CHAPTER 7

COMITY OF NATIONS

DIMENSIONS
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7.1 In modern times Income Tax has come to be universally adopted as a national fiscal weapon by different countries of the world. This has given rise to a peculiar problem of double taxation in the comity of nations. Income tax has of necessity, assumed international dimension with rise and development of international commercialism. It is possible that a person may have his residence in one country and he may earn income in other country or countries. Income tax being generally an essential item in the financial systems of the world it is levied on all incomes originating in the country, as well as on the entire income belonging to the residents of the country. This wide scope results in obvious complications. This could be explained by a simplistic, though, an extreme illustration. If A derives all his income from country B, where his income originates, and again in country A where he has residence. He will be taxed in both the countries — in country B because his income originates there and in country A because he has his residence there. This phenomenon of double taxation in international income tax domain is assuming an added vigour with the growth of international commercial and industrial enterprise, and the persistent search of capital to find newer and more fruitful fields of investment. Modern income is a thing widely diverse in its origin; and the place where its income arises is not necessarily identical with the place where the owner of that income has his residence. Though the picture as depicted is not that simplistic as stated aforesaid, yet by the joint adoption of principles of origin and residence the individual pays income tax to two different countries, though only on parts of his income.

In view of its inevitability this chapter delves into origin and development of double taxation in international domain and analyzes the Indian scenario in the light of changing international situation. The discussion in this chapter thus begins with the diagnostic aspects of double taxation in the comity of nations followed by practical solutions adopted in the form of international agreements with a detailed treatment of agreements between India and different nations. The discussion concludes with indication of implications of liberal economic policy recently announced by Government of India.

7.2 Justiciability of double taxation in international domain:

Double taxation of individual's income by two or more distinct sovereign authorities has certainly got its theoretical justification. If an individual resides in a country, he is under certain economic obligations to the state which protects his property. The same is true of the country from which he derives his income. Thus, an individual owes economic allegiance to the state where he lives as well as to the state whence he gets his
income; and there is no reason why the state should not tax the person who is under its economic obligation. The committee of experts appointed by the League of Nations to go into the problem of double taxation found its theoretical validity in the doctrine of economic allegiance. Any individual pays to the state under whose economic allegiance he is and economic allegiance is to be found not only in the place where the income originates but also where its recipient resides.

Not with standing the soundness of theoritic justiciability of double taxation it causes great hardship to the individual whose incomes come under its scope. Those whose incomes arise abroad have to pay on the same aggregate sum more by way of taxation, than those whose incomes are derived from the very country where they have their residence. Thus the individual with income abroad is penalised as compared with one with a domestic income. Such a treatment seems rather unfair to the adventurous section of the community which seeks to bring home wealth from abroad.

To find a solution to the rigour of international double taxation the League of Nations had appointed a committee to which Prof. V.K.R.V. Rao feels inclined to give a nomenclature "Seligman Committee". This committee elaborated the doctrine of economic allegiance under the following heads:

i> Origin
ii> Situs
iii> Enforceability
iv> Domicile.

Chart 7.1 showing the Problem of Double Taxation:

<table>
<thead>
<tr>
<th>Predominant Element</th>
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<tr>
<td>Category of Wealth</td>
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<td></td>
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<tr>
<td>Land</td>
</tr>
<tr>
<td>Mines, Oil Wells etc.</td>
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<tr>
<td>Commercial Establishment</td>
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<tr>
<td>Agricultural Machinery</td>
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<tr>
<td>Money, Jewellery, Furniture</td>
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<td>Vessels</td>
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<tr>
<td>Mortgages</td>
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<tr>
<td>Corporate Shares</td>
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<tr>
<td>Corporate Bonds.</td>
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<tr>
<td>Public securities</td>
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<tr>
<td>General Credits</td>
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<td>Professional Earnings</td>
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</tbody>
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By origin they meant the place where the yield is physically or economically produced, by situs the place where the final
results like the complete production of wealth are actually to be found; by enforceability the place where the rights to handing over these results can be enforced; and finally by domicile they meant the place where the wealth is spent, consumed or otherwise disposed of. They, then, proceeded to classify all income on the basis of these factors, finally grouping them under the two heads of domicile and origin. The result of their researches are reproduced in the above chart.

**Criticism of Seligman Committee:**

There are several grounds on which the Seligman committee report may be criticised. In the first place the committee themselves were not optimistic about the validity of their conclusions. They confess that "to allocate the exact proportion of economic allegiance to origin or domicile in each particular category is well nigh impossible." The classification, they attempted, in spite of this assertion is based on the crude method of assigning items which have a predominant element of origin to the place of origin, and of assigning the item with the predominant element of residence to the place of residence.

They admit the relative impracticability of their method and opine in favour of the reciprocal exemption of non residents by every country. Their elaborate analysis, therefore can not be taken as the basis for framing any practical measures for the alleviation of the hardships of double taxation. As a matter of fact, their conclusions were not accepted by the commission of technical experts which met to consider their report at the instance of the League of Nations. The technical experts recommended the adoption of the principle of origin with some modifications in the case of schedular income taxes, while as regards personal income taxes they agreed that the burden of relief should lie with the country of domicile.

Even from the theoretical point of view, the committee's recommendations are open to objection. The distinction they drew between situs and enforceability appears very thin, because the place where the income is to be found in its final form is generally the place where the rights can be enforced. There may be exceptions to this rule but exceptions are no reason why enforceability should have been classed as a separate factor and given such significance. Moreover wherever such enforceability exists, the state takes its toll by means of stamp duties. This is an additional justification for the belief that "enforceability" should not play any part in determining relief from double taxation. The analysis itself seems to have too much fineness for practical use and Prof. Griziotti's distinction between the production of income and its consumption appears reasonable.

The committee appeared to have treaded on slippery ground when in its zeal for an original classification, it asserts in a priori fashion that "What each country would lose in the one case it would roughly gain in the other" Such an assertion, one is
afraid could hardly be ventured in the absence of detailed statistical information. The classification advanced by the committee, it is indeed difficult to agree to for practical purposes in one's quest for an attempt at solution of the problem in double taxation.

The committee indulged in theoretic exercise at corroboration in problem of double taxation. Such a venture can not fructify in offering ready-made solutions to the hardship of double taxation. A solution to the problem warrants a practical solution from the hardship of international double taxation.

7.3 The principle on which relief from double taxation be based in practice.

Before framing any scheme of relief from double taxation, the primary thing to be determined is the question whether the proposed relief should be granted to doubly taxed income or doubly taxed individuals. Though all income is ultimately received by persons, doubly taxed income is not necessarily identical in respect of nationality with doubly taxed individuals. For example if an Indian owns shares in a corporation in U.S.A. and makes a profit of say 2,00,000 dollars. He pays income tax on it both to Indian and American governments. In this case individual taxed doubly is an Indian while the income doubly taxed is American. Conversely if an American receives income from India he pays income tax to both the Indian and American Governments. In this case the individual doubly taxed is American while the income doubly taxed is Indian. This distinction between doubly taxed person and doubly taxed income is very important. Because on this distinction depends the enunciation and working of a right scheme of relief from double income tax. Leaving theory apart the practical question one is confronted with is continuing the aforesaid example of an Indian with incomes derived from U.S.A. - whether U.S.A. is prepared to give relief to doubly taxed American income, which means in effect relief to an Indian, or a foreigner, or is U.S.A. desirous of restricting such relief to doubly taxed Americans alone which means the grant of relief to American nationals. If the state decides for restriction of relief to doubly taxed American income it will leave unredressed the hardships of Americans with foreign income. While redressing that of the foreigners with American Income; if on the other hand if it is in favour of only doubly taxed Americans it will meet the grievance of all nationals while leaving those of some foreigners unredressed. On the other hand it is also open to the state to give relief to both doubly taxed Americans and doubly taxed American income. Following considerations are important before deciding on the proper principle on which double taxation relief should be based :-

1> The duty of every state lies essentially to its citizens. Its business is primarily to redress the grievances of its own citizens. Any hardship suffered by foreigners should call for relief from the countries whose nationals they are. No state has any right to spend its revenue in relieving non nationals, unless
such relief is absolutely necessary from the point of view of expediency, for example, a steady import of foreign capital.

2) Even if every country grants relief only to its own citizens, foreigners will not suffer in practice, as they will obtain relief from their own countries. If every country restricts such relief to its own citizens, the problem of double taxation is automatically solved. As every doubly taxed person will receive relief from his country. This will necessarily mean that all doubly taxed income obtains relief.

3) From the early 20th century, several advanced countries have been following the principle of restricting double income tax relief to their own nationals. Even the technical experts of the League of Nations recommended that in the case of personal income-tax, remission should be granted by the country of domicile which practically means the same thing as restrictions of relief to nationals. Such a course has been being practised in the United states of America, Canada, Italy and Belgium from the early 20th Century period.

7.4 Indian Scenario:

To assess the Indian position in the comity of nations the study could be conveniently conducted on following lines

I> British period
ii> Post - independence period.

British Period:

In the British period the problem had one more dimension viz. double taxation by two or more taxing authorities in India viz. by Indian states but since relevant to this study India's position in the comity of nations double taxation in intranational context is very briefly discussed here. There were 32 Indian states levying income-tax in the early 20th century period. The income tax systems of these Indian states were modelled on the system prevailing in British India. Most of the Indian States taxed all income received within their borders, without any regard to the place whence the income was derived. The natural result was that persons resident in British India and deriving income from any of these states had to pay double tax on it if they received it in British India. Conversely persons residing in these states and deriving their income from British India paid double tax on it if they received it within the state. This double taxation resulted in great hardship to Indians engaged in business both in states and in British India. Despite their difference in political status British India and 'Indian' India formed an integral economic unit. Representations were made from early times to the Indian Government to remove this defect and as a result the amount of income tax paid to Indian states was allowed as a deductible business expense in British India.
This concession however, only touched the fringe of the problem. A person who paid income-tax both in British India as well as in one or more of the Indian States, was in a substantially worse position than his compeer who had an equal amount of income, but derived it only from British Indian sources.

In the year 1922, when the Income Tax bill was before the Legislative Assembly, Rao Bahadur Rangachariar moved an amendment to Sec. 49 to provide for relief from double income taxed both in British India and in Indian states. The amendment ran:

"If any such person proves to the satisfaction of the Income-Tax officer that he has paid income tax for that year in respect of the same part of his income in any Indian state or elsewhere in the British Empire, he shall be entitled to a refund of the sums so paid which however shall not exceed one half of the Indian rate of tax."

The amendment was withdrawn on an assurance given by Government that executive instructions would be issued to provide for such relief. Four years later the promise materialised and on the 1st of July 1926 Government issued a notification providing for a partial relief for such double taxed income. This was to the tune of a sum representing half the rate of state tax levied on his income. Such relief was not to exceed half the Indian rate of tax. The state, in return, refunded to the double taxed person the other half of state tax. Thus, in effect, an Indian having his income taxed both in British India and Indian states was required to pay only the higher of the two income tax.

From intra-India double taxation to extra-India position it would be necessary to study the position of double taxation in the British Empire. This has following aspects viz. 1> India & Great Britain and ii> India and the Dominions & III> India and countries outside the Empire.

7.5 India & Great Britain

Great Britain, in the matter of taxation believed in the principles both of origin and residence and taxed income tax on the basis of both. The scope of her income tax was thus comprehensive. India on the other hand, though partial to income from salaries and securities receivable abroad, rigorously taxed income from business carried on in India, without any regard to the place where such income was receivable. The natural result was, there was double taxation of the same business income by the British and Indian Governments. In view of the huge volume of British capital invested in India and the considerable share that the Britis hers had of Indian commerce and industry, one can imagine that the problem of double taxation was pretty serious so far as these incomes were concerned. As far back 1898 Sir John Baden Powell
pointed out the evils of double taxation in the House of Commons.

The Bengal Chamber of Commerce addressed a memorial to the Viceroy in 1902 pointing out the hardships they had to endure from double taxation, and submitted that all income which was subject to the payment of the Indian income-tax should, to the extent of that tax, be relieved from the payment of income tax in England.

The Bombay Chamber accorded their support to the Bengal Chamber and Madras Chamber followed suit in 1905, but apparently nothing was done in the matter. With the rapid and almost world-wide increase of income tax rates following the war, the problem of double taxation assumed greater importance. The question of double taxation was therefore specially referred to the British Royal commission on Income-Tax. The Royal commission appointed from among themselves a special committee to deal with the problem; they were assisted by representatives from the different Dominions and India. The committee laid stress on the theory of imperial unity, and concluded that relief should be provided equivalent to the lower of the two taxes imposed on the individual. They agreed that the relief should be apportioned on the following basis:

In the first place, that in respect of incomes taxed both in the United Kingdom and in a Dominion; there should be deducted from the appropriate rate of the United Kingdom Income-Tax (including super tax), the whole of the rate of the Dominion income-tax charged in respect of the same income, subject to the limitation that in no case the maximum rate of relief given by the United Kingdom exceed one half of the rate of the United Kingdom income tax (including super tax), to which the individual taxpayer might be liable; and secondly, that any further relief necessary in order to confer on the taxpayer relief amounting in all to the lower of the two taxes, should be given by the Dominion concerned.

The recommendations of the Royal commission on this matter were accepted in toto by the British Government and embodied in their Income-Tax Law by sec. 27 of the Finance Act 1920. The provision of the said section ran thus, "If any person who has paid by deduction or otherwise, or is liable to pay United Kingdom Income-tax in any year of assessment on any part of his income proves to the satisfaction of the special commissioners that he has paid Dominion income-tax for that year in respect of the same part of his income, he shall be entitled to relief from United Kingdom income-tax paid or payable by him on that part of his income at a rate thereon to be determined as follows:—

a> If the Dominion rate of tax does not exceed one half of the appropriate rate of United Kingdom tax, the rate at which relief is to be given shall be the Dominion rate of tax.

b> In any other case the rate at which relief is to be given shall
be one half of the appropriate rate of United Kingdom tax."

"For the purpose of this section, the expression "The appropriate rate of United Kingdom tax means the rate at which the claimant for the year to which the claim relates has borne or is liable to bear United Kingdom income-tax and where the claimant is liable to the United Kingdom super-tax a rate equal to the sum of the rates at which he has borne or is liable to bear United Kingdom Income-tax and super-tax respectively for that year"

The Indian Government became a party to this arrangement, and their share of agreement was carried out by means of Sec. 49 of the Income-tax Act 1922. This section provides that where any person who has paid Indian income-tax on any part of his income, proves to the satisfaction of the Income-tax officer that he has also paid the United Kingdom income-tax on the same part of his income, and has obtained relief under Sec.27 of the English Finance Act 1920, he should be entitled to a refund of a sum equal to the difference between the Indian rate of tax and the rate at which he has obtained relief from the British exchequer. The maximum rate of relief thus allowable by India is restricted to one half of the Indian rate. Thus, in the final analysis, the individual is taxed only at the higher rate on his total income.

7.6 India and the Dominions:

The same income taxed both in Great Britain and India was eligible for the benefit as aforesaid. But there was no similar arrangement with regard to income which might be doubly taxed by India and one or more of the self governing Dominions of the British Empire. This was not true for all individuals who came under the operation of such double taxation. The law of New Zealand specifically exempted its citizens from being taxed on income that had already paid tax in any part of the British Empire; Similarly Canada allowed its subjects to deduct from their income tax, any amount that they had already paid as income tax in any other part of the British Empire. Thus Canadians and New Zealanders enjoyed Indian income without corresponding onus of double taxation. Thus nationals of other Dominions who derived Indian income were not subjected to double taxation. It was only Indians, who derived their income from any other part of the British Empire had to face the music of double taxation and suffer. In the contemporary times many Indians had an extensive trade in South Africa. They had to pay income tax on it not only to the South African Government but also to the Indian Government. In this way, though the income doubly taxed was South African income, the persons who suffered double taxation were the Indians. This led to the breach of horizontal equity in the field of international income-tax domain.

7.7 India and Countries outside the Empire:

With regard to income doubly taxed in India and any other Country of the world the position was similar to that existing
between India and the Dominions, because there were no provisions for relief from double income tax. Except in some neighbouring Asiatic countries, and the Federated Malay States, however, the problem was no more than a theoretical one in so far India was concerned. But in relation to these few countries the problem did exist. In contemporary period many Indians derived an appreciable income from the French Indo-China Saigon, Federated Malay States etc. Dewan Bahadur Rangachariar pleaded for their relief from double taxation in the Legislative Assembly. The Government treated his request sympathetically but no further steps were taken by the Government.

7.8 Criticism of the Indian Position:

As regards relief from double income-tax between British India and Indian states, the income given relief to was clearly Indian in the sense that it arose in India while the persons given relief to were also Indians. So, technically viewed it was not a case of double taxation. Hence position between British India and Indian India (Indian States) amounted to intra India matter. Hence it warranted no special comment. But relief from double income-tax between Great Britain and India required an elaboration on a different pedestal.

Very few Indians possessed income in Great Britain, and the amount thus received was by no means considerable. On the other hand, many Englishmen possessed income arising in India; even if their number be small the total amount of income affected was large. According to the then contemporary estimate of London Financial Times the total amount of British Capital invested in India came to nearly pound 583 millions. This meant that 'Indian' income received relief under the system predominantly benefited the Englishmen. As regards British India and the Dominions or British India and the rest of the world, no provision for relief was made by the Indian Government Indians, therefore, with incomes from these countries suffered all the rigours of double taxation.

In such contextual fibre therefore the relief given to income doubly taxed by British India and the Indian states was perfectly legitimate as the beneficiaries were mainly Indians. The financial losses were not appreciable. In 1927-28 these losses amounted to only Rs. 120000.

The grant of relief to income tax both in India and the United Kingdom was open to serious objection. In actual practice there were a few Indians who benefitted by sec. 27 of the British Finance Act. While a good number of Englishmen benefited from section 49 of the Indian Income Tax Act. The income relieved from double taxation was Indian; but the persons relieved were not Indians. This was, most inconsistent with the true principles of relief from double income-tax, as Indian revenues were spent to relieve the
distress of foreigners. Besides the loss of revenue emanating from this relief showed a steady increase. Figures of refunds under section 49 depicts the position as given below:

<table>
<thead>
<tr>
<th>Years</th>
<th>In lakhs of Rs.</th>
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<tbody>
<tr>
<td>1922-23</td>
<td>08</td>
</tr>
<tr>
<td>1923-24</td>
<td>41</td>
</tr>
<tr>
<td>1924-25</td>
<td>47</td>
</tr>
<tr>
<td>1925-26</td>
<td>92</td>
</tr>
<tr>
<td>1926-27</td>
<td>106</td>
</tr>
<tr>
<td>1927-28</td>
<td>97</td>
</tr>
</tbody>
</table>

The amount of tax refunded had more than doubled these years. Further it continued to grow, for with every fall in the British rate and every rise in the Indian rate the burden of relief thrown on the British exchequer (measured by half the British rate) became less, while the burden on the Indian treasury showed a corresponding increase till the maximum of one half of Indian rate was reached. Thus the relief given by India to incomes doubly taxed in India and the United Kingdom was undesirable as the relief mainly accrued to the foreigners. Dr. Rao, therefore recommended abolition thereof.

As regards income doubly taxed by India and the Dominions or India and a foreign country, India was not concerned with giving relief to the nationals of other countries who were subjected to Indian taxation. But there were Indians receiving incomes from South Africa, Saigon, French Indo-China, Federated Malay States who are subjected to double taxation. And as from 1939 the total world income of the residents came to be assessed to income tax the hardships of the Indians who suffered double taxation further increased. This is an unfounded onus which the Government of India was dutybound to remove. To do this and to base income tax provisions on lines conducive to lightening the burden of double taxation in international arena Dr. V.K.R.V. Rao as long back as 1930 had suggested the following amendment to sec.49 of the Indian Income-Tax Act 1922:–

"On satisfying the Income-Tax officer that a part of his income has paid income-tax in a country other than British India, the assessee should be allowed to deduct from the tax payable on that portion of his income the amount already paid as tax abroad, provided the rate of relief thus afforded does not exceed half the Indian rate of tax".

He defended his amendment on the following grounds:

1. The relief was limited to one half the Indian rate, because the
fact of an individual's foreign investment was a prima facie evidence of higher profits.

ii> Countries, except in Great Britain from which Indians derived income did not impose very high income taxes.

He further recommended that companies be granted relief, only if a majority of shareholders resided in India and only to the extent of the shares thus held. He also recommended rules to be framed under the Act for prescribing the mode of obtaining relief.

7.9 Dr. V.K.R.V. Rao's proposition of abolition of relief between India and the United Kingdom appraised:

Dr. Rao's proposal of abolishing the then existing relief between India and the United Kingdom involved a great disturbance of status quo which provoked the opposition of the vested interests.

The foremost ground for objection to Rao's proposition from whatever quarters possible could be that of economic expediency. It could be argued that double taxation of Britishers might result in deterring the free inflow of British capital into India. As a matter of fact it was asserted by Sir Percy Thompson, a member of the Indian Taxation Enquiry committee, on the authority of the League of Nation's committee on Double Taxation, the taxation of foreigners would recoil on the head of the borrowing country, and result either in a discouragement of foreign capital or in a higher rate of interest. Accepting the generality of truth of Sir. Percy Thompson's in the context of Indian situation the contention was a weak one against which following counter contentions could be

i> Section 27 of the British Finance Act 1920 did not make the relief conditional on reciprocal arrangements by the Dominions. As a matter of fact, with the exception of Australia and British India the other Dominions had not adopted this particular provision. Hence, even if India did not grant relief, British capitalists would continue to get refunds of the Indian Income-tax paid by them to the maximum extent of one half the British rate; therefore the hardship suffered by them would not be to the full extent of the lower (then Indian) tax, but only that portion of it which was in excess of half the British rate. This would, therefore, not prove as a deterrent for the Britishers to invest their capital in India.

ii> Even this considerable amount of double taxation was more than compensated for by higher profits that British Capital could and did realise in India. Many of the jute, tea and banking companies working in India were financed and managed by Britishers; and the rate of interest realised by them in the form of profits was much higher than the market rate. Even if an allowance were made for the slight double taxation it was obvious that the profits which British capital could realise in India were greater than what it could realise in the United Kingdom. So that in spite of the extra
burden, it would pay them to continue to invest in India.

iii> Great Britain had surplus capital which it was difficult for her to invest profitably in her own industries. In 1930s also Great Britain exported considerable amount of capital elsewhere. The field of such export in the 1930s was very limited, as next to India came the South American republics Revolutions were more frequent in South America, and more menacing to foreign capital as they were generally violent. India offered much better security and therefore continue to attract British capital in-spite of slight double taxation involved.

iv> British capital already invested in India was very considerable, and no part of it already invested in business was likely to be with-drawn as a result of the abolition of relief from double income-tax. Besides, the very fact that British capitalists had invested large amounts of capital in Indian commerce and industry, compelled them to continue adding to the capital reserves of their business concerns. This had to be done, even if the yield was lower than before; otherwise their business would suffer in competition, and in course of time their original capital would disappear. Thus, inspite of the double taxation, a part of British capital would, by the very nature of things, continue to be invested in India.

v> This was a fact needing no special evidence that after the First World War Britain had lost her prewar position as the greatest creditor country of the world. It had, by then, yielded place to the United States of America as a capital supplying centre, and Indian requirements of foreign capital might be met as much by America as by the United Kingdom. [And this indeed came to be fait accompli in the years to come especially after 1950s U.S.A and not U.K came to be reckoned with as the the greatest capital supplier of the world.] American capital had this additional advantage that U.S.A exempted its citizens from "any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the

United States". With this advantage America emerged a powerful creditor country in the years to come.

vi> Assuming that abolition of relief from double income tax would ipso facto stop the flow of British capital. No special fear was needed on that count. India possessed huge reserves of capital and given a proper banking organisation could meet her own requirement.

In the controversy between the relief abolitionist Dr. Rao and relief retentionist Sir Perey Thompson. Sir Thompson had, (if at all any) ground in theory only. Tested on the rock of practical realities the contention of Dr. Rao was more sound but as the fate of a colonial country is destined to be the double income tax relief arrangement could be abolished after India's independence only and pre-independence schemata of double taxation relief that was closed to the outer world and open only for Britain, yielded place for new arrangement that manifested itself in bilateral
double income tax agreements with countries in the wider comity of nations. This will be discussed in the following section.

7.9 Post Independence period

Even at the cost of repetition the pre independence position of double income tax relief shall better be restated. In intra India incomes an Indian having his income taxed both in British India and Indian states was required to pay only the higher of the two income taxes. As between India and Great Britain the relief position was circumscribed by section 27(1) of the British Finance Act 1920 the arrangement where under was reciprocated by section 49 of the Indian Income Tax Act 1922. For other Dominions there was no provision made for double income tax relief. This position served to safeguard the British interests in British India to the total neglect of 'Indian' interest.

This was the background under which India attained its independence in 1947. It would be but befitting here to briefly review the legislative transformation in this connection.

7.10 Legislative transformation vis a vis double taxation relief

At the time of independence the Act contained section 49 (providing for relief against double taxation in India and the U.K) and 49A (providing for relief against double taxation in India and other dominions) but there was no provision enabling the Government to enter into double tax avoidance agreements with other countries. Hence the following provision was added to Income Tax Act 1922.

"The Central Government may enter into an agreement with Pakistan for the avoidance of double taxation of income profits and gains under the Act and under corresponding law in force in Pakistan, and may by notification in the official gazette make such provision as may be necessary for implementing the agreement".

This provision was extended by the Income-tax and Business Profits Tax (Amendment Act (Act 48 of 1948) to the U.K. by adding the words "or in the United Kingdom" after "Pakistan" in the above section. But soon it was realised that there was no purpose in providing for bilateral or unilateral relief only in respect of Pakistan/U.K. or the dominions respectively. Section "49A was on the following lines viz

Agreement for granting relief in respect of double taxation or for avoidance thereof. The Central Government may enter into an agreement -

a> With the Government of any country outside India for the granting of relief in respect of income on which have been paid both income tax (including super tax) under this Act and income tax in that country, or

b> With the Government of any other country outside India for the avoidance of double taxation of income, profits and gains under
this Act and under the corresponding law in that country; and may by notification in the official gazette, make such provisions as may be necessary for implementing the agreement. and the section 49A aforesaid was therefore substituted for the earlier section 49A and 49AA by the Finance Act 1953, the latter enabling double taxation agreements being entered into with any country.

In exercise of the powers conferred by section 49A of the Indian Income-tax Act, 1922 (XI of 1922) and in supersession of the Notification of the Government of India in the late Finance Department (Central Revenues) No. 1, dated the 4th January, 1941 the Central Government made the Income tax (double taxation relief) 19 (Dominions) Rules 1956 which provided for the scope and modus operandi of the Double taxation agreements to be entered into by the Central Government with the Governments of any other countries. And thus these developments paved the way of the Central Government to play its independent role in the world comity of nations.

In 1962 when Indian Income tax Act 1961 was introduced section 49A of the earlier statute (i.e. 1922 Act) was substituted by section 90 of the 1961 Act. Section 90 of the present Act was a verbatim reproduction of sec. 49A of the 1922 Act.

In 1965 the brackets and words "(including super tax)" in clause a> were omitted by the Finance Act 1965 w.e.f. 1 April 1965.

A crucial change has been brought about since 1 April 1972. The object and scope of the change could be explained as follows:–

Some of the taxpayers having transactions with outside countries resort to dubious methods for evading their liability under the tax laws. Tax evasion is thus closely linked with transactions involving over invoicing and import and export business operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. Case of taxpayers who thwart the attempts of the administration to collect tax dues by either retaining their assets abroad or transferring them secretly outside India are also not unknown. With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications the Finance Act 1972 has substituted a new section for the existing section 90 of the Income-tax Act, in order to empower the Central Government to enter into agreements with foreign countries not only for purposes of avoidance of double taxation of income but also for enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on reciprocal basis.
Thus, the legislative transformation in India has shaped itself so as to be conducive to keep abreast with the changing requirements of double taxation treaties in international domain.

7.11 Anatomy of double taxation relief treaties

Any international treaty must have the following anatomical elements:

i> **Scope of the treaty:** It must cover the specific taxes to be extended double taxation relief under both the countries constituting the parties to the bilateral agreement.

ii> **Definitions:**
   a> In general
   b> Nationality or domicile
   c> Residence or domicile of individual
   d> Permanent establishment.

iii> **Quantum and conditions of abatement:** It must state categorically the quantum and conditions pertaining to tax relief.

iv> **Methods of avoiding double taxation**
   a> Exemption
   b> Credit for foreign taxes.

v> **Determination of source of income**
   a> Objective taxes
   b> Personal taxes.

vi> **Determination of source of income from business.**

vii> **Determination of source of income from employment.**

viii> **Determination of source of income from capital**
   a> Interest, annuities and pensions
   b> Dividends
   c> Royalties
   d> Capital Gains.

ix> **Industrial and Commercial Profits**
   a> In general
   b> Apportionment of profits
   c> Controlled enterprises.

x> **Income from shipping and Air Transport.**

xi> **Individual claims for relief.**

xii> **International administrative cooperation & exchange of information.**
   a> Assistance in collection &
   b> Consultation with respect to taxes of particular taxpayers.

xiii> **Tenure**

xiv> **Modifications.**

xv> **Persons engaged in Education, Research & Training.**

The above anatomical sketch of the format of double taxation treaties in international income tax could, at best be, enumerative than exhaustive, for international treaties are dynamic rather than static in nature.

7.12 Types of double taxation relief treaties
The double taxation treaties could be of the following types

i> Double taxation avoidance agreements. This may be a treaty where two countries agree that income from various specified sources which are likely to be taxed in both the countries should tax only a particular specified portion of the income so that there is no overlapping. Such a treaty will result in a complete avoidance of double taxation of the same income in the two countries.

ii> The other kind of treaty is one that does not envisage any such scheme of single taxability but merely provides that, if any item of income is taxed in both the countries, the assessee should get the relief in a particular manner. Under this type of agreement the assessee is liable to have his income taxed in both the countries, but is given a deduction from the tax payable by him in one country, of a part of taxes paid by him thereon, usually the lower of the two taxes paid. In practice, both the types of treaties operate in the same way.

From a different angle the treaties could also be

iii> Comprehensive treaties :- as the very nomenclature suggests it covers a wide spectrum of items.

iv> Treaties having limited applicability.

It goes without saying that the type of treaty has an important bearing so far as its anatomical contents are concerned.

7.13 Some Indian treaties overviewed

In the world history of bilateral double income-tax relief treaties the first agreement was one that was between U.K and U.S.A signed in the year 1945. Upto the expiry of the sixties India entered into the first of such type of treaty with Pakistan in the year 1947. Thus, Pakistan was the first country with which India entered into a double taxation avoidance agreement. This was under a special provision enacted on the eve of the Independence of the country.

Under the agreement with Pakistan each of the two dominions was entitled thereunder to make assessments in the ordinary way. Dividends were to be assessed without apportionment of the dividend as attributable to Indian or Pakistan profits. The restriction under the agreement was only in respect of the liberty to retain the tax assessed. The hire income of vessels was income from transport business 100% taxable in the country in which the traffic originated. Under item 5 of the schedule to this agreement and that item 9 had no application. Under the agreement, abatement was available only when the source of income was taxable in both
countries and that (Profit or) loss in agriculture suffered in Pakistan will have to be ignored.

The agreement for avoidance of double taxation reached with the Dominion of Pakistan applied to 1> assessments for 1947-48 (and subsequent years) made after 14th August, 1947 and 2> assessments for 1946-47 and earlier years made after 31 March 1948.

The avoidance basis was operative on following lines:

Each dominion will determine the total income of the assessee in the ordinary way under its own laws, but in respect of the source of income or categories of transaction specified in the schedule to the Agreement, it is entitled to retain tax on such portion of the income therefrom as is calculated according to the percentages shown in the schedule. The remaining portion can be included in the total income for purposes of rate if it is so includible. And, if it is actually charged, the Dominion which is not entitled to retain the tax thereon will give credit for the lower amount of the tax payable thereon in either Dominion. In the case of income chargeable under the head 'salaries', 'interest on securities', 'property' etc. where 100 percent is liable in one Dominion and nil in the other, no difficulty ordinarily arises. But in the case of goods in respect of which operations resulting in profit are partly performed in one Dominion and partly in the other, difference of opinion may arise as the category in which the income falls and the percentage of profit chargeable by either Dominion. Each Dominion is to decide this question independently of the other and the assessee who feels aggrieved by the assessment in any Dominion will pursue the remedies open to him under the law of that Dominion.

This agreement ceased to be operative from the assessment year 26 1972-73 after the outbreak of the Indo-Pakistan armed conflict in December 1971.

At present there exists between India and Pakistan an agreement for the avoidance of double taxation of income derived from International Air Transport under 1989 agreement.

Position of Jammu & Kashmir

Section 49A of the 1922 Act originally envisaged a double taxation avoidance/relief agreement with Jammu & Kashmir. But this provision was dropped in view if the extension of the provisions of the Income-tax Act to Jammu and Kashmir by the Taxation Laws (Extension to Jammu & Kashmir) Act, (XLI of 1954).

United Kingdom

U.K. stands on a distinct pedestal in view of its special historical relations. Pre-independence Indo-U.K. relations vis a vis
vis double income taxation has been dealt with at a greater length. A double taxation agreement with U.K has recently been arrived at. It is a comprehensive agreement applying to United Kingdom tax viz i> the income tax, ii> the corporation tax, iii> the capital gains tax, iv> the petroleum revenue tax and v> the development land tax and the "Indian tax" viz. 1> the income tax and any surcharge imposed under the Income tax Act 1961 (43 of 1961).

This convention shall also apply to any identical or substantially similar taxes imposed subsequently by the contracting states. Fiscal domicile is defined in Article 4 of the convention. This convention covers in its scope income from immovable property (Article 6 of the convention), Business profits (Article 7), Air transport (Article 8), Shipping (Article 9), Associated enterprises (Article 10), Dividends (Article 11), Interest (Article 12), Royalties and fees for technical services (Article 13), Capital gains (Article 14), Departmental personal services (Articles 15 & 16), Director's fees (Article 17). It also extends to Artists and Athletes (Article 18), Governmental remuneration and pensions (Article 19), Students and trainees (Article 20) and Teachers (Article 21). The method of elimination of double taxation has been deal with under Article 22. It provides both the methods of deduction and credit for tax. The states undertake to the policy of non discrimination to the nationals of the contracting states. (Article 23). Mutual agreement procedure is governed by Article 24. Exchange of information is provided for in article 25 of the convention.

The tenure of the convention is generally indefinite. But either of the contracting party may terminate the convention, through the diplomatic channel, by giving notice of termination at least six months before the end of the calendar year beginning after the expiration of ten years from the date of entry into force of the convention. In such an event the convention shall cease to have effect.

In view of the special relationship (which came to an end in 1947 ) Britain occupied an important position in the diplomatic and economic life of India. India can hardly conceive of total severance of relationship with Britain. Immediately after independence there was a problem of common wealth of countries of which Britain happened to be a leading member. In contemporary times there was a hot controversy on the issue. One school of thought propagated total severance of relationship with Britain while the other view supported some or other liason with Britain. The late Prime Minister Jawaharlal Nehru was a strong supporter of accepting membership of common wealth. The moment India accepted common wealth membership it ipso facto accepted need of economic ties with Britain and the necessity of such a convention. Even today Britain plays no less important a role in India's economic life. Therefore, a comprehensive agreement on the aforesaid lines
shall go a long way in serving the reciprocal interests of the two sovereign nations. Between 1947-1981 the double-income tax relationship with Britain was governed by section 91 of the 1961 Act.

Ceylon (Sri Lanka)

Double-taxation relief with Ceylon was previously governed by the rules framed under section 49 (A) as it stood prior to 1953. Subsequently a double taxation agreement was entered into with Ceylon. On India's side taxes imposed under the Indian Income tax Act 1922 (XI of 1922) and on Ceylon's side the tax imposed by the Ceylon profits Tax Act, 1948 (V of 1948) and the tax imposed by the Ceylon Income-tax Ordinance of 1932 (II of 1932), exclusive of the taxes mentioned in sub sub clauses (i), (ii), and (iii) of section 45 (4) (b) of the said ordinance were covered by the treaty.

Transactions and rates are specified in the schedule appended with the convention. Each country shall make assessment in the ordinary way under its own laws and where either country under the operation of its own laws charges any income from the sources or categories of transactions specified in column I of the schedule in excess of the amount calculated according to the percentages specified in columns II and III thereof, that country shall allow an abatement equal to the lower of the amounts of tax attributable to such excess in either country.

There also exists a provision for inter governments exchange of information (being information which is at their disposal under their respective taxation laws in the normal course of administration.) as is necessary for carrying out the provisions of the agreement.

The Governments may modify from time to time the schedule appended with the agreements. The modified convention shall then be applicable in the proper context.

The convention shall ordinarily continue indefinitely but either of the contracting Governments may, in any calendar year, give to the other contracting Government written notice of termination on or before the 30th September in any calendar year, in such event the present agreement shall cease to have effect in relation to assessment commencing after the said date.

In view of the geographical proximity, and the historical background Sri Lanka is a country which is very close to India. From the standpoint of ethnic groups the majority of the populace have Indian origin. In view of these factors there is exchange of university students and teachers. They ought to have been
specifically treated as a class in itself for relief from double taxation. But convention seems to be wanting in this respect. This class inferentially seems to have been placed in the residual item viz item No. 8. Express mention of item granting relief to students and trainees and teachers, researchers etc. would have been more propitious in view of the exigential circumstance and situation of this neighbouring island.

Convention between the Government of Republic of India and the Government of Japan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income

Government of Republic of India entered into agreement with Japan for the avoidance of double taxation of income for the first time in 1960.

The 1960 convention was modified in the year 1970, which brought about the following modifications.

i) Surtax has been brought about in the purview of the bilateral agreement. Since surtax has been introduced in India by the companies (Profits) surtax Act of 1964.

ii) With reference to sub paragraph (i) (ii) of paragraph (i) of Article II of the Agreement "an enterprise of one of the contracting states shall be deemed to have a fixed place in the other contracting state if it carries on in that other contracting state of construction, erection or assembly project or the like."

For the purpose of the said sub paragraph, where a resident of one of the contracting states fulfills an order for the sale of plant or machinery to a resident of the other contracting state and it is incidental to the sale of the plant or machinery that a person or persons employed by the resident of India (the first mentioned contracting state) should proceed to (that other contracting state) Japan for assisting in the installation of the plant or machinery therein, in such activity shall not be deemed to constitute a permanent establishment unless it is carried on for a period exceeding ninety days or the expenses incurred on such activity are more than 10% of the total sale price of the order.

iii) With reference to sub paragraph (i) (iii-a) of paragraph (i) of Article II of the Agreement "an enterprise of one of the contracting states shall not be deemed to have a permanent establishment in the other contracting state if it maintains a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise."

"An enterprise of one of the contracting states shall not be
deemed to have a permanent establishment in the other contracting state for any purpose or purposes other than the purposes specified in the said paragraph.

iv) With reference to paragraph (2) of Article XI of the Agreement: "The amount of Japanese tax payable under the laws of Japan and in accordance with provisions of the present Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Japan which has been subjected to tax both in India and Japan shall be allowed as a credit against Indian tax payable in respect of such income, but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax".

For the purposes of the said paragraph where the resident of India is a company by which the surtax is payable, the credit to be allowed against Indian tax shall be allowed in the first instance against the income tax payable by the company in India, and as to the balance, if any, against the surtax payable by it in India.

In 1975 the following modifications were made in the Agreement:

1. The competent authorities in the contracting states shall exchange such information including documents (information) as is necessary for carrying out the provisions of the Agreement including information for the prevention or detection of evasion or avoidance of the taxes which are the subject of the Agreement. Any information so exchanged shall be treated as secret but may be disclosed to persons (including a court or administrative body) concerned with the assessment, collection, enforcement of prosecution in respect of the taxes which are the subject of the Agreement or to persons with respect to whom the information relates.

2. The exchange of information shall be either on a routine basis or on request basis with reference to particular cases.

3. However, exchange of information shall not be to the detriment of trade, commerce or industry of contracting state or it shall not be at variance with the laws of the contracting state or public policy thereof.

The modifications brought about in the agreement are clearly in tune with the powers taken by the Central Government for doing away with tax evasion attempts in the international sphere. The Government of Japan seems to have completely cooperated with the Government of India in their attempt at exchange of information targeted at this end.

The new convention has been entered into by the Government of Republic of India and Government of Japan on 29th December 1989 for the avoidance of double taxation and the prevention of the fiscal evasion with respect to taxes on income.
This Agreement is a comprehensive Agreement incorporating all the provisions of the earlier Agreements (viz 1960 & 1975) with a great deal of focus on prevention of fiscal evasion with respect to taxes on income. As has been stated earlier nowadays tax evasion with international ramifications is on increase and the Governments must joint hands to do away with this evil. 1989 convention is the best example of international endeavour in the comity of nations.

7.14 General overview of Indian treaties pertaining to double income tax relief

After independence India broke off the shells of political bondage. Now her compulsion to remain tied with Great Britain alone was no more required. Immediately after independence an agreement with Pakistan was signed. It has been earlier dealt with at a greater length. Agreement with Ceylon, U.K. and Japan have been dealt with in greater details. She entered into agreements with Swiss Federal Council, Sweden, Denmark, Norway, the Federal Republic of Germany, Finland, Republic of Austria, Republic of Australia, Greece, Romania, Republic of Lebanon, United Arab Republic, Federal Republic, Iran, Italy, Afghanistan, Belgium, U.S.S.R., U.S.A., Bulgaria, Malaysia, Ethiopia, German Democratic Republic, Czechoslovak Socialist Republic, Tanzania, U.K. It has been dealt with in greater details; Singapore, socialist people Libyan Arab Jamahiriya.

It is impertinent to go into clausewise analysis of every agreement. Most of these agreements mutatis mutandis conform to ideal sketch of an International treaty for double taxation avoidance relief agreement. But one very interesting thing is discernible that in agreements before 1972 in most of the agreements there is no article pertaining to exchange of information intra parties. And in those agreements such as ceylon, Sweden, Norway, F.D.R., Finland, Austria, Greece, U.A.R. etc the conventions do have the Article with provision of exchange of information. But the scope is very limited. This information pertains to one requisite for carrying out the provisions of the bilateral agreements. But in Agreement after 1972 in most of the Agreements there are extensive provisions relating to exchange of information not only limited to that necessary for carrying out the provisions of the conventions but also for avoidance of fiscal evasion of taxes of income.

During 1985-1990 as many as 26 Agreements are entered into with various countries of which 10 ones are amendments or modifications...
of the old ones.

From the point of view of the nature of Agreement it is found that India has entered into comprehensive agreements with the following countries:

1) Australia
2) Belgium
3) Canada
4) Czechoslovak Socialist Republic
5) Denmark
6) (the) Federal Republic of Germany
7) Finland
8) Finance
9) German Democratic Republic
10) Greece
11) Hungarian People Republic
12) Indonesia
13) Italy
14) Japan
15) Kenya
16) Korea
17) Libya
18) Malaysia
19) Mauritius
20) Nepal
21) (the) Netherlands
22) New Zealand
23) Norway
24) Polish People’s Republic
25) Singapore
26) Ceylon (Sri Lanka)
27) Sweden
28) Syria
29) Tanzania
30) Thailand
31) U.A.R. (United Arab Republic)
32) U.S.S.R.
33) Zambia
34) United Kingdom

On the other hand India entered into bilateral agreement with limited scope with certain countries. Agreements for receipts from air traffic have been entered into with Afghanistan, Australia, Ethiopia, Iran, Italy, Kuwait, Lebanon, Oman, Pakistan (1989), People’s democratic Republic of Yemen, Switzerland, U.A.E., U.S.A., Yemen Arab Republic.

Agreements for shipping receipts have been entered into with Bulgaria, Czechoslovakia, Germany (G.D.R.) U.S.S.R.

An agreement has been entered into with Rumania governing receipts from both air and shipping trade.

It will be clear from the above narrative that in the post independence period India has grown both in the sphere of
development in trade and commerce and along with that it has come to occupy its place of honour in the comity of nations. Recently its pace is very rapid as is clear from the number of agreements it entered into or rejuvenated during a short span of 5 years of 1985-1990.

India can look forward for intensification of its double taxation relief Agreements as of late the SAARC movement has gained ground and with economic cooperation at the regional level there is scope for intensification of Agreements in the taxation field with SAARC nations.

With the advent of new liberal economic policy and with Indian attitude to invite the intending world community to participate in India's endeavour of economic emancipation this problem is likely to assume new dimensions. The would be investing countries with other economic problem of double income taxation which is likely to prove a stumbling block in the materialisation of their investment proposals. Government of India shall have to take a fresh probe into the imminent situation. Though it would be premature to predict the magnitude of the problem yet its undercurrents could hardly be lost sight of by Government of India. Hence this caution.
Chapter References and notes


Prof. Rao gives justification to his nomenclature on the ground that Prof Seligman happened to be the most distinguished of the members of the committee and further that he (Prof. Seligman) had written a book on double taxation and which in contemporary times had come to be reputed as the most noted work on the subject. Other members of the committee were Bruins, Enaudi and Sir J.C. Stamp.

2) Ibid p.39


4) V.K.R.V.Rao op.cit. p.221

5) Punjab Annual Report 1915-16 p-10

6) L.A.D. Pat II pp.2027 .203

7) See page _____ supra.

8) Quoted in the Bengal Chamber’s Memorial, Appendix B, B.C.C. 1902.

9) Appendix B, B.C.C. 1902

10) PP.168-173 Royal Commission on Income Tax. The Indian representative was Sir James Meston.

11) U.K.Finance Act 1920, S.27(1)

12) V.K.R.V.Rao op.cit. page 231


15) V.K.R.V.Rao op.Cit. page 232

16) Ibid page 238

17) Section 222(a) U.S.A. Revenue Act 1926.

18) Section 49 AA introduced by the India (Adaption of Income Tax, Profits tax and Revenue Recovery Act) order, 1947:
22) A.R. Prest Public Finance in theory & practice WEIDENFELD
AND NICOLSON LONDON 1960 P.344.
23) See within supra.
41 (SC.) affirming [1968( 70 ITR 100 (cal.))]
25) Article VII b of the Double taxation agreement with
Pakistan 1947.
26) Board circular No.171 dated 8 July 1975 ; ( 1975 ) 100
ITR (st) 14.
28) See within Supra.
30) Article I of the Agreement for relief or the avoidance of
double taxation of income between the Government of India
and the government of ceylon.
31) Ibid Article III
32) Ibid Article VII
33) Ibid Article IX
34) Ibid Article X
35) Notification No G.S.R.101(E) dated 1 March 1990 ITR 182
ITR 98, 61.
39) (1958) 34 ITR (st)62
40) (1959) 35 ITR (st)17
41) (1960) 38 ITR (st) 57
42) (1960) 38 ITR (st) 75
43) (1969) 40 ITR (st) 21, (1972) 86 ITR (st) 1
44) 1962 44 ITR (st) 2, (1979) 120 ITR (st) 22
45) (1965) 656 ITR (st) 17; (1965) 58 ITR (st) 12
46) (1967) 64 ITR (st) 86
47) (1969) 71 ITR (st) 9
48) (1969) 73 ITR (st) 24
49) (1969) 74 ITR (st) 11
50) (1970) 76 ITR (st) 1 ;(1971) 80 ITR (st) 87.
51) (1973) 91 ITR (st) 31.
52) (1975) 99 ITR (st) 181.
53) (1975) 101 ITR (st) 68.
54) (1975) 101 ITR (st) 6.
57) (1977) 107 ITR (st) 34.
58) (1977) 107 ITR (st) 36.
60) (1969) 118 ITR (st) 14 ;
64) (1982) 137 ITR (st) 27.