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Revised paper clears air on double taxation treaties

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Foreign institutional investors (FIIs) could not be happier as the revised discussion paper on direct taxes code (DTC) clarified that the domestic code would not override the double taxation avoidance agreements (DTAAs).

This could come as a huge relief as majority of the FIIs operating in India are registered in tax havens. The discussion paper also removed the ambiguity on income classification for tax computation.

“It is proposed to provide that between the domestic law and relevant DTAA, the one which is more beneficial to the taxpayer shall apply,” noted the discussion paper.

This is a shift from the earlier stand, as the DTC clearly said that neither the DTAA nor the code would have a preferential status and in cases of conflict ‘the one that is later in point of time shall prevail”. India, incidentally, has signed bilateral tax avoidance treaties with countries like Mauritius, Isle of Man, Seychelles and Cayman Islands, among others.

“This is positive for the FIIs as the treaty over-riding provisions have been done away with,” said Siddharth Shah, head - funds practice, Nishith Desai Associates. “So, in a sense it is good but we need to wait for the fine print. But it will surely provide some comfort to the FII community.”

“It is proposed that the income arising on purchase and sale of securities by an FII shall be deemed to be income chargeable under the head ‘capital gains’,” said the discussion note. This, according to experts, would help in avoiding unnecessary litigation as many FIIs were classifying their income as ‘business income’ to claim total exemption from taxation in the absence of a permanent establishment in India.

Sameer Gupta, director at Ernst & Young, said given that characterisation of income from sale of securities was driven by circumstances, it had the potential for litigation and to that extent, the provision deeming income of FIIs on sale of securities as capital gains would provide clarity to foreign investors.

Also, the proposal to revert to a concessional tax treatment for listed equity shares and units of equity-oriented mutual funds held for more than a year was a right step, but would fall short of market expectations, he said.