Fiscal policies, tax laws and procedures constitute important elements of the investment climate of a country. The general conception as to the scope of the taxing power of a state is that, given a sufficient territorial connection or nexus between the person sought to be charged and the country seeking to tax him, income-tax may properly extend to that person in respect of his foreign income.\(^1\) The territorial connection or nexus can be founded not only on the residence of the person taxed within the territorial limits of the state but also from the situation within those limits of that from which the taxable income is derived.\(^2\) Once such territorial nexus is established there is no rule of international law which puts any shackles on the powers of a state to tax properties or incomes of foreigners or foreign enterprises. According to Kelsen, a country has the right to tax the income and wealth of its residents (nationals or aliens) or citizens whose rights to the protection

\(^1\)Per Lord Uthwatt in *Wallace Bros. & Co. Ltd. v. Commissioner of Income-Tax*, 16 ITR 240 (PC).

\(^2\)Per Lord Herschell in *Colquhoun v. Brooks*, (1939) 14 AC 493 (HL).
and services provided by the state are matched by their
duties to the state among which is the duty to pay
taxes. In Oppenheim's view, it is an accepted prin-
ciple of international law that the right to tax, which
is an aspect of sovereignty, extends to aliens.

According to Albrecht, the right to tax aliens is a
prerogative of the sovereign state and this right
is co-extensive with the territorial sovereignty of
the state. Hyde goes further and says, "no duty
is imposed upon a state to leave unburdened either
property owned by aliens or persons who may them-
selves be aliens. Nor does any principle of inter-
national law forbid the territorial sovereign to
impose in some instances, a heavier burden upon the
interests of such individuals than is placed upon
those of its own nationals". Albrecht also says
that fair and reasonable discrimination between
aliens and nationals is in accordance with inter-
national law and points out that some kind of dis-
crimination, such as that involved in the appointment
of an agent to bear the alien's tax liability, is

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3Hans Kelsen, The General Theory of Law and

4Oppenheim, International Law (London, 1926)
edn 4, pp. 256, 620.

5A.R. Albrecht, "The Taxation of Aliens Under
International Law," British Year Book of International

6Charles Cheney Hyde, International Law (Boston,
1951) vol.1, pp. 663-64.
almost inevitable. In upholding the legality of a Louisiana law imposing a discriminatory tax upon legacies to persons who were aliens, the Supreme Court of the United States sanctioned such discrimination in the absence of a treaty obligation. The existing practice tends, however, to place aliens generally upon an equal footing with nationals and there is wide acceptance for the view that discrimination, if any, between aliens and nationals should be fair and reasonable. Unfair tax discrimination against foreign nationals and their property is regarded in international practice as an unfriendly act which may give rise to protest or retaliation.

In the absence of any established rules in the nature of international tax law, the growth of international trade and commerce and of overseas investment in capital and technology in the twentieth century posed the problem of international double or multiple taxation.

7 Albrecht, n. 5, p. 170.
9Hyde, n. 6, p. 664.
The problem became particularly acute with the widespread use of corporate taxes at ever rising rates after World War I. If a person can be taxed on the same income by the country of his residence as well as by the country where the source of his income is situated in the form of his property, investment or business, and sometimes also by the country of his nationality, the sum total of such taxes could indeed be more than his total income itself. The minority of the British Royal Commission\(^{11}\) recommended that the United Kingdom should press through the League of Nations or other international bodies for the adoption of binding international conventions concerning the principles to be followed in the taxation of trading profits which would make it possible to proceed towards a more rational, effective and equitable system of profit's taxation than any one country would be able to adopt acting in isolation.\(^{12}\) The Economic and Finance Commissions of the Genoa Conference (1921) recommended that double taxation should be avoided by agreement between

\(^{11}\) Royal Commission on Income Tax of 1920.

nations in accordance with principles established by an enquiry of the League of Nations. 13 Committees of economic and technical experts appointed by the League of Nations made prolonged attempts in the twenties to establish principles on which international tax relationships might be based and implemented by unilateral statute or international treaty agreement to solve the problem of overlapping national tax jurisdictions. 14 The reports of these committees and the subsequent draft conventions drawn up by the Fiscal Committee of the League of Nations in the 1930's expressed a strong preference for the principle of residence as the basis for the jurisdiction to tax business income. 15 This was understandable as creditor nations were more strongly represented on these committees.

The emergence of a large number of developing countries lent another dimension to this problem. Unlike the developed countries, among whom transfer of overseas investment, and hence also of resultant incomes was generally a two-way affair, the newly emerging developing countries knew that they would, for a considerable length of time, be always at the receiving end of overseas

13 Peggi Brewer Richman, Taxation of Foreign Investment Income: An Economic Analysis (Baltimore, 1963) pp.43-44
investment and the giving end of incomes resulting therefrom. Proposals envisaging a weightage of tax jurisdiction in favour of the country of residence of the investor were, therefore, not acceptable to them. Accordingly, the Second Regional Conference of the Fiscal Committee of the League of Nations (1945), in which developing countries of Latin America participated, adopted a Model Bilateral Convention for the Prevention of Double Taxation of Income (Mexico Model) which departed from the earlier draft conventions and gave primacy of tax jurisdiction to the source country. This convention put the burden of tax relief explicitly on the creditor country. It stipulated that business income should be taxed only at source and the country of residence of the taxpayer should, in its assessment of his total income, afford full credit for the taxes levied by the country of source. The UN Manual describes this as: "the first attempt by the developing countries to write a model treaty reflecting their particular problems."

The Fiscal Committee which met in London in 1946 considered the Mexico Model Convention. The membership

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16. C. 2, M. 2, 1945 II.A.
of this meeting differed considerably from that of Mexico City. The capital exporting countries reasserted themselves and the draft convention (London Model) that emerged from this meeting shifted the balance of tax jurisdiction again in favour of the country of residence. While the Mexico Model assigned unconditional tax jurisdiction to the country of source except only in respect of profits from purely isolated occasional transactions, the London Model made the tax jurisdiction of the source country conditional on the existence of a permanent establishment of the taxpayer in that country.

The Mexico and London drafts were used as a starting point by the Tax Committee of the OECD in preparing a new draft convention. The OECD draft which was first attempted in 1959 was published in 1963. The OECD Model was based, in substance, on the London Model. The tax jurisdiction of the source country was however sought to be circumvented further by subjecting it to a second condition of its being confined to profits attributable to the permanent establishment of the taxpayer in the source country as distinguished

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from all profits except only those resulting from stray isolated transactions as stipulated in the Mexico Model.

Under the UN System, the Economic and Social Council had recommended as early as in 1953 that the principle of taxation at source constituted the primary basis of tax agreements between the developed and the developing countries. In 1967, the Economic and Social Council requested the Secretary General to set up a Group of Experts to formulate guidelines and techniques for tax treaties between developed and developing countries. An Ad-Hoc Group of Experts (UN Group) was accordingly set up in 1968. By that time the OECD Model was being used by the developed countries as a basis for conclusion of bilateral tax treaties. The UN Group used this Model as its main reference text. After discussions and deliberations spread over eight reports, the Group finalised, in December, 1979, the UN Model Double Taxation Convention Between Developed and Developing Countries.

20 ECOSOC, Res. 486-B (XVI) of 9 July 1953.
21 ECOSOC, Res. 1273 (XLIII) of 4 August 1967.
22 Adopted by the General Assembly in 1980.
In an attempt to secure a consensus the UN model seeks to tone down some of the more stringent provisions of the London-OECD models. The UN model defined 'permanent establishment' to include, inter alia, "a building site or construction or assembly project which exists for more than twelve months". The UN Model reduced the period from twelve to six months with a provision for its further reduction to three months in bilateral negotiations. The UN Model confined the tax jurisdiction of the source country to profits attributable to the permanent establishment. The UN Model extended this jurisdiction also to profits resulting from sales of goods or merchandise and other business activities of same or similar kind as dealt with by the permanent establishment. For investment incomes like dividends, interest, royalty and technical fees, the Mexico model had adopted the source principle. The London Model adopted the residence principle. The OECD model retained the residence principle but gave a limited tax jurisdiction to the source country also. The UN Model only enhanced the share of the source country marginally. All in all, the UN Model did not restore the source principle as suggested by the developing countries.

\[23\] See K.B. Rao, *Double Tax Treaties Between Developing and Developed Countries*, (New Delhi, 1983).
The efforts of more than half a century have not produced a universally acceptable set of principles bearing the genesis of what could ultimately be called international tax law proper. The wide attention that this subject has received has, however, given rise to a large number of bilateral double tax treaties as well as to a large number of regional models like the OECD Model and the Andean Model. Since customary rules of international law may and do emerge from treaties entered into by other countries, Carrol takes the view that this growing volume of tax treaties shows the evolution of international tax law. But the fact remains that in bilateral treaties the developing countries have, generally, succumbed to accepting provisions analogous to the OECD Model out of force of circumstances rather than from a sense of conviction. In any evaluation of bilateral tax treaties as a source of international law, therefore, it may be nearer the truth to say, with Albrecht, that these treaties constitute a body of particular rather than general international law which may eventually become more generalised.

24 See Continental Shelf Cases, ICJ Reports, 1969, p.3.
25 Carrol, n, 19, p. 721.
26 Albrecht, n. 5, p. 185.
Some of the broad principles which find place in almost all bilateral treaties and tax conventions are:

1. Income from immovable property, or real estate should be taxed in the country of situs of such property or, in other words, the source country.

2. Business profits should be taxed in the source country with the country of residence providing double taxation relief.

3. Taxation of investment incomes (dividends, interest, royalty) should be shared between the source country and the country of residence.

4. There should be no unreasonable tax discrimination between nationals and foreigners.

5. The profits embedded in transactions between related persons or entities should be assessed on the basis of arm's length principle, i.e., the indicated profits in such cases should be substituted by profits that would result if the transactions were between two independent persons in the normal course of business.

6. An aggrieved taxpayer should be able to approach competent authorities in the two countries and such competent authorities should then consult with each other to arrive at a settlement of the dispute or problem.
7. There should be exchange of information between the competent authorities to tackle problems of international tax avoidance/evasion.

While these broad principles are not in dispute the problems arise in their actual working. In connection with business profits, for example, there is no meeting ground as to what precisely would constitute a sufficient territorial nexus to say that the source of income lies in a certain country. The OECD Model, as already mentioned, takes the view that the source of business profits lies in a country only when there exists a permanent establishment of the taxpayer in that country and the profits are attributable to such permanent establishment. The Andean Model and the Latin American writers deny both these requirements of the existence of a permanent establishment, and of the profits being attributable to such permanent establishment. In their view the source lies in a country as long as an enterprise carries on in that country any business activities which are not merely isolated occasional transactions.\(^{27}\) The definition of 'permanent establishment' itself is a matter of considerable controversy.

The definition contained in the OECD Model is considered by the developing countries as highly restrictive. Even the UN Model does not satisfy them. In their view, in these days of quick communications and business methods, construction, assembly and similar activities of very short duration can produce considerable profits for the enterprise carrying on such activities and inclusion of any minimum time limit whatsoever in the definition of permanent establishment would curtail tax jurisdiction of the source country unjustifiably.

Similarly, for investment incomes, the OECD Model gives a very limited tax jurisdiction to the source country while the Andean Model gives an extensive tax jurisdiction on these incomes to the source country on the pattern followed earlier in the Mexico Model. The UN Model gives a slightly bigger slice to the source country while retaining the residence principle.

In the matter of tax relief also there is no common ground as to whether the country of residence should afford such relief only in respect of the tax actually paid by its investor to the foreign country or should also give credit for the tax spared as represented by the tax incentives given by the source country.
In fact, even on procedural matters like allocation of incomes and expenses and exchange of information, resolution of disputes, there is considerable difference of opinion when it comes to matters of detail. John Surr suggested what he called 'Inter-tax', an inter-governmental world-wide organization to promote co-operation between national tax administrators for exchange of information to fight international tax evasion/avoidance.\(^{28}\) In support of that suggestion Oldman observed that serious consideration of the role of inter-tax would explore ways in which developed and less developed countries might exchange general information about tax enforcement techniques as well as specific information about particular types of incomes or particular tax-payers.\(^{29}\) Kragen suggested a multi-lateral double income-tax convention to lay down uniform set of allocation rules and an international tax court for resolving disputes.\(^{30}\) The UN Group of Eminent Persons requested the UN Ad Hoc Group on Tax Treaties to consider the feasibility of an


\(^{29}\) Oliver Oldman, "Taxation of Foreign Income" in Richard M. Bird and Oliver Oldman, Eds, Readings on Taxation in Developing Countries, rev. edn. (Baltimore, 1967), p. 201.

international agreement on rules concerning transfer pricing. The Ad Hoc Group considered this suggestion but concluded that for the time being it did not seem feasible to initiate preparatory work for the conclusion of a multilateral agreement. Rao has recently suggested the composition of a Panel of Experts by the United Nations on which competent authorities of different countries could draw for the settlement of tax disputes. None of these suggestions have found universal acceptance.

The above discussion is mostly in the context of direct taxes, like income-tax. The position is not much different in respect of commodity taxes. The Customs Cooperation Council set up under the Convention on Nomenclature for the Classification of Goods in Customs Tariffs (signed in Brussels on 15 December 1950) has brought about a considerable amount of standardisation in the classification of commodities for levy of customs and other duties. The Brussels Tarif Nomenclature (BTN)

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33 Rao, n. 23, p. 143.

34 *Customs Cooperation Council, Nomenclature* (Brussels, 1976), edn 5, p. 1 E.
or the Customs Cooperation Council Nomenclature (CCCN) brought out by the Council is now followed by almost all countries. But on matters of substance there has been but little real progress. The General Agreement on Tariffs and Trade, the surviving limb of the abortive International Trade Organization, is a multilateral agreement designed to promote free and non-discriminatory trade. The Agreement enjoins non-discrimination with regard to customs duties, as well as internal taxes and charges.\(^35\) While the Agreement has helped in bringing down tariffs to a certain extent, its substance has been circumvented all too often not only by taking recourse to its emergency provisions but also by putting up non-tariff barriers in violation of it, whether unilaterally or by negotiating 'voluntary export restraints', or 'orderly marketing arrangements' in accepting which the developing countries have no real choice.\(^36\) Apart from the exceptions made in the Agreement itself and the waivers granted under it, devices like minute tariff classification and barter agreements have also tended to defeat its purpose. Duties have also been raised by indirect means, such as the changing of modes of ascertaining assessable values of goods for

\(^{35}\) Articles I and III of the Agreement.

ad valorem duties. In the event of failure of a Contracting Party to carrying out its obligations under the Agreement, most that the other Contracting Parties can do is to authorize the affected Contracting Party to suspend application to the offending Party of such concessions/obligations as they determine to be appropriate. The successive conferences of the UNCTAD have also not made any real break through in bringing about an agreement on issues of restructuring international trade relations or the monetary framework.

In sum, therefore, while there has been considerable activity in various international fora aimed at devising certain rules of international law in the matter of taxation, basically taxation still remains almost entirely a subject of municipal law. International tax law, in the words of Carrol, is in "a state of perpetual becoming".

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37 Article XXIII.

TAXATION IN INDIA, PAKISTAN, SRI LANKA AND BANGLADESH

Major taxes levied in India, Pakistan, Sri Lanka and Bangladesh are income-tax, duties of customs, duties of excise and turnover tax. Minor taxes include wealth tax, gift tax, duties of succession, property taxes, etc. A complete summary of the tax laws of these countries is given in Appendix I. The law given in the summary is based not only on available official publications and commentaries of repute but also on the latest amendments spread over various amending statutes. Since these countries follow the common law doctrine of precedent, important judicial decisions of superior courts interpreting the law are also indicated to make the summary, useful and complete, both for purposes of an academic study as well as for more detailed reference. The following paragraphs, deal only with some of the more important conceptual aspects. These have necessarily to be considered in the background of the summary in Appendix I.

The common source of income-tax laws obtaining in these countries is the old Indian Income Tax Act, 1922. Although, except in Bangladesh, the Act of 1922 has been replaced by later and more detailed enactments,
the basic concepts and principles continue to be common.

Income subject to tax in these countries includes capital gains. But capital gains resulting from transfer of capital assets which, before such transfer, have been held by the taxpayer for a certain length of time, are given concessional tax treatment.

A company is a separate taxable entity in each of these countries. The company pays full tax on its total income and the shareholders are taxed separately on their dividend income. But dividends received by companies on inter-corporate holdings are given concessional tax treatment. Foreign companies generally pay a little higher tax than domestic companies to off-set the additional tax liability of domestic shareholders. Among domestic companies a distinction is made in all these countries as between closely-held companies and widely-held companies - the latter being taxed at lower rates. The nomenclature and definition of widely-held companies vary but the basic requirement of free and unrestricted transferability of shares is common.

The extent of tax liability depends on the factum of residence of the taxpayer. An individual is 'resident' if he is physically present in the country for a certain number of days in the year. A company is 'resident' if
it is registered in the country or the control and management of its affairs is situated wholly within the country. The situs of control and management depends not on the place where trading activities or physical operations are carried out but on the place where "the head and brain" is situated.\textsuperscript{39} A resident person is taxed on his total world income i.e. including income earned outside the country. A non-resident person is taxed only on income arising within the country. Income wheresoever arising from a property or source of income situated in the country is deemed to arise in the country by fiction of law. There is also a provision in the tax laws of India, Pakistan and Bangladesh according to which income accruing or arising to a non-resident person through or from any business connection in the country is deemed to accrue or arise within the country. The phrase 'business connection' is not precisely defined in any of the laws but it has been held to involve a relation between a business carried on by a non-resident which yields profits or gains and some activity in the country which contributes directly or indirectly to the earning of those profits or gains. The courts have however insisted that a

\textsuperscript{39}San Paulo (Brazilian) Rly. Co. Ltd. v. Carter 3 TC 407 (HL).
business connection must be something tangible, real and intimate. It must be shown, as a fact, that some part at least of the operations of the non-resident were carried out within the country. Thus, in a case where, under a technical collaboration agreement a foreign company rendered to an Indian company technical know-how and services by sending technical information, documents and personnel, it was held by the Supreme Court of India that no part of the technical fees received by the foreign company was taxable under the doctrine of business connection; the fact that technical information supplied by post was put to use in India was not relevant, the lending and deputing of foreign technical personnel to the Indian company for service under it did not amount to a business activity in India by the foreign company, and no part of the operations or activities of the foreign company were carried on in India. 40 Also a stray and isolated transaction cannot be regarded as a business connection. In a case where part of the purchase price of machinery bought by an Indian company was treated as an interest-bearing loan by the foreign seller it was held that the

40 Carborundum Company v. CIT, 108 ITR 335 (SC).
Indian company was not liable to be treated as an agent of the non-resident seller in respect of the latter's interest income.41

The tax laws in these countries also contain provisions extending the liability to tax of a non-resident person in respect of incomes from interest, royalty and technical fees, wheresoever arising, as long as such incomes are connected with a business carried on in the country.

The taxable profits of business are computed in these countries on ordinary commercial principles according to the method of accounting regularly employed by the taxpayer. If the taxpayer follows mercantile system of accounting accrued liabilities are allowed as expenses even if these are disputed in courts or otherwise. Thus in a case where a sales tax demand raised by the sales tax authorities against a taxpayer was contested by the taxpayer in appeals it was held by the Supreme Court of India that the liability on that account was still allowable as an ascertained

41 Addl. CIT v. Bharat Fritzwermer Ltd., 118 ITR 1018.
liability in the computation of taxable profits of the taxpayer. But a mere contingent liability i.e. a liability, which is not a liability in praesenti but a mere liability de futuro is not allowed.

Under the Sri Lanka law all expenses 'incurred solely for the purpose of earning profits or gains' are allowed. In India, Pakistan and Bangladesh, on the other hand, expenses 'laid out or expended wholly and exclusively for the purposes of the business' are allowed. The latter formulation is much wider than the former; expenditure may be for the purposes of business, although it may not be incurred for the purpose of earning profits of the business. In CIT v. Malvalam Plantations Ltd., Subba Rao, J. of the Supreme Court of India, observed:

The expression 'for the purpose of the business' is wider in scope than the expression 'for the purpose of earning profits'. Its range is wide; it may take in not only the day to day running of a business but also the rationalization of its administration and modernization of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from

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42 Kedarnath Jute Manufacturing Company Ltd. v CIT, 82 ITR 363 (SC).
43 Indian Molasses Co. Ltd. v. CIT, 37 ITR 66 (SC).
44 Morgan v. Tata and Lyle Ltd., 26 ITR 195 (ML) and Weenakshi Mills Ltd. v. CIT, 63 ITR 207 (SC).
45 53 ITR 140 (SC).
expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for carrying on of a business; it may comprehend many other acts, incidental to the carrying on of a business.

It has also been held that the words, 'wholly and exclusively' denote a determination based upon the principles of ordinary commercial trading. It is not necessary that the spending of monies should be obligatory on the taxpayer. As Viscount Cave LC observed in *Atherton v. British Insulated & Helsby Cables Ltd.*, "A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade". The Supreme Court of India quoted this test with approval and applied it in *Eastern Investment Ltd. v. CIT* and *CIT v. Chandulal Keshavlal*. The above formulation does not also require that the expenditure must necessarily produce profits. Expenditure may be

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46 Robert Addie & Sons’ Collieries Ltd. v. IR 8 TC 671 and CIT v. Chandulal Keshavlal, 38 ITR 601 (SC).
47 10 TC 155 (HL)
48 20 ITR 1
49 38 ITR 601
allowable though it may not turn out profitable at all. Lord Thankerton said in *Hughes v. Bank of New Zealand*, \(^{50}\) "Expenditure in course of the trade which is unremunerative is nonetheless a proper reduction if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense". This principle was also affirmed by the Supreme Court of India in *Eastern Investments Ltd. v. CIT* (supra).

There are, however, specific provisions in the tax laws in these countries putting restrictions on the admissibility of certain types of expenses, such as those on entertainment, advertisement and publicity. In India and Pakistan there is also an upper limit on the amount of administrative expenses of a foreign head office that could be allowed in the computation of business income of the Indian/Pakistani establishment.

The rates of tax on companies vary from 57.75 to 73.5 per cent in India, 57.75 to 68.25 per cent in Pakistan, 40 to 55 per cent (with a separate tax on

\(^{50}\) 21 TC 472 (HL).
gross dividends distributed or profits remitted abroad) in Sri Lanka, and 55 per cent in Bangladesh. Like all other developing countries, however, these countries also use tax laws as instruments of socio-economic change so as to encourage or discourage investments in certain areas or sectors of economy. This entails very frequent amendments in the tax laws in keeping with not only the changing policies of governments from time to time, but also the emerging requirements of a developing economy. The tax laws are riddled with concessions and incentives of various types. There are capital allowances, like normal depreciation, additional or initial depreciation in the year of new investment, additional depreciation for investment in particular sectors of economy, extra shift allowance for double or triple shift working and amortisation of intangible assets. There are so many of such allowances that Kaldor called them, "unnecessarily complicated and unnecessarily costly in terms of revenue to the State". 51 There are investment allowances over and above the aforesaid capital allowances for new investment or investment in certain areas or sectors of

51Kaldor in Bird and Oldman, n. 29, p. 165.
economy. There are substantial tax concessions in the interest of development of export markets or indigenous technology. All these countries have also started free trade zones or export processing zones which are free of all local taxes, including customs and excise duties and turnover taxes. As a result of these so many incentives the effective rates of taxes are generally much lower and the statutory rates are not a true index of the real tax incidence. In India, for example, the effective rate of tax has been found to be around 40 per cent. In a study of 220 largest companies in India for the fiscal year 1981-82 it was found that as many as 78 companies making considerable profits had no tax liability as they could set off all their profits against tax incentives.

There are a number of special provisions in these countries about the assessment of incomes and payment of taxes by non-resident persons. There are also special exemptions such as those for foreign technicians or advisers employed in these countries. The details of these are given in the summary in Appendix I.

All these countries have also entered into bilateral tax treaties with many countries for avoidance
of double taxation. These tax treaties follow, in
assence, the OECD Model.

Most of the taxes are paid by the taxpayers
on their own either because of the provisions about
withholding taxes, or by way of payment of taxes in
advance or on self-assessment. The taxpayer is, never-
theless, under an obligation to submit a return of his
income every year and obtain final assessment from the
Income-tax Officer/Assessor. The tax laws, in all
these countries, contain periods of limitation within
which such final assessment must be completed. The
procedures of assessment are, however, often quite
cumbersome and the bigger cases are generally taken up
only towards the fas end of the prescribed periods of
limitation.52 There are also frequent complaints of
the taxpayers being harassed in many ways, such as,
their being called again and again for inquiry, demands
against them being created without linking payments
already made, refunds due to them in respect of taxes
overpaid being delayed, etc. The Income Tax Officers/

52 See India, Lok Sabha Secretariat, Hundred and
Eighty-Sixth Report of the Public Accounts Committee
(Fifth Lok Sabha), MRXX 1975, para 11.27.
Assessors also tend to make arbitrary additions to returned incomes virtually forcing the taxpayers to take recourse to appellate/judicial proceedings. Further, there are varied provisions about completed assessments being reopened to bring to tax escaped incomes. In India such reopening may take place over periods ranging from four to sixteen years depending upon the amount of income escaping assessment and the fact whether or not the alleged escape is caused by any omission or failure on the part of the taxpayer. In Pakistan a completed assessment can be reopened within ten years if there is definite information that any income has escaped assessment or has been under-assessed. In Sri Lanka a completed assessment can be reopened 'at any time' if there is 'fraud, or wilful evasion on the part of the taxpayer'. In Bangladesh a completed assessment can be reopened within a period of four to six years.

The tax laws in these countries contain ample provisions for appellate or judicial proceedings. An aggrieved taxpayer can approach a hierarchy of departmental appellate authorities and tribunals and can also

take recourse to superior courts on points of law. These proceedings are, however, time-consuming as well as costly. In India, for example, as many as 3,53,739 appeals were pending with the departmental appellate authorities at the end of fiscal year 1981-82 against 2,37,567 appeals disposed of in that year. Many of these appeals had been pending for over ten years. 54

In addition to income-tax (corporation tax), in India companies making superprofits, i.e., profits in excess of fifteen per cent of capital have to pay a tax called sur-tax at rates ranging from twenty-five to forty per cent. In the case of widely-held domestic companies, however, the sum total of income-tax and sur-tax is limited to seventy per cent of total income. In India also a wealth tax at the rate of 2 per cent has been recently imposed on non-productive assets, like jewellery, residential properties and motor cars of closely-held companies. In Sri Lanka a non-resident company pays a property tax of one per cent in respect of its immovable properties situated in Sri Lanka.

Customs tariff, in all these countries, follows the BTN classification of commodities. The rates of

duty are mostly ad valorem and these are often varied by executive orders. The assessable value is generally the price at which like goods are sold in the course of international trade between independent buyers and sellers at the relevant time. Export-oriented industries are permitted to import input duty-free and export goods are also allowed abatement of duties and taxes paid on inputs.

Duties of excise are levied in India, Pakistan and Bangla Desh. In India these duties are levied on all manufactured goods, while in Pakistan and Bangla Desh these are levied on specified goods as well as services. The rates of duty are mostly ad valorem and these are also changed often by executive orders.

All these countries levy sales tax/turnover tax. In India sales tax on inter-state sales is levied under a Central Act while sales tax on intra-state sales is levied under various State Acts; there is no tax on export goods. The rates of tax vary from one to fifteen per cent; goods of essential consumption being taxed at lower rates and luxury goods at higher rates. In Pakistan, there is a single point sales tax of 12.5 per cent on all goods produced, imported into or sold in Pakistan. In Sri Lanka there
is a business turnover tax which extends to all turnover of a business carried on in Sri Lanka, of services rendered outside Sri Lanka but paid for from Sri Lanka and of imports of manufactured goods into Sri Lanka. In Bangladesh sales tax at a general rate of 20 per cent is charged on all import goods and on some specified export goods.

The summary in appendix I gives more detailed information on all these taxes.

CONCLUSIONS

One of the greatest problems of the fiscal policies and tax laws and procedures in these countries is the lack of clarity, certainty and stability. The tax laws are highly complex and these are changed far too often. Some of these changes are inherent in the process of socio-economic development but there are many others which cannot be justified on that ground. In India, the Income-tax Act 1961, came into force on 1 April 1962. This Act has undergone major amendments on as many as 56 occasions. The number of amendments exceeds one thousand. The Act started with 298 sections; it has had as many as 213 sections added to it. With some sections deleted, the Act, presently, has over 450 sections. There are instances where amendments
made in one year are reversed the very next year and brought forth again after a couple of years. Many a time, amendments are necessitated by initial faulty drafting. While commenting on these aspects, the Public Accounts Committee of the Indian Parliament observed as under:

The Committee have observed that numerous amendments made to the direct tax laws were necessitated on account of faulty drafting. Continuous spate of amendments make the law incomprehensible and the job of the assessing officer exceedingly difficult. The Committee are of the view that frequent amendments for purposes of plugging the loopholes become counter-productive in so far as instead of helping the Government to augment its revenue, they provide scope for easy evasion and avoidance because of the increased complexity of law implicit in frequent amendments. The Committee, therefore, recommended that while the proposed comprehensive enactment is prepared, so as to simplify the direct tax laws both with reference to procedural and substantive laws, particular attention is paid to carefully graft the same. It would obviate the necessity of amendments year after year. Care should also be taken that the entire enactment is made more methodical so as to be capable of being comprehended and understood by the taxpayers. 55

Many other Committees and Commissions, 56 especially

55 India, Lok Sabha Secretariat, Thirty-Fourth Report of the Public Accounts Committee (Seventh Lok Sabha) (New Delhi, 1981), para 10.9.

appointed to "rationalize and simplify" the tax laws have submitted their reports during these years but the resultant amendments have only left the tax law all the more complicated. There are individual sections running into several closely printed pages with numerous sub-sections and clauses, with provisos within provisos and exceptions within exceptions and explanations galore, so that the law is verily a maze into which the most seasoned tax experts fear to tread. In Pakistan the Income Tax Ordinance promulgated in 1979 to "consolidate and amend the law" has undergone over 200 amendments in the years 1979 to 1982 including addition of nine new sections. In Sri Lanka the Inland Revenue Act (No. 28) was enacted in 1979 to replace the Inland Revenue Act (No. 4) of 1963. Within a year, in 1980, the Act was amended extensively. The amendments ranged over as many as 29 sections as well as the rate schedules. Six new sections were also added. In 1981 there were another forty amendments with four more new sections. This is a problem which needs to be given some serious thought. Any amount of tax incentives/concessions in the law would not serve the purpose if the foreign investor would shy away at the very threshold. The biggest incentive lies in the tax laws being simple, certain and stable so that the taxpayer knows in advance what his tax liability is going to be over
a certain length of time. The International Chamber of Commerce emphasized this particular aspect is one of their recent papers in the following words:

Evaluation of an investment and its likely success demand that reliable figures be used, including the taxes in the host country. This can only occur when there is clarity and stability of national policies, laws, regulations and administrative practices. Consequently, when investments are being planned, legal certainty, dependable tax forecasts and reasonably stable tax terms for investors rank high in importance.57

The next important question is that of tax incentives. All these countries have placed a heavy reliance on incentives designed for the attainment of various socio-economic objectives, which include attracting and encouraging foreign capital and technology. The role of such tax incentives has come up for considerable criticism in various quarters. Surrey says58:

Tax incentives are open-ended, they place no limit on how much tax benefit a taxpayer can earn. Hence it is difficult to foretell how much will be spent by the Government through a tax incentive.

According to the UN Report on Foreign Investment in Developing Countries, the precise effect of tax incentives in attracting investments which otherwise would not have been forthcoming, vis-à-vis the revenue loss suffered where concessions are not needed, is not adequately known. The Report took the view that temporary exemptions from normal tax burdens are unlikely, by themselves, to constitute a determining factor in many investment decisions. The UN Ad Hoc Group also felt that there was need for the developing countries to agree among themselves or at least on a regional basis as to how far they were willing to go in generating tax incentives as such an arrangement might reduce some wasteful competition among them. A Task Force on Private Foreign Investment set up by the IMF/IBRD Development Committee in 1978 stated in its Report submitted in August 1980

... the impact of foreign investment incentives is not known with certainty and may, in any event, not be a major

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60 UN, Sixth Report of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, Doc. ST/LEG/42 (1976), p. 57.
factor in the decisions of foreign investors, sometimes they may represent a needless expenditure of resources, while at other times they may increase the net benefit for recipient countries.  

According to the OECD Survey itself tax incentives appear to be a particularly inappropriate way of attracting foreign investments. The main thrust of the criticism is two-fold. Firstly, the incentives are often given either in a spirit of competition with other countries, or merely on an ad hoc basis without any machinery to evaluate or assess their effectiveness or to compare results achieved vis-a-vis the revenue sacrifice involved. Secondly, in the case of countries like the United States of America, which give tax credit to their investors in foreign countries only in respect of tax actually paid and not for the tax spared by way of incentives given by the host countries, the revenue sacrifice involved in the tax incentives merely constitutes a transfer of resources from the developing country to the developed country,

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rather than being any incentive to the foreign investor as such. On an examination of the working of the tax incentives contained in the Indian tax law, the Public Accounts Committee of the Indian Parliament stated

... The percentage contribution of corporation tax to gross collections under Income Tax and Corporation Tax has come down steadily from 55 per cent in 1977-78, to 51 per cent in 1978-79 and 1979-80 and has further dropped to 48 per cent in 1980-81 despite the fact that the number of companies and the company assessments completed have been generally going up and the rates of tax have remained stationary... though pre-tax profits of these companies have increased the tax as percentage of pre-tax profits has declined from 45.3 per cent in 1979-80 to 43.3 per cent in 1980-81. The number of companies with no tax liability has increased from 35 in 1979-80 to 49 in 1980-81. The number of companies in the effective tax rate of 0 per cent to 20 per cent of the pre-tax profits has increased from 52 in 1979-80 to 71 in 1980-81... The Chairman, Central Board of Direct Taxes further acknowledged in evidence that no comprehensive study has so far been made by the Board to evaluate the impact of various incentives which are being given year after year with certain objectives... The Committee recommended that an objective study of the entire system of tax incentives built into the Income-tax Act over the years should be entrusted to a team of eminent economists/experts in taxation with a view to ascertaining to what extent the underlying objectives have been realized vis-a-vis the revenue sacrifice involved and whether the plethora of concessions/incentives need to be continued and if so, in what form...63

The Finance Minister himself stated in the Indian

63India, Lok Sabha Secretariat, Hundred and Forty-Third Report of the Public Accounts Committee (Seventh Lok Sabha) (New Delhi, 1983), para 157, 163.
Parliament in the course of his Budget Speech for the
year 1983-84.

Hon'ble Members must be aware of the
phenomenon of companies which are flouri-
shing, but are paying no tax at all, or
only a nominal tax. This is largely due
to these companies availing of the tax
incentives and concessions available
under the provisions of the Income-tax
Act. It has been a matter of concern
to us that under our tax system several
highly profitable companies are able to
reduce their tax liability to zero even
though they continue to pay high divi-
dends... Our corporate tax structure is
riddled with a large number of different
kinds of deductions. While each deduction
may seem to have a merit, the aggregate
effect is to complicate tax administra-
tion, provide opportunities for misuse, and
reduce the growth of revenue...64

Yet another aspect of these incentives is that they
comouflage the real effective rate of tax leaving the
relatively high statutory rate itself to drive away
many investors. In one of the recent hearings of the
Sub-Committee on Foreign Operations of the House
Committee on Appropriations of the US Congress65

64 Government of India, Budget 1983-84:
Finance Minister's Speech - Part B (New Delhi, 1983),
pp. 27-28.

65 Hearings of the Sub-Committee, 13 April
1983, The Hindustan Times (New Delhi), 25 April
1983.
a point was made that India had a very high tax rate, "one of the highest in the world". Apparently, the reference was to the statutory rate of tax which, at the highest point, comes to 73.5 per cent. It goes unnoticed that the effective tax rate in India after taking into account the effect of tax incentives, is far lower. According to a recent study of the 220 largest companies in India (pretax profits, Rs. 10,584 million), the effective tax rate for the year 1981-32 was 40.3 per cent; for the 89 largest companies with pretax profits of Rs. 7500 million the effective tax rate was still lower, 35.7 per cent. As many as 73 companies, in fact, reported zero tax liability.

Along with the rationalisation and simplification of tax laws in these countries it is necessary, therefore, to have another look at the tax incentives so as to retain only such of them as have really served their objects, and are capable of such an evaluation. It would be useful to give thought to creating appropriate management information systems and statistical database to monitor the working of tax incentives on a continuing basis.

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66 A.D. Suklikar et al., "Private Sector Corporate Grants", Economic Times (New Delhi) 1 June 1983
Closely connected with the question of tax incentives is the question of capital exporting countries giving tax credit not only for tax actually paid but also for tax spared by the capital importing countries through tax incentives. The main opposition to this is based on the argument that it violates the principle of tax equity in the investor's home country in the sense that the tax burden on his income from investment in the foreign country is reduced to a lower level compared to that on his income from investment in the home country. In other words, tax sparing brings in a sort of discrimination between one investor and another depending upon the place of investment, inside or outside the country. The tax treaties concluded by the US in 1957 with India, Pakistan, Israel and the United Arab Republic were not ratified by the US Congress on the ground of the alleged violation of this principle of tax equity. The counter arguments from the developing countries have been based either on the fact that in the absence of tax sparing provisions tax incentives in the developing countries constitute only a

transfer of resources in the reverse direction from the developing to the developed countries, or on the consequential plea that the developed countries must make this concession in the interests of accelerated development of the developing countries. The argument of tax equity can, however, be met more strongly on purely legal grounds. The developed countries insist that investment in developing countries is beset with many handicaps, not only those arising from political uncertainties, but also those of a more economic nature, such as the lack of supportive infra-structure and the lack of skilled labour. The tax incentives are also linked with economic handicaps like investments directed into industries that are less profitable or areas that are less developed even by the standards of the developing countries. If so, tax equity would really lie in making a distinction between investment in a developing country and that in a developed country in favour of the former rather than in treating the two at par. The idea of compensatory state action to make people who are really unequal in their environment equal was developed by the Supreme Court of the United States itself. The principle has

68 See, for example, OsCSD Survey, n. 61, p. 8.
been applied by the Supreme Court of the United States in interpreting the equality clause of the US Constitution. The Supreme Court of India accepted and followed this principle in applying the doctrine of equality enshrined in Article 14 of the Constitution of India and held that equality "implies differential treatment of persons who are unequal". It is clear that the principle of tax equity is wrongly applied to tax sparing in respect of investments in developing countries. The United States, which is by far the leading investor in foreign countries, should reconsider their position not only in the interest of international development but in the context of the principle of compensatory state action developed by the US Supreme Court.

It has been mentioned that the international community is nowhere near an international tax law, or even a universally accepted multilateral tax convention. Specific suggestions for international action, even in limited areas, have not met with much success. There is no general agreement on exchange of information on tax enforcement techniques or on particular incomes or tax payers. The UN Commission on Transnational

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Corporations has not so far been able to frame an acceptable code of conduct for transnational corporations. In the meanwhile, the poorer countries continue to suffer many handicaps. Firstly, in their bilateral tax treaties they are forced to make concessions demanded of them by the developed countries. For example, even though the source rule relating to business profits contained in the Indian Income Tax Act is based on a simple 'business connection' analogous to the view taken by the Latin American writers, most of the tax treaties entered into by India follow the OECD Convention on this point and link tax jurisdiction of the host country to the existence of a permanent establishment and further limit it to the profits attributable to such permanent establishment. Secondly, in the absence of any standard norms of income and expenditure classification these countries often find themselves in the position of helpless spectators of large scale international tax evasion/avoidance. The Public Accounts Committee of the Indian Parliament has often commented upon specific cases of substantial leakages of revenue resulting from practices like, import of second-hand

or even obsolete technology, charging of grossly exaggrerated amounts (going upto 70 per cent of Indian book profits) on account of administrative expenses of the foreign head offices, exchange rate manipulations, under and over-invoicing, inter-company billing prices and other transfer-pricing devices. In this situation it would be in the interest of these countries of South Asia to attempt at least a regional approach. Their tax systems are not very dissimilar. Their socio-economic conditions are not much different. They are at about the same stage of development. The fact that they include a country, viz. India, which is also a capital exporting country in a small way, can only help introduce a balanced approach. It is suggested that a beginning may be made by setting up a Regional Tax Centre which may serve as a forum for sharing technical experience in the field of tax administration. Specifically, it may take on the following tasks to the mutual advantage of the principal countries:

72 See, India, Lok Sabha Secretariat, Hundred and Eighty-Seventh Report of the Public Accounts Committee (Fifth Lok Sabha), (New Delhi, 1975), Paras 3.31 -3.37, Two Hundred and Twenty-First Report, 1976 XXxxxxx
1. The Centre may help standardize concepts of income, source rules, accounting returns and norms of income and expense classification. Such standardization is helpful in avoiding multiple tax jurisdictions as well as preventing international tax evasion. To illustrate the point, in India, income-tax jurisdiction is divided between the Union and the States in that income from agriculture falls exclusively in the State jurisdiction while taxation of all other incomes falls in the federal jurisdiction. The Constitution of India itself contains a provision about the definition of what is agricultural income, so that this definition is binding both on the Union as well as the States and no disputes of overlapping jurisdiction in respect of particular incomes can arise. In the United States, the State Tax Commission formed in 1967 adopted federal tax base as a starting point in defining income for state tax purposes. The role of the Customs Cooperation Council in standardising nomenclatures for classification of commodities has already been mentioned. The Regional Centre could do some useful work in these matters in relation to direct taxes.

**78** Rao, n. 23., p. 25.
2. The Centre may help exchange of information to tackle the problem of international tax evasion/avoidance on a regional basis. In many cases the tax abuses referred to earlier, including practices like transfer-pricing, aimed not only at tax evasion but also at beating exchange regulations or price control regulations, are practised within the region across national frontiers. The Centre could be useful help in tax enforcement in the countries of the region.

3. The Centre may maintain a panel of tax experts who could be available not only for the resolution of tax disputes at the option of the national Governments but also for advice on specific matters thought of by individual countries.

4. The Centre may also help in the negotiation of bilateral tax treaties between countries of the region and other countries, particularly the developed countries.

5. The Centre may take up preparatory work to evolve a Regional Tax Code and a Regional Tax Convention suited to the needs of the countries in this region. In the long run the Centre may be able to take initiatives in the evolution of a Multilateral Tax Convention.