110] OECD Report, *Action Plan on Base Erosion and Profit Shifting*, (2013), available at http://dx.doi.org/10.1787/9789264202719-en , accessed on 17.03.2016.

### 4.5. TAX AVOIDANCE AND GARR

The GAAR is a wide arrangement of procurements which allows authorities to 'discredit any arrangement', for tax purposes, in the event that it is followed by the assessee with the primary objective of getting a 'tax reduction'. A tax reduction would incorporate an advantage identifying with Income-Tax, Wealth Tax, Dividend Distribution Tax and Branch Profit Tax. Aside from the 'tax benefit' test, the course of action likewise needs to fulfill no less than one out of four extra tests examined in the resulting passages. The primary condition for negating a course of action under the GAAR procurements is that the game plan (or any stride thereof) probably been gone into with the principle reason for acquiring 'tax reduction'. This condition as a rule is liable to get fulfilled naturally at the evaluation stage itself. Given that, under the proposed law, particular assumption is to that impact, GAAR procurements will be pulled in consequently unless the citizen can demonstrate something else. This would cast a burden on the citizen in such cases which will be released with fitting positive confirmation.

Once the test of the primary objective behind tax benefit is fulfilled, the citizen is required to experience further investigation to breeze through different other basic tests to keep away from the utilization of the GAAR procurements and keep the conceivable activity of nullifying the course of action. These basic tests, incorporate whether (a) the plan is not completed in a way typically not utilized for bonafide purposes or (b) it is not at a manageable distance or (c) it results in immediate or circuitous abuse/misuse of the procurements of the Code or (d) it needs business substance. Further, as per the amplified meaning of the test of 'absence of business substance', it would likewise be fundamental for the citizen to finish certain further tests, for example, whether there is a huge impact upon the business dangers or net income of the concerned gatherings, the test of substance over structure, whether the course of action includes 'round outing financing' or any pleasing or duty unconcerned gathering or any component having impact of counterbalancing each other et cetera. The majority of these tests (for points of interest allude to Chapter 4) are profoundly subjective. On the off chance that any of these tests is fulfilled, then the CIT would expect the ward to apply the GAAR procurements. Such a game plan would be viewed as 'Impermissible Avoidance Arrangement', and the CIT would have the ability to refute the game plan and decide the results thereof under the Code with especially wide powers.[111]

### 4.5.1. SCOPE AND PRACTICAL EFFECT

The extent of the Indian GAAR is wide as it looks to cover inside of its ambit about every one of the game plans (the expression "arrangements" is generally characterized to cover verging on each exchange plan, understanding and so on.) which have a component of 'tax benefit' accumulating to the citizen and for its wide scope, essential go down procurements have likewise been made. Accordingly, at first sight, different business (even non-business) game plans bringing about tax benefit might come-up for addressing under the GAAR procurements and considering past experience these might bring about long drawn expense prosecution. This might make an incredible measure of vulnerability as far as assessment and different ramifications of any such course of action. In this manner, genuine thought should be given to these procurements by persons working at all levels in an association including at the level of strategy and choice making. Truth be told, while taking every business choice and deciding the way of their usage, the duty ramifications of these procurements might assume an indispensable part.[112]

### 4.5.2. PROCEDURE

The errand of conjuring and regulating GAAR procurements is depended to the CIT. It should be perceived that in the Indian Tax system, the CIT is the leader of the assessment regulatory purview, which comprises of a few AOs working under him. He is additionally to a great extent in charge of accomplishing the objectives of tax accumulations given to him by the Government. The likelihood of irreconcilable situation in execution of GAAR procurements in a reasonable and simply way, however unintended, can't be precluded. The CIT is required to issue notification to the citizen obliging him to deliver confirmation, particulars, and so forth on which the citizen depends in backing of his claim that the arrangement being referred to is not an 'Impermissible Avoidance Agreement'. For this reason, it is required for the CIT to give

[111] Rahul Garg, *Removing the fences through GAAR*, available at https://www.pwc.in/assets/pdfs/publications-2012/pwc-white-paper-on-gaar.pdf , accessed on 17.03.2016.
[112] *Id.*

the chance of hearing to the assessee. Amid the procedures before the CIT, it is normal that the standards of common equity will be taken after.

From there on, the CIT is required to pass a request (inside of 12 months) in the event that it is held that the course of action is impermissible as considered in the GAAR. At that point, he is required to give fitting bearing to the AO in his request. Interestingly, no particular time point of confinement is accommodated issuing such a notification. It appears that the notification ought to be issued before the time excepting date for finishing the pertinent evaluation. Taking into account these bearings, the AO is required to pass a draft request. The cure accessible to the citizen is to document complaints before the DRP – comprising of three CITs. The DRP, in the wake of taking after the fitting methodology, is required to choose the matter inside of a time of nine months and give proper headings to the AO who, thus, is required to pass the final appraisal request in light of these bearings. The citizen can record an advance before the Income Tax Appellate Tribunal (ITAT) against the request. Considering past experience, the DRP ought to be made free and ought to work on the lines of ITAT to give a genuine and successful solution for the citizen. This will ingrain certainty amongst the citizens, locally and in addition comprehensively. Such an instrument will likewise help in keeping India as an aggressive destination for drawing in outside speculations. Once the CIT passes a request under the GAAR procurements, he is additionally required to send a duplicate to the CIT having purview over the other party included in the course of action. The other CIT will then continue against the other party under the GAAR procurements. The other CIT might again freely analyze the same game plan. In a given circumstance, the other CIT might arrive at an alternate conclusion in connection to that other gathering.[113]

### 4.5.3. CONSEQUENCES

Once the procurements of the GAAR are conjured in appreciation of any game plan, the CIT has been given wide powers to neutralize the resulting charge focal points and to decide the expense outcomes either by overlooking the arrangement being referred to or in some other way as the CIT might esteem proper, for the anticipation or lessening of the

[113] *See* Ajay Kumar, *Ready for GAAR*, Business Line, (December 5, 2009), available at, http://www.thehindubusinessline.com/todays-paper/tp-opinion/article1070925.ece., accessed on 17.03.2016.

applicable tax reduction. The CIT might nullify, dismiss, put aside or re-describe any game plan or he might derecognize one or more gatherings to the course of action and so forth. The procurement for all intents and purposes enables the CIT to lift the corporate cloak to reallocate Income/price/, nullify exchanges and even regard a few elements as one for tax purposes. In specific cases, the discoveries and choice of the CIT might have even non-charge outcomes under different laws. Adequately, the CIT would have colossal optional forces (which, obviously, are relied upon to be judicially worked out) for counteractive action or lessening of the pertinent tax benefit and decide the outcomes of the game plan being referred to under the Code. For instance, in a given case, the CIT might regard an advance as capital and prevent the finding from claiming interest. Upon such treatment, comparing results might take after under the Code. So also business benefit can be recharacterised as eminence or expenses for specialized administrations and saddled in India in the hands of a non-inhabitant even without a Permanent Establishment (PE). Unless reasonably worked out, these activities can make issues in the nation of origin of a non-occupant citizen particularly in regards to characterisation of a certifiable income exchange, particularly where India has gone into an arrangement with the other nation. The Code likewise accommodates overriding of assessment bargain procurements where the GAAR is connected under the Code. [114]

[114] *I*d.

# CHAPTER V

# 5. INTERNATIONAL TAXATION: INDIAN PERSPECTIVE ON DISPUTE RESOLUTION MECHANISM

## 5.1. DISPUTE RESOLUTION MECHANISM IN INDIA

One of the main issues that revolve around the corporate is Litigation, which is generally based on the premise of tax uncertainty. Various cases that have arisen in the later past in this respect have attracted media focus and acts as alarm for all the foreign investments. In the arena of taxation, issues related to the its construction are unavoidable in numerous jurisdictions, what makes India's sector particularly baffling is the lack of ability of the framework to determine them quickly where the only choice left is of lengthy litigation process. This prompts the worldwide observation that India is a troublesome jurisdiction to work in or to work with. India has a four-level dispute resolution system.

An appeal can be filed with Commissioner of Income Tax (Appeals), in the event that a taxpayer is dissatisfied with the assessment, subsequently, a second appeal can be filed to the Income Tax Appellate Tribunal (ITAT). A ruling given by ITAT is taken as final with respect to the question of fact and recourse by way of the appeal can be taken where such appeal can be filed to HC or the SC with respect to question of law that can arise in such order. There are two inbuilt drawbacks with respect to the dispute resolution system in India that are as follows–the time consuming process along with the cost that is involved and also the anti-taxpayer approach of the tax authorities. (i) Time-Consuming and High Cost: The cost is very high with respect to the appellate mechanism. The time limitation as provided in the statute is of 1 year with respect to CIT(A) and 4 yrs with respect to ITAT. But such time limit is not mandatory and only directory in nature. The statute for disposal of appeals prescribes a time limitation of one year for CIT (A) and four years for the ITAT. However, the time limitation is only directory and not mandatory.

There is log jam of numerous appeals with various different appellate authorities. As compared to the other developed and developing countries where it takes 3-4 years, India takes 15 to 20 years for resolving disputes. . The problem of pendency of cases is the not only at the appellate level but also at the appraisal phase, which is due to filing of various groundless cases which are there for investigation.

Furthermore, there are not enough judicial precedents in the field of India's international taxation. Though, the application of different commentaries and judgments is upheld by SC, the tax authorities are not willing to apply it. This subsequently led to obtain a stay order on the tax authorities. (ii) Anti-Taxpayer Attitude of Tax Authorities: It was pointed out amid stakeholder deliberations there exists anti-taxpayer outlook by the Indian taxation authorities while deciding the cases via the mechanism of dispute resolution. Distinctive officers at various levels give clashing decisions and constructions of the same problem.

The disputes and cases are not resolved at the tribunal phase or get dragged in courts in the area of taxation in the most developed nations. Arbitration is not taken as a good option to resolve cases by the tax administration. It leads to the high time consumption and burden of high cost of litigation is attached with the taxpayer. There are also other alternatives for dispute resolution for MNEs in India. Such alternatives are based on the premises of international best standards and practices so as to strengthen the process of dispute resolution. But these alternatives also have certain limitations that lead to making the mechanism dysfunctional.[115]

**Dispute Resolution Panel (DRP):** In India, a Dispute Resolution Panel (DRP) was established which includes 3 Commissioners/Directors of Income Tax so as to resolve the TP related disputes. In this system, tax authorities do changes in accordance with the ALP in connection to exchanges with affiliates in overseas. This component was to be there at assessment phase so as to furnish different business and corporate with a period bound distinct option to the appellate recourse by means of CIT(A).

The DRP has a predefined time period of nine months and its powers related to affirm, lessen or upgrade additions that were proposed in the drafted order is wide. It is the right

[115] Chattopadhyay and Das-Gupta, *The Income Tax Compliance Cost of Indian Corporations", National Institute of Public Finance and Policy,* (2002), available at http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN014796.pdf , accessed on 17.03.2016.

of assesse to prefer appeal in the assessment orders passed by DRP to the tribunal. In view of American provisions, the DRP was established to autonomously decide TP related disputes in India. In United Sates of America, the taxing authorities that deals with such disputes are kept independent of the IRS and methodology adopted is to carefully examine the case so as to reach a settlement. The outcome of such approach is that not many disputes go to courts. Then again, in India, the DRP comprises of authorities from the CBDT, making the system one-sided and inequitable.

Another weakness lies in the trust issue where the taxpayers are of the impression that the issue is not resolved by the DRT independently of the tax authorities. One way to combat such weakness was an attempt whereby it was made sure that no member of taxation department was to be a part of DRP. It was many times suggested that a HC judge should preside DRP with the institution of permanent body. Furthermore, the direction given by DRP is not rendered as binding in nature and hence is not final in nature. Previously, there was no right of appeal against the ruling given by DRP. Nonetheless, this has been modified by way of amendment and the right to challenge the order is given to tax officers before ITAT. It means that by means of appellate mechanism, the orders given by DRP can be challenges except CIT(A)

In many of the most developed nations, the tendency is that the tax officers have not been given right of appeal against the decisions of the higher tax authorities. The CBDT Board, has acknowledge the fact that the present mechanism of appeal is very much length and is time consuming and further has given suggestion that this mechanism should also exist for the present mechanism of appeals. But this suggestion might not solve the problem of delay in resolving the dispute because such cases exists at higher appellate phase and not at the phase of CIT (A). It thus is likely that this problem tends to remain in the structure. The only advantage is that there exists a right of appeal given to taxpayer against the Orders where such appeal can be filed to the tribunal.

It was discussed at stakeholder level that DRP has not managed to work efficiently as it was expected. There is no mechanism of accountability and its performance. Further, there is also no advantage to the panel for solving cases without the recourse of expensive litigation. In addition to it, The Assessing authority or officer have right of appeal there exists a drawback that it is not consonance with the international standards and practices.[116]

**Mutual Agreement Procedure (MAP):** The DTAA provides for MAP which is a kind of dispute resolution mechanism. In this, the competent authority can be approached by the taxpayer where it can be seen that the conduct of tax authorities of any of the country involved in the case has resulted into tax incidence which is in contradiction to the other country.

When it is accepted, then the application is to be sent to other nation's CA. The resolution is typically accomplished by means of transactions between two CAs and thereby the decision taken by them is of binding nature on both the nation's tax authorities. In the event that such decision is adequate then the taxpayer can waive his right of appeal. Subsequent to it, such case can be withdrawn via the formal mechanism. Various corporate and companies, in India, that have operation in the country, opt for MAP, particularly in the arena of the tax demanded by the tax authorities.

In December 2013, with an end goal to give an unambiguous structure to global corporates for determining cases related to tax emerging via assessment of transfer pricing, the existence and the attributed benefits of PE, and its characterization, the taxation authorities of USA and India have concluded the wide contours in relation to MAP. Nonetheless, the MAP has its own particular inalienable issues. It incorporates the issue of time limit, where it has not been yet prescribed, to solve the disputes. Recently, CAs of both India and US, have not been able to come up with agreements amid the various negotiations. This has resulted into a backlog and caused cases to delay for two to five yrs.

In the absence of agreement between the CAs of both India and the US, there is no precedent inspite of the various deliberations between them. In light of a legitimate concern for US-India respective commercial business, USIBC has asked the GOI to determine the present backlog in cases related to the transfer pricing as per the set

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[116] Vineet Kothari, *International Taxation :Indian perspective on Dispute Resolution Mechanism,* available at http://www.hcraj.nic.in/Paper-Speech/isil.pdf , accessed on 18.03.2016.

international standards and practices. In a huge leap forward, in 2013, the two nations chose to finish the 3 years old bitterness & re-begin arranging tax negotiations and settlements under the purview of MAP. The CAs under MAP that were appointed earlier who differed in their views with respect to many disputes were removed and were replaced by their governments. These measures adopted have increased the bar of expectations of speedy settlement of pending cases related to taxation of various US multinationals having operation in India, offering New Delhi as an environment for friendly investment. Consequently, The Us has ensured that It would acknowledge the APA of India which would boost many US Corporates to seek the taxation authorities of India so as to recognize its taxation liability arising in the future. [117]

**Authority for Advance Ruling (AAR):** In the Income Tax Act (1961), the establishment of Authority for Advance Ruling (AAR) was done with the target of ascertaining the liability of taxpayer in advance and maintaining a strategic distance from the likelihood of a lengthy suit. Both the residents and the no-residents, involved in international business and transactions, can took the recourse of going to the authority in context of the business and transactions they are likely to enter. In spite of the fact that taxpayers have filed before AAR, many cases have been there where clashing decisions have been reached despite the fact that they don't have precedent significance. Additionally, the disputes have not been resolved by the Authority within the time limit of 6 months that have been provided to resolve the dispute and giving of decisions. It is of the utmost necessity that the structure should be strengthened.[118]

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[117] *Id*

[118] S.S. Khan, *Will Dispute Resolution Panels really be able to resolve disputes*?, Tax India International (2011), available at http://www.taxindiainternational.com/columnDesc.php?qwer43fcxzt=NDU, accessed on 19.03.2016.

# CAPTER VI

## RECOMMENDATION AND CONCLUSION

In connection to the moderately grim monetary approach by the nation, during a time when cynicism with respect to future development prospects is at its top, sudden and unfavorable declarations could lead to irreversible harming consequences to Indian economic prospects. With the nation battling to rise up out of an economic emergency, poorly framed policies and additionally, their antagonistic outcomes could severely harm the position of India as investment friendly nation.

Since the monetary allowance of FY 2012-13, Since past four five years, many essential contentious advancements in taxation schemes have been introduced, which have unlocked the door to past injuries and once again, put forward the problems of transfer pricing and framework of resolving the conflicts, which have since quite a while ago, had exasperated the outside investors. The nation has seen a considerable ascent in policies vulnerability and insecurity that have resulted into portraying India as a non-friendly investment nation to carry out operations.

In spite of the fact, that the issue of taxation conflicts had long history in our country, just like in other nations, such conflicts, specifically in arena of taxation of international businesses, has risen extensively in the last three years subsequent to the decision rendered by the Apex court in the Vodafone Plc case, trailed by amendments done in the Income Tax Act, 1961, retrospectively. The conflicting and subjective methodology adopted by taxation authorities, also have aggravated the declined the friendly investment environment in India.

In spite of the fact that, there exists, accessibility of skilled labor at sensible cost, good profit on the income, and an expansive domestic business sector which have portrayed our country as an attractive venture place for business, issues related to tax governance have faded the country's appeal, particularly, during the time, when other competitive nations are giving a superior venture atmosphere and an all the more amicable tax governance.

It is required that changes must be done in taxation regime with respect to its governance and also, adjust such in line with global standards. This needs assurance in taxation regime as well as a more organized elucidation of taxation schemes, legislation and guidelines, with the goal that no door to subjective interpretation by the tax authorities or taxpayers is left unlocked.

Comprehensive rules and regulations must be issued by the makers of policies and schemes for effective application of tax laws. It is important to entitle the taxation authorities with much adequate power so as to resolve the antagonistic conflicts, which might emerge. In the sphere of endeavoring to aim MNEs underlying the int. standards related to taxation, India has not yet progressed in singling out US corporate. In any case, because of their huge vicinity, with respect to number and also the vicinity in the market, an extensive number of these corporate are confronting tax scrutiny and review. In respect to this, US MNEs, have contested against the Indian taxation administration, and makers of policies, demonstrating that if such conditions keep prevailing, India would soon drop out as friendly investment environment.

Provided that there exists a constrained space to generate income by means of imposition of through higher taxes, what needs to be done by the government, is to assemble its endeavors towards the introduction of third generation taxation changes which would concentrate on rebuilding and advancing the tax governance. This in turn, necessitates disentanglement of taxation related laws, enhanced framework for tax governance, balancing and fusing legislation all over the nation. A modification with respect to these facets would lessen the compliance expense of the individual paying taxes as well as lessen the managerial burden of the administration.

Vital elements in the area of developments in tax governance includes providing better class of information facilities, computerization and institutionalization of techniques, eliminating taxation related conflicts and snappy determination, in the event that, these emerges. Few of them could be achieved by means of effectual utilization of IT. In the past two decades, India has made advancements in this aspect, particularly, with reference to e-filing of profits and sum to be paid via online services which has been increased in last three years.

In any case, the impressive part which the utilization of IT could serve, in the area of computerization and coordination of procedures, reducing communication in the middle of authorities and taxpayers, gathering of information and scrutinizing for making sound strategies, has still not been utilized to its maximum capacity. The present frameworks of tax governance needs transparent administration, which reduces rent-seeking conduct and increases the ability to voluntary pay the taxes

The judgments, state of mind and acts of tax authorities are for the most part, based on presumption that most payers, are normally disposed to stay away from paying taxes. Such absence of trust in the middle of payers and taxing authorities requires prompt consideration and efforts. The counter taxpayer disposition should be supplanted by a more open compliance outlook. Countries like USA, and UK follows a collaborative compliance scheme whereby taxpayers are considered as consumer or client and energizes the reception of more consumer driven methodology in respect of taxpayers. Beside aiming the income targets, assessing the implementation and establishing institutional goals, there exists solid accentuation on the factor of consumer contentment. Another fruitful method is to check the effect of different laws and policies, by analyzing such prior and then afterward, an enactment is introduced. This methodology is prevalent in UK and USA for a long period of time. Being a facet of responsive governance, this effect analysis acts as guard to scrutinize acts of red tape practices.

Despite the fact that, tax authorities, around the globe, are habitually rebuked for adopting arbitrary and harsh monitoring standards, it is paramount to note that corporates and enterprises, all around, have taken recourse to aggressive taxation schemes through the benefits attached with operating in low-tax countries, and also of DTAA. Many taxation administrations have adopted laws such as GAAR so as to keep check on the tax evasion activities. Prima facie, GAAR is not repugnant to taxation laws and legislation.

However, in India, what created uproar were its unanticipated enactments of debatable laws without any sufficient measures to monitor.

As It could be seen that India's rivals in international marketplace, for example, Indonesia and China, have adopted many changes in tax governance and policies, it is important for India to resolve the issues, in relation to create a certain and fair environment for the foreign investors. There is need to introduce proposed schemes and laws in public arena for considering various suggestions, to have effect analysis of laws prior and subsequent to enacting a legislation and to introduce comprehensive manuals relating to the procedure along with samples and representations so as to rule out any eventualities.

Consideration of int. standards and methods can significantly lessen the disputes, which is for the most of the part, is a misuse of economic and financial assets. Thus, with the adoption of the recommended measures, it is likely that emerging concerns of dissatisfaction, vulnerability and negativity within the sphere of trade and commerce, and particularly among the MNEs, that generally are accustomed to operate in much advanced and investor friendly nations having efficient tax governance.

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