TAX TREATY OVERRIDE: A DETAILED STUDY

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I. INTRODUCTION:

"Treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation[1]. The treaties or conventions are instruments which signal the sovereign political choices negotiated between the states.Thetreaty between countries relating to subject matter of tax is called tax treaties.

The power of entering into treaties is an inherent part of the sovereign power of the state[2].Article 73 of the Constitution of India, provides the executive power of the Union to extend the matters with respect to which the Parliament has power to make laws and to exercise such rights, authority and jurisdiction as exercisable by the Government of India by virtue of any treaty or agreement. The contracting states after ratifying the said agreement and making a domestic legislation mutually binds the parties not to levy tax, or to tax only to a limited extent in case where the treaty reserves taxation for other contracting states, partly or wholly. Thus, international treaties do not automatically form part of domestic law. This is because India follows a dualistic theory for implementation of international law at domestic level. They must, where appropriate, be incorporated into the legal system by a legislation made by the Parliament.[3]

The power to legislate in respect of treaties lies with the Parliament under entries 10 and 14 of List 1 of the Seventh Schedule read with Section 246 of the Constitution of India. The Parliament has the power of legislation in respect of foreign affairs and all matters which bring the Union into relation with other countries. The Parliament has the power to make any laws for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.[4]

[1]Article 2 of the Vienna Convention on Laws of Treaties,1969
[2] Articles 2(1) and 2(2) of the UN Charter
[3] Jolly Jeorge Vs. Bank of Cochin AIR 1980 SC470
[4] Article 253 of the Constitution of India

II. Relevance to Constitution

The Indian Constitution through its fundamental duties enshrined in Part IV of the Constitution envisages to promote international peace and security by fostering respect for international law and treaty obligations in the dealings of organized people with one and other.[5] Though the directive principles are not enforceable by any court, the principles therein laid down are nevertheless fundamental in the governance of the country and it shall be the duty of the State to apply these principles in making laws[6]. The Directive Principles form the fundamental feature and the social conscience of the Constitution and the Constitution enjoins upon the State to implement these directive principles.[7] Courts are bound to evolve, affirm and adopt principle of interpretation which will further and not hinder the goals set out in the Directive Principles of State Policy. This command of the constitution must be everpresent in the minds of the Judges while interpreting statutes which concern themselves directly or indirectly with matters set out in the Directive Principles of State Policy.[8] Thus, the international treaties are to be respected and complied by the State as enshrined in the Directive Principles of State Policy.

III. INCORPORATION INTO THE INCOME TAX ACT,1961

The Parliament had made an exclusive Chapter in the Income Tax Act, 1961 in order to accommodate these treaties entered into by the Government of India. The very object of this provision is to promote mutual economic relations, trade and investment with the countries with whom the agreements are executed.

Section 90 of the Income Tax Act,1961 states as follows:

(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) *for the granting of relief in respect of—*

[5] Article 51 (c) of the Constitution of India
[6] Article 37 of the Constitution of India
[7] Kesavanandha Bharati Vs State of Kerala, AIR 1973 SC 1461
[8] UPSC Board Vs Harishanker AIR 1979 SC 65

*(*i*)* *income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or*

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

*(*b*)* *for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or*

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

*(*d*)* *for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,*

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, ***in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.***

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation 1.—*For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.*

Explanation 2.—*For the purposes of this section, "specified territory" means any area outside India which may be notified as such by the Central Government.***]**

IV. METHODS ELIMINATING DOUBLE TAXATION:

There exists two different methods of elimination of double taxation, viz., **the exemption method or the tax credit method**, the provisions of the particular DTAA only could indicate the particular method adopted with a particular country. No one method or strait-jacket formula has been adopted uniformly in all cases.

For example, reference to the agreement entered into by India with the Government of Sri Lanka would demonstrate the distinguishing disparity in the pattern of agreements adopted.

"The laws in force in either of the Contracting States shall continue to govern the taxation of income and capital in the respective Contracting States except when express provision to the contrary is made in this Convention. When income or capital is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article."

The agreement with Sri Lanka provides that each country shall make assessment in the ordinary way under its own laws and then only provides for abatement of a portion of the tax liability in the manner and to the extent stipulated.

V. MEANING OF TREATY OVERRIDE

The OECD defines 'Treaty Override' as a "situation where the domestic legislation of a State overrules the provisions of a single treaty or all treaties hitherto having had effect in that state".

However in India, the expression 'treaty override' often refers to the situations where the provisions of tax treaty prevail over any inconsistent provisions of domestic law. This approach, however, seems to be at variance with the international practices.

VI. BACKDROP TO TREATY OVERRIDE

'Every treaty in force is binding upon the parties to it and must be performed in good faith'[9]. This basic concept of international law popularly known as '*Pacta sunt servanda'* obliges the signatories to respect and execute the said agreement in good faith. 'A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty'[10]. The Supreme Court of India cited the relevance of general rule of interpretation outlined in the Vienna convention on law of treaties. The Supreme Court observed that though India is not a party to the Vienna Convention, the principles of customary international law and principles of interpretation contained therein provides a broad guideline for the appropriate manner of interpreting a treaty in the Indian context also[11].

VII. INTREPRETATION OF TREATIES

'The comity of Nations requires that Rules of International law may be accommodated in the municipal law even without express legislative sanction provided they do not run into conflict with Acts of Parliament. But when they do run into such conflict, the sovereignty and the integrity of the Republic and the supremacy of the constituted legislatures in making the laws may not be subjected to external rules except to the extent legitimately accepted by the constituted legislatures themselves.'[12] It is the duty of these courts to construe Legislation so as to be in conformity with international law and not in conflict with it[13]. It is a well established principle laid by the Indian Courts that regards must be given to international conventions and treaties while interpreting the domestic legislations made by the Parliament.[14]In the present instance, it was the legislature which had introduced the provisions in the Income Tax Act in order to accommodate the Double Taxation Avoidance Agreements. In view of standard O.E.C.D models which are being used in various countries, a new area of genuine "international tax law" is now in process of development. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties.[15] Moreover, the Income tax Act, 1961 envisages that when there is a conflict

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9 Article 26 of Vienna Convention on Law of Treaties,1969
10 Article 27 of Vienna Convention on Law of Treaties,1969
11 Ram JethmalaniVs Union of India W.P. (Civil) No. 176 of 2009
12 Gramophone Company of India Ltd Vs Birendar Bahadur Pandey, 1984 AIR 667
13 Corocraft v. Pan American Airways (1969) 1 All E.R. 82
14Visakha Vs State of Rajasthan AIR 1997 SC 3011
15 British Tax Review [1978] p.394

between the provisions of Double Taxation Avoidance Agreement and the provisions of the Income Tax Act, 1961, the provisions which is more beneficial to the assessee is applicable[16]. The Double Tax Avoidance Agreement by necessary implication takes away power of Indian Government. to levy tax on specified categories of income. Sections 4 and 5 have to be read subject to provisions of Agreement. In case of conflict between the provisions of the Act and of the Agreement, the latter would prevail. This is clarified by CBDT's Circular No. 333, dt. 2nd April, 1982.

In CIT vs. VR.S.R.M. Firm & Ors[17], the Madras High Court held that 'where there exists a provision to the contrary in the agreement, there is no scope for applying the law of any one of the respective contracting states to tax the income and the liability to tax has to be worked out in the manner and to the extent permitted or allowed under the terms of the agreement. In respect of some categories of income, total exemption or elimination is not contemplated and in certain other cases, the exemption depends upon the fulfillment of certain conditions and in all such cases only tax credit or relief can be accorded to the extent permissible under the various provisions of the agreement to avoid double taxation'.

However **DTAA cannot be thrust on an assessee because,** as per s. 90(2), the provisions of Indian IT Act shall apply to the extent these is more beneficial to the assessee. In such a case, the provisions of DTAA cannot be thrust upon the assessee. There is no support for the proposition that in case the assessee does not opt for being taxed on the basis of DTAA for one year, he will be shut out from the benefits of DTAA in the subsequent years. Fact that a double dip of losses may occur in such a situation is inevitable corollary to the existing legal position

Thus, when there is an inconsistency between them, the treaty is given an overriding effect over the domestic laws and the courts are under obligation to interpret the municipal law in order to avoid confrontation with the well-established principles of international law.

[16] Section 90(2) of the Income Tax Act,1961
[17] 208 ITR 400

VIII. PROVISIONS OF TREATY WHICH OVERRIDE THE DOMESTIC LAW

i. DTAA with Mauritius

ARTICLE 13 -*Capital gains- 1." Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.*

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.

3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in that State.

5. For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States."

The Hon'ble Supreme Court of India in the case of Union of India vs AzadiBachaoAndolan[18], considered the Double Taxation Avoidance Agreement between the Government of India and Mauritius and discussed the validity of Circular No.789 dated 13.04.2000 issued by CBDT. ***The Court held that the DTAA between India and Mauritius was absolutely valid and that the residents of Mauritius would not be taxable in India on***

[18] [2003] 263 ITR 706 (SC)

income from capital gains arising from sale of their shares. The Court reiterated that the provisions of DTAA would always prevail over the Income Tax Act.

The above mentioned provision overrides the following provisions of the Act:

Section 5. (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."

<u>Income deemed to accrue or arise in India.</u>

9. (1) "*The following incomes shall be deemed to accrue or arise in India:-*
(i)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 situate in India."

Section 9(1)(i) gathers in one place various types of income and directs that income falling under each of the sub-clauses shall be deemed to accrue or arise in India. Broadly there are four items of income.

In this case, we are concerned with the last sub-clause of Section 9(1)(i) which refers to income arising from transfer of a capital asset situate in India. Thus, charge on capital gains arises on transfer of a capital asset situate in India during the previous year.

In the case of *Vodafone International Holdings. vs Union Of India*[19], the Supreme Court of India has dealt with this issue. It was contended on behalf of the Revenue that under Section 9(1)(i) it can look through the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and indirect transfers of capital assets. Further, it should be of an asset in respect of which it is possible to compute a capital gain in accordance with the provisions of the Act. Moreover, even Section 163(1)(c) is wide enough to cover the income whether received directly or indirectly.

[19] 341 ITR 1

It was held by the court that Section 9 on a plain reading would show, it refers to a property that yields an income and that property should have the situs in India and it is the income that arises through or from that property which is taxable. Section 9, therefore, covers only income arising from a transfer of a capital asset situated in India and it does not purport to cover income arising from the indirect transfer of capital asset in India. Thus, as per the DTAA the gains was liable to be taxed only in the contracting state and not India.

ii. DTAA with Malaysia

Clause 1 of article 6 reads as follows:

"Income from immovable property may be taxed in the Contracting State in which such property is situated."

The provision mentioned above overrides ***sections 4 and 5 of the Income-tax Act,*** *1961, that if the assessee is a resident in India, his income from whatever source is liable to be taxed under the said Act.*

In *CIT vs. P.V.A.L. Kulandagan Chettiar (Decd)(through LRs)* [20]*,* the Supreme court held that where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the provisions of the Act, as is clear from the provisions of s. 90(2) After coming into force of the Double Taxation Avoidance Agreement with Malaysia, income arising to Indian resident in Malaysia cannot be subjected to Indian income-tax even for rate purposes. Doing so will frustrate the agreement itself and this decision upheld several High Court decisions on this issue.

In *CIT vsR.M.Muthaiah*[21], the Karnataka High Court held that the provisions of Indo-Malaysian would prevail over the provisions of Income Tax and can be enforced by the appellate authorities and court. Thus, where the Double Taxation Avoidance Agreement provides for a particular mode of computation of income, the same should be followed, irrespective of the provisions in the Income-tax Act.

[20] 267 ITR 654
[21] [1993] 202ITR 508

There is no change to this position in the subsequent Double Tax Avoidance agreement entered into in 2004.

iii. **DTAA with UK**

"Royalty" has been denned in the Agreement for Avoidance of Double Taxation between India and the U.K., as follows:

"XIII(3) The term 'royalties' as used in this article means payments of any kind including rentals received as consideration for the use of or the right to use:

(a)any patent , trademark, design or model, plan, secret formula or process

(b)industrial, commercial or scientific equipment , or information concerning industrial, commercial or scientific experience;

(c)anycopyright of literary , artistic or scientific work, cinematographic films, and films or tapes for radio or television broadcasting

butdoes not include royalties or other amounts paid in respect of the operation of mines or quarries or of the extraction or removal of natural resources."

Section 9 (1) of the Act: The following incomes shall be deemed to accrue or arise in India-

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in

connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or

(vi) the rendering of any services in connection with the activities referred to in sub- clauses (i) to (v); 1[Explanation 3.- For the purposes of this clause, the expression" computer software" shall have the meaning assigned to it in clause (b) of the Explanation to section 80HHE;]

(vii) income by way of fees for technical services payable by-

(a) the Government; or

(b) a person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non- resident, where the fees are payable in respect of services utilized in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India: 2[Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976 , and approved by the Central Government.] 3[Explanation 1-For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976 , shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.] Explanation 4[2].- For the purposes of this clause," fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head" Salaries".]

The High Court of Calcutta in the case of *CIT vs Davy Ashmore*[22], held that the term "royalty" has been defined in the agreement to mean, inter alia, the payment of any kind including rentals received as consideration for the use of or the right to use any patent, trademark, design or model, plan, secret formula or process. Therefore, what is important to

22 [1991] 190 ITR 626(Cal)

consider is that, in order that a payment may be treated as royalty for the purposes of Article XIII of the Agreement for Avoidance of Double Taxation between India and the U. K., the person who is the owner of such patents, designs or models, plans, secret formula or process, etc., retains the property in them and permits the use or allows the right to use such patents, designs or models, plans, secret formula, etc. In other words, where the transferor retains the property right in the designs, secret formula, etc., and allows the use of such right, the consideration received for such user is in the nature of royalty. Where, however, there is an outright sale or purchase, as in the present case, the consideration is for the transfer of such designs, secret formula, etc., and cannot be treated as royalty. Thus, the importation of the designs and drawings postulates an out and out transfer or sale of such designs and drawings and the non-resident company does not retain any property in them leaving the grantee to use or exploit them.Therefore, in terms of the Circular No. 333 of the Central Board of Direct Taxes dated April 2, 1982 ([1982] 137 ITR (St.) 1) the provisions contained in Clause 3 of Article XIII of the Avoidance of Double Taxation Agreement between India and the U.K. would prevail. Thus, the consideration paid for transfer, therefore, cannot be treated as royalty falling under Article XIII of the Agreement for Avoidance of Double Taxation between India and the U. K. The consideration paid is for an outright transfer of the drawings and designs by the non-resident company and such consideration cannot be termed as royalty.

iv. DTAA with GERMANY

Art. III(1) of the Agreement is so far as it is material on this point reads as follows :

"Subject to the provisions of paragraph (3) below, tax shall not be levied in one of the territories on the industrial or commercial profits of an enterprise of the other territory unless profits are derived in the first-mentioned territory through a permanent establishment. ....."

In Para. 3 of Article III are enumerated certain specified items of income, i.e., rents, royalties, interest, dividends, etc., which are excluded from the "industrial or commercial profits" of the foreign enterprise.

It is true that under s. 9(1) (i) of the Act all income accruing or arising whether directly or indirectly, through or from any "business connection" in India, or other income mentioned in that section shall be deemed to accrue or arise in India. But the charging provision, s. 4, as well as s. 5 of the Act defining the "total income" of either a resident or a non-resident are expressly made" subject to the provisions of the Act", including agreements made under s. 90.

The Andhra Pradesh High Court in the case of *CIT vs Vishakapatnam Port Trust*[23], considered the above mentioned provision of Indo-German Double Taxation Avoidance Agreement and it was held, that the assessee is immune from liability either wholly or partly to Income Tax in view of provisions of Double Taxation Avoidance Agreement.

This view was taken from the House of Lords in *Ostime (Inspector of Taxes) v. Australian Mutual Provident Society*[24], where it was held that if there was a conflict between the terms of the agreement and the taxation statue, the agreement alone would prevail. Later, however, s. 497 of the U. K. Income and Corporation Taxes Act, 1970, provided expressly for legislation by way of statutory instrument in the form of an Order-in-Council declaring the arrangements specified in the order to have effect, "notwithstanding anything in any enactment".

v. <u>DTAA with France</u>

ARTICLE 14 — Capital gains -

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in article 6, and situated in the other Contracting State may be taxed in that other Contracting State.*
2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other Contracting State.*
3. *Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

[23] [1983] 144 ITR 146
[24] [1960] AC 459, 480-81; 39 ITR 210

4. *Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that Contracting State. For the purposes of this provision, immovable property pertaining to the industrial or commercial operation of such company shall not be taken into account.*
5. *Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.*
6. ***Gains from the alienation of any property other than that mentioned in paragraphs 1, 2, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.***

In the case of *Sanofi Pasteurs vs The Department of Revenue*[25], MA made a substantial gain on disposal of their investment and controlling rights in , an Indian Company; (c) such gain is a direct result of realization of "investment" of MA in India by its sale to Sanofi; (d) the same was chargeable to tax in India as under Section 9 (1) (i) of the Act, income accruing indirectly through or from any business connection in India is deemed to accrue or arise in India; (e) under Section 195 of the Act, Sanofi should have deducted tax at source on the payment made to MA; The High Court of Andra Pradesh held that the capital gain arising as a consequence of the transaction in issue is chargeable to tax in France; and the resultant tax is allocated to France (not to India) under the DTAA.

IX. CONCEPT OF MOST FAVOURED NATIONS:

This refers to a situation where there is equal treatment of two non-resident taxpayers by the Country of Source. It is generally used in DTAAs when countries are reluctant to forgo their right to tax some elements of income.

The object is twofold:-

(1) To guarantee that no discriminatory treatment when compared with a third Country

(2) To offer a better treatment because of a favourable change in policy

[25] W.P.No.14212 of 2010

In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and Fees for Technical Services) if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention

Benefit of more favourable rate and restricted scope granted to other countries is extended to existing DTAA

(i) Lower tax rate

(ii) Narrowing scope

<u>List of Indian DTAA's with MFN clause:</u>

Belgium, Sweden, UK, Finland, Spain, France, Hungary, Switzerland, Israel, Netherlands, Phillipines, Kazakastan, Saudi Arabia

In case of most Indian DTAAs - MFN clause applies automatically except Switzerland and Philippines where fresh negotiation is required

<u>Eg.,DTAA with SWITZERLAND</u>

Agreement for avoidance of double taxation and prevention of fiscal evasion with Swiss Confederation

With reference to Articles 10, 11 and 12

If after the signature of the Protocol of 16th February, 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then, Switzerland and India shall enter into negotiations without undue delay in order to provide the same treatment to Switzerland as that provided to the third State.

X. RATE OF TAX

		Dividend			Interest			Others		
No.	**Country DTAA between India &**	**General Rate**	**Special Rate Note 5]**	**Level of voting control (%)**	**General Rate**	**Special Rate for Bank**	**Special Rate for Govt.**	**Royalties**	**Fees For Technical Services**	**Remarks**
1.	Mauritius	15	5	10%	#	E	E	15+$	Note 1	#Exempt if the beneficially owned by Government or bank carrying on bona fide banking business, in other cases rate as per domestic laws.
2.	United Kingdom	15			15	10	E	Note 2	Note 2	#Royalties @ 10% for Equipment Rental and for services ancillary or subsidiary thereto
3.	United States of America	25	15	10%	15	10*	E	Note 2#$	Note 2	#Royalties @ 10% for Equipment Rental and for services ancillary or subsidiary thereto. *Also applicable to bonafide Fis

4.	Singapore	15	10	25%	15#	10		10	10	#10% in case of Ins. Co. or similar FIs. Effective from AY 1995-96
5.	Germany	10			10		E	10	10	Effective from AY 1998-99
6.	Cyprus	15	10	10%	10		E	15#$	10	#Royalties include "Fees for included services"
7.	Japan (Revised)	10			10#		E	10$	10$	#Interest derived and beneficially owned by certain entities is exempt.
8.	France	10			10		E	10	10	Effective from AY 1996-97
9.	Switzerland	10			10		E	10	10	Effective from AY 1996-97
10.	South Africa	10			10		E	10	10	Effective from AY 1999-00
11.	Brazil	15			15		E	25#$	Note 1	#Royalties other than "Royalty arising from use or right to use trademarks" taxable at 15%
12.	China	10			10		E	10	10	Effective from AY 1996-97

13.	Denmark	25	15	25%	15+	10+	E	20$	20$	Effective from AY 1991-92
14.	Israel	10			10			10	10	Effective from AY 1995-96
15.	Malaysia	10			10#		E	10	10	Effective from AY 2005-06. # Interest derived and beneficially owned by certain entities is exempt.
16.	Netherlands	10			10		E	10	10	Effective from AY 1998-99
17.	New Zealand	15			10		E	10	10	Protocol restricting treaty benefits to Indian or New Zealand residents

Note: The rates mentioned above are the rates of tax applicable in the source country. Taxability in the country of residence would be as per the domestic law of country of residence, unless otherwise specified.

+ Beneficial ownership may not be required

E Exempt from tax

$ For agreement made after 31st May, 1997, the rate of tax under the Income Tax Act on royalty or fees for technical services receivable by a foreign company is reduced to 20% (plus Surcharge &Cess, as applicable) by the Finance Act, 1997. As per section 90(2), this rate may be adopted if is lower than rates under DTAA.

The rate is reduced to 10% (plus surcharge &cess, as applicable) for agreements entered into on or after 31st May, 2005 vide Finance Act, 2005.

Note 1: There is no separate provision for fees for Technical Services under the Treaty. Therefore, the same may be taxed under "Business Profits" or "Independent Personal Services" as per relevant DTAA, whichever is applicable.

Note 2: In the country of source, Royalties and fees for technical services are taxed at following rates:

10% for Equipment Rental and for Services ancillary or subsidiary thereto

For other cases:

a. during 1st five years of agreement

- 15% if Government or Specified Organization is payer

- 20% for other payers

subsequent years, 15% in all cases

Note 3: Taxable as per Domestic Law.

Note 4: Refer Treaty for detailed provisions.

Note 5: Special Rate of Tax on Dividend (other than Section 115-O Dividend) as mentioned in col. 4 is applicable if the recipient is a company beneficially holding at least specified percentage of voting control (mentioned in col. 5) in the company declaring Dividend.

Note 6: The above rates should be applied after carefully analyzing and applying each Article of the Treaty and the Protocols, if any.

Note 7: Dividend u/s. 115-O is exempt u/s. 10(34) of the IT Act, 1961.

Note 8: Contracting States will review the provisions of this Agreement after a period of 4 years from the date on which this Agreement enters into force in order to consider the inclusion of an Article on "Fees for Technical Services" within the scope of this Agreement.

XI. LIMITATION OF BENEFITS

i. INDIA-USA DTAA

ARTICLE 24 - *Limitation on benefits - 1. A person (other than an individual) which is a resident of a Contracting State and derives income from the other Contracting State shall be entitled under this Convention to relief from taxation in that other Contracting State only if:*

(a) more than 50 per cent of the beneficial interest in such person (or in the case of a company, more than 50 per cent of the number of shares of each class of the company's shares) is owned, directly or indirectly, by one or more individual residents of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or other individuals subject to tax in either Contracting State on their worldwide incomes, or citizens of the United States ; and

(b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not resident of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or citizens of the United States.

2. The provisions of paragraph 1 shall not apply if the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct by such person of a trade or business in the first-mentioned State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company).

3. The provisions of paragraph 1 shall not apply if the person deriving the income is a company which is a resident of a Contracting State in whose principal class of shares there is substantial and regular trading on a recognized stock exchange. For purposes of the preceding sentence, the term "recognized stock exchange" means:

(a) in the case of United States, the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Act of 1934 ;

(b)in the case of India, any stock exchange which is recognized by the Central Government under the Securities Contracts Regulation Act, 1956 ; and

(c) any other stock exchange agreed upon by the competent authorities of the Contracting States.

4. A person that is not entitled to the benefits of this Convention pursuant to the provisions of the preceding paragraphs of this Article may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income in question arises so determines.

ii. INDIA-SINGAPORE DTAA

ARTICLE 13 : **CAPITAL GAINS** - *1. Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.*

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.

[*4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of this Article shall be taxable only in that State.****]***

The treaty provides that the gains from alienation of any property other than those mentioned in Para will be taxable only in that state. However, there is a recent LOB provision added to the Singapore Treaty which is illustrative of India's new direction. The India-Singapore Comprehensive Economic Co-operation Agreement ('CECA') was signed on June 29, 2005. As part of the CECA, Singapore and India agreed on a Protocol and the tax treaty was amended. The amendments introduced by this Protocol came into force from August 1, 2005.

The Protocol provides that capital gains arising to a resident of a Contracting State from the sale of property and shares (other than immovable property or property forming part of a permanent establishment) in the other Contracting State would be taxed only in the Contracting State where the alienator is resident.

In other words, when the Singapore Company divests its interest in the Indian company, it will be exempt from Indian capital gains tax. However, to prevent third country residents from misusing the capital gains exemption by establishing a holding company in Singapore, an LOB provision was also added to the treaty.

The LOB provision is very limited in scope, in that it only impacts capital gains tax and no other benefits provided by the treaty. Under the LOB provision, a resident company of Singapore will not be entitled to the capital gains exemption if the primary purpose for the company's establishment was to obtain the capital gains exemption. In addition to this test that looks at a taxpayer's motive for its holding structure, the provision includes a second test which provides that companies (referred to as 'shell' companies) that have no or negligible business operations, or with no real or continuous business activities in Singapore, would not qualify for the capital gains exemption under the treaty. Under a safe harbour rule, a Singapore company would not be a shell if : (1) it was listed on recognized stock exchanges of India or Singapore, or (2) its total annual expenditure on operations in its state of residence is equal to or more than S$ 200,000 or Rs.50,00,000, as the case may be, in the 24 months immediately before the date its capital gains arise. It is not entirely clear whether the Singaporean company still has to satisfy the motive test even if it passes the safe harbour rule.

iii. <u>INDIA-UAE DTAA:</u>

In contrast to the Singapore Treaty, the LOB provision added to the UAE Treaty is broader in scope in that it applies to *all* benefits under the treaty. The LOB provision provides that a company would not be entitled to treaty benefits if "the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits. . ." of the treaty. Once again the intention behind the provision is to curb the use of holding companies that do not have *bona fide* business activities in India/UAE from being granted treaty benefits. However, unlike the Singapore Treaty, the UAE Treaty does not give any guidelines on what is required to prove that a company has sufficient business activities to obtain treaty benefits. As a result, this LOB provision will surely create unnecessary uncertainty as to the application of the treaty. The treaty partners may need to provide some guidance on this at some point.

From a policy standpoint it appears that India will continue to request some form of an LOB provision to be added in its treaties in future treaty negotiations, including renegotiations of existing treaties (such as Cyprus and Mauritius) where it perceives misuses taking place, making tax-efficient inbound investment planning for foreign companies more challenging.

"Limitation of benefit clause as available in India's DTAAs has limited application and would not cover all the cases/circumstances which would be covered through GAAR". The domestic laws will apply in case the provisions of LOB in the treaty are not fulfilled. Thus, the purpose of LOB is to prevent abuse of the treaty.

In the absence of LOB Clause in any Treaty, the scope of the treaty would be positive for Special Purpose Vehicles (SPVs) created specifically to route investments into India, meets with approval[26].

XII. TREATY OVERRIDE AND GENERAL ANTI-AVOIDANCE RULE

The objective behind introduction of GAAR is to counter aggressive tax avoidance schemes[27].Section 90 states in its section *(2A) notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee, even if such provisions are not beneficial to him*[28]. It is quite clear that GAAR mandates a complete treaty override and all the DTAAs have to submit to the wishes of the legislature which constitutionally under Article 73 is empowered to make a treaty come into existence, which in its wisdom brought Chapter X-A to curb the unscrupulous practice of tax avoidance on the pretext of treaty approval.

However, a mere tax benefit under a tax treaty would not automatically lead to the application of GAAR unless other conditions prescribed under section 96(1) are also filled[29].

[26] Vodafone Holdings vs Union of India
[27] Finance Minister's speech while introducing the Finance Bill,2012
[28] w.e.f. 01.04.2016
[29] Response of Ministryof Finance, para 15.31 of the SC report

In *UOI v. AzadiBachaoAndolan*[30], the Supreme Court observed that there is pointer to the Parliament for incorporating suitable limitations/provisions in the domestic legislation (para 91). This suggests that domestic legislation could be used to avoid grant of treaty benefits.

The relevant portion of OECD Commentary on Model Tax Convention on Income and Capital (2010 edn.) on Article 1 is as follows:

This raises a fundamental question that is discussed in the following paragraphs:

Whether specific provisions and jurisprudential rules of the domestic law of a Contracting State that are intended to prevent tax abuse conflict with tax conventions?

As indicated in paragraph below, the answer to that second question is that to the extent these anti avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts giverise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule, there will be no conflict between such rules and the provisions of tax conventions.Therefore, it is agreed that States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of theconvention have beenentered into.

Other forms of abuse of tax treaties (e.g. the use of a base company) and possible ways to deal with them, including "substance- over- form", "economic substance" and general anti-abuse rules have also been analyzed, particularly as concerns the question of whether these rules conflict with tax treaties, which is the second question mentioned above.Such rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule and having regard to the above mentioned points, there will be no conflict".

Thus, the OECD Commentary provides that there is no conflict between a domestic GAAR and DTAA. The United Nations Commentary on UN Model Double Taxation Convention between Developed andDeveloping Countries (2012 edn.) ("UN Commentary") on Article 1 also endorses the aforesaid as follows:

As is the case for specific anti- abuse rules found in domestic law, the main issue that arises with respectto the application of such general anti- abuse rules to improper uses of a treaty is possible conflicts with theprovisions of the treaty. To the extent that the application of such general rules is restricted to casesof abuse, however, such conflicts should not arise. This is

[30][2003] 132 Taxman 373/263 ITR 706 (SC)

the general conclusion of the OECD, which isreflected in the points mentioned above of the Commentary on Article 1 of the OECD Model Convention.

Having concluded that the approach of relying on such anti- abuse rules does not, as a general rule,conflict with tax treaties, the OECD was therefore able to conclude that "[…] States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of theconvention have been entered into."

In *UOI V. AzadiBachaoAndolan*[31], the Supreme Court held that whenever a certificate of residence is issued by the Mauritius authorities, such certificate will constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAC accordingly.

In *E Trade Mauritius Ltd*[32], the AAR held that by virtue of the circular no. 789 issued by CBDT (which has been upheld by the Supreme Court), the tax residency certificate issued by the Mauritius authorities is at least a presumptive evidence of the beneficial ownership of the shares and the gains arising therefrom, even if it does not give rise to a conclusive presumption.

In *Re.Dynamic India Fund-I*[33], the applicant being a tax resident of Mauritius in the light of the tax residency certificate produced by it, going by the decision in *Union of India vs. Azadi Bachao Andolan*, it has to be held that the gain that may arise to the applicant is not chargeable to tax in India.

The Finance Bill 2013 had proposed to amend Section 90 and 90A to provide that submission of TRC containing prescribed particulars is a necessary but not a sufficient condition for claiming the benefits of the DTAA.

This proposal has not been introduced and has been substituted by the Finance Act to read *"a certificate of his being a resident".* Rule 21AB and Form Nos. 10FA and 10FB have prescribed the requisite certificates.

The proposal in Finance Bill 2012 had created uncertainty among foreign investors, especially those routing investments through Mauritius.

The Minister has clarified that the status quo with regard to investment from Mauritius would continue till the double taxation avoidance agreement with that country is revised.

[31] Supra 23
[32] [2010] 190 Taxman 232 (AAR – New Delhi)
[33] [2012] 23 Taxmann 266 (AAR - New Delhi)

By inserting the sub-section (5) to section 90 & 90A in the Finance Bill, 2013, the legislature had gone a step ahead of the judicial rulings (as abovementioned) by making TRC as a necessary but not a sufficient condition for claiming benefits under DTAA. The relevant part of the section is as under:

"(5) *The certificate of being a resident in a specified territory outside India referred to in sub-section (4), shall be necessary but not a sufficient condition for claiming any relief under the agreement referred to therein*."

This clause in the Bill gave rights to speculation as to the requirement by the Tax Officer for proving the residential status. However, the Finance Act has watered it down and the requirement now is for "a certificate of his being a resident". However, it is still not clear as to what the officer would require to substantiate the residential status.

The Finance Minister later said that changes have been made to make it clear that Tax Residency Certificate (TRC) issued by a foreign government will be accepted as a certificate of residence. "Additional information can also be asked by the government but the TRC issued by a foreign government will be accepted as a certificate of residence," he said.

XIII. RETROSPECTIVE AMENDMENTS TO DOMESTIC TAX LEGISLATION AND INFLUENCE OVER THE TAX TREATY

The scope of the definition transfer was expanded in the Finance Act, 2012 and states as follows:-

2 (47) *"transfer", in relation to a capital asset, includes, --*

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in trade of a business carried on by him, such conversion or treatment; or

(iva) the maturity or redemption of a zero coupon bond; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Explanation 1. – For the purposes of sub-clauses (v) and (vi), "immovable property" shall have the same meaning as in clause (d) of section 269UA;

Explanation 2. – For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or directly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India; (Inserted by the Finance Act 2012 w.e.f. 1 April, 1962)

Further, Section 9 of the Act was also amended as states as follows:-

Section 9. (1) The following incomes shall be deemed to accrue or arise in India : -

(i) *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 situate in India.*

Explanation 4. – For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

Explanation 5. – For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if

the share or interest derives, directly or indirectly, its value substantially from the assets located in India. (Inserted by the Finance Act 2012 w.e.f. 1st April, 1962)

<u>The Canadian Concept: (in favour of the assessee)</u>

In *R. v. Melford Development Inc.,* the Canadian Supreme Court spelt out principles applicable to interpretation of domestic tax law and international tax conventions, where their provisions are said to compete.

<u>FACTS:</u> (1) There was in force and operation, relevant to the transactions in question, the Canada-Germany Tax convention (the Convention) brought into effect in Canada by the Canada-Germany Income Tax Agreement Act, 1956 (for short 'the 1956 Act'); a distinct legislation, by the Canadian Parliament.

(2) The respondent-Melford Developments Inc.*,* made payments to a German Bank, which admittedly had no permanent establishment in Canada; the payment being towards fee payable to the German Bank for guaranteeing the Melford loan advanced by a Canadian Bank (the Bank of Nova Scotia). Canadian Revenue sought to recover withholding tax on payments by *Melford*.

(3) Revenue contended that the payment by Melford is subject to withholding tax under Section 212(1)(b) and 214(15)(a) in Part XIII of the (Canadian) Income Tax Act where a provision is made for the taxation of non-residents. Revenue contended that the payment in question is, for the purpose of (the Canadian) Income Tax Act "interest".

(4) In defense, Melford asserted that whatever provisions of the Income Tax Act may provide, these cannot override provisions of the Convention and in particular provisions of the 1956 Act introducing the Convention to the domestic law of Canada.

Section 3 of the 1956 Act provided: *In the event of any inconsistency between the provisions of this Act, or the Agreement (*Convention*), and the operation of any other law, the provisions of this Act and the Agreement prevail to the extent of the inconsistency*. (Broadly corresponding to Section 90(2) of the Act)

(5) Article III of the Convention provided that the contracting states have agreed that industrial or commercial profits of an enterprise in Germany would not be subject to tax in Canada unless it carried on business in Canada through a permanent establishment here.

(6) Article II (2) of the Convention provided that undefined terms in the Convention shall take the meaning which they take in the laws in force in the contracting countries. (corresponding to Article 3(2) of DTAA)

(7) In 1974, Parliament introduced Section 214(15) to the Income Tax Act with a view to extend withholding tax to interest, to payments by way of guaranty fees or standby charges.

ISSUE: Whether the 1974 amendment to the Income Tax Act amends the Convention so as to expose Melford to the burden of withholding tax at the prescribed rate when making payment of the guaranty fees to the non-resident guarantor-the German Bank was the core issue involved.

JUDGMENT: The Supreme Court of Canada concurred with the Federal Court of Appeal to rule that payment by the respondent to the German Bank constituted industrial or commercial profits of the German enterprise which did not carry on a trade or business in Canada or have permanent establishment and was therefore exempt from subjection to tax in Canada.

Decision in favour of the Revenue:

Revenue can place reliance on the dictum of the South African Supreme Court of Appeal in *Commissioner for the South African Revenue Services v. Tradehold Ltd.*[34]

The relevant facts may be noticed. On 02-07-2002 Tradehold Ltd., resolved that all further Board meetings be held in Luxembourg. As a consequence, the company (incorporated and resident in South Africa - SA) became effectively managed in Luxembourg. It however continued to be a *resident* in SA notwithstanding the re-location in view of the definition of the term *resident* in the South African Income Tax Act 1962 (the 1962 Act). On amendment of the definition of the term *resident* in the said Act w.e.f. 26-02-2003, Tradehold Ltd ceased to be a resident of SA. SA Revenue relying on provisions of the 1962 Act asserted that the company is deemed to have disposed of its only relevant assets i.e., 100% shareholding in another company (Tradegrow Ltd) resulting in capital gain being realized; and levied tax accordingly.

The assessee, in the appeal before the Tax Court contended that if there was a deemed disposal of investments during the relevant year, the resultant capital gain was taxable in Luxembourg, not in SA. This contention was predicated on the basis that at the relevant time Tradehold Ltd, was deemed to be a resident of Luxembourg in terms of Art. 4(3) of the Double Tax Agreement between South Africa and Luxembourg, the terms of which applied to the transaction. Under Article 4(3), the deemed place of residence of a company is where

[34] (2010) ZASAC. 61

its effective management is situated. Art. 13(4) of the treaty provides that: *Gains from the alienation of any property referred to in Paras 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident* (a provision corresponding to Art.14(6) of the DTAA). The Tax Court rejected the contention (by SA Revenue) that the expression *alienation* does not include deemed disposal of the property, as deemed disposal of assets falls within Para 12 of the Eighth Schedule of the 1962 Act.

The appeal by the Revenue was rejected by the Supreme Court of Appeal. The Supreme Court referred to Sec.108(2) of the 1962 Act which provides that a tax agreement (treaty) on approval by the Parliament and its notification would be effective as if enacted in the 1962 Act. The Court noticed that the expression *alienation* is not defined in the treaty. Therefore, Art.3(2) [corresponding to Art.3(2) of the DTAA] applies and the undefined expression must bear a meaning ascribed to it under the 1962 Act. The Court observed that an international treaty must be interpreted so as to give effect to its provisions; that the first step is to determine into which Article of the treaty the particular tax falls; that Art. 13 includes within its ambit capital gains derived from the alienation of all properties; it must be assumed that the parties to the treaty were aware of provisions of the 1962 Act and have intended Art. 13 to apply to capital gains of the kind provided therein (the 1962 Act). The Court reasoned that Art. 13(4) incorporates no distinction between capital gains that arise from actual or deemed alienation of property; and there is no reason in principle why the parties to the treaty would have intended that Art.13 should apply only to taxes of actual capital gains resulting from actual alienation of property.

The Court concluded that *alienation* being a neutral term having a broader meaning as well (comprehending both actual and deemed disposal of assets), Art.13(4) would apply to the transaction in question; the tax is allocated to Luxembourg and is consequently immune to levy and collection in SA, under provisions of the 1962 Act.

Thus, section 2(14) and 2(47) of the Act, provided that if rights in India are transferred owing to a transfer of an asset outside India, then those rights are deemed to be a capital asset giving rise to capital gains. However, if one confined the capital asset to the "rights" such as the "right to vote", the "right to control" and the "right to carry on business", then as no cost of acquisition can be determined in respect of these rights, there would be no liability as per ***B. C. Srinivasa Setty***[35].

[35] 128 ITR 294 (SC)

XIV. CONCLUSION:

Double tax treaties seek to regulate conflicts which may arise between the domestic tax laws of the Contracting States. The primary purpose of tax treaties is to eliminate double taxation as an obstacle to international trade and investment**.**

The issues could arise from

1) Dual residence –– Both countries may seek to tax the person on global income basis. DTA allocates residence to one country with tie-breaking rules.

2) Dual source–– the income may be considered as sourced in both countries

The objectives of double taxation avoidance agreements is to help in avoiding and alleviating the adverse burden of international double taxation, by -

a) laying down rules for division of revenue between two countries;

b) exempting certain incomes from tax in either country ;

c) reducing the applicable rates of tax on certain incomes taxable in either country

Thus, it could be concluded that DTAA has been given due importance by all the three organs i.e, the legislature, executive and judiciary. The scope of judiciary has always been active when the subject matter is about DTAA. Through judicial decisions it could be ascertained that DTAA has always been a priority over the municipal laws and in case of a conflict between the municipal law and DTAA, the courts in its majority held that the DTAA would prevail. Furthermore, it has become a settled proposition that the courts must interpret municipal laws in accordance with international conventions and treaties. The legislature on the other hand has the complete authority to make municipal laws in order to implement the treaties or conventions. The Parliament has specifically incorporated Section 90 in the Income Tax Act, in order to give effect to the DTAAs. The issuance of Circular No.789 dated 13.04.2000 and Circular No. 333, dated. 2nd April, 1982 issued by CBDT is evident that the DTAAs override the domestic law.