

## Tax Hotline

December 05, 2027

### INDIA – UAE TAX TREATY AMENDED TO WITHDRAW CAPITAL GAINS TAX EXEMPTION

In an attempt to prevent the misuse the beneficial provisions of the double taxation avoidance agreement (“DTAA”) between India and the United Arab Emirates (“UAE”), the Government of India and the Government of UAE signed a protocol on March 26, 2007 amending the India – UAE DTAA. On November 28, 2007, the Government of India issued a notification (notification no 282/2007) directing that all the provisions of the protocol are to be given effect to in the Union of India with effect from April 1, 2008.

The India – UAE DTAA has been a subject matter of conflicting decisions at various levels of judiciaries in India. There have been many conflicting decisions on whether or not individuals resident in UAE will be entitled to claim the treaty benefits in India. This is because the UAE does not currently impose tax on individuals.

Some significant amendments to the India – UAE DTAA are summarized below:

- The amendment now specifically provides that for an ‘Individual’ to be a resident of UAE, he should be present in the UAE for at least 183 days in the calendar year concerned. As regards a ‘Company’, for it to be a resident of UAE, it should be incorporated in the UAE and should be wholly managed and controlled from UAE. Both the conditions should be cumulatively satisfied in order for a Company to be regarded as resident of UAE. Such quantitative or qualitative tests (as the case may be) were not present in the earlier treaty. The word ‘wholly’ has been strictly construed in India. Hence, even a fraction of control outside the UAE could potentially make it a non-resident company ineligible for treaty benefits.
- The article on dividend has been amended to provide a withholding tax rate of 10 percent in the country of source. Earlier, the withholding tax rate was 5 percent where the beneficial owner was a company which owned at least 10 percent of shares in the company paying dividends; and 15 percent in other cases. However, this is not relevant as currently India does not impose any withholding tax on dividends.
- The Article relating to capital gains tax has been amended to provide source based taxation. Henceforth, capital gains arising from sale of shares of a company in one Contracting State shall be taxable in that State itself. In other words, capital gains earned from sale of investments in shares of Indian companies will be taxed in India (except where exemptions are provided under the domestic tax laws of India). This amendment will directly hit the individual investors and companies investing in India. There has not been any grandfathering for investments already made.
- The benefits earlier provided under the non-discrimination clause for taxation of profits of a permanent establishment (“PE”) have now been constrained. It is now provided that the provisions of the non-discrimination clause shall not be construed as preventing a Contracting State from charging the profits of a PE at a rate of tax which is higher than that imposed on the domestic companies.
- A new clause on ‘Limitation of benefits’ (“LOB”) has now been included in the DTAA. The LOB clause provides that the benefits of India – UAE DTAA shall not be available if the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits of the DTAA between India and UAE. While no precise parameters are laid down in identifying circumstances when an entity may not be entitled to treaty benefits, the DTAA provides that legal entities not having bonafide business activities shall be covered by the LOB article.

In general, while the amendments in India – UAE DTAA will provide a lot of certainty as regards determining tax residency for UAE residents, the amendments in the capital gains tax provisions are likely to affect the inbound investments in India from the UAE. The amendments will be effective in India from April 1, 2008.

#### India – Kuwait tax treaty

The Government of India signed a comprehensive DTAA with the Government of Kuwait on June 15, 2006; the DTAA being notified vide notification no 277/2007 dated November 27, 2007. The DTAA with Kuwait will be effective in the Union of India from April 1, 2008.

Some significant provisions of India – Kuwait DTAA are briefly listed below:

- Capital gains arising from sale of shares of a company in one Contracting State shall be taxable in that State itself.
- Interest payments may be taxed at the rate of 10 percent of the gross amount in the Contracting State in which it arises. Such interest may not be taxed where the recipient and beneficial owner is a Government / political subdivision / local authority / Central Bank / other governmental agencies or financial institutions as may be specified and agreed between the competent authorities of the respective Contracting States.
- Royalty or fees for technical services may be taxed at the rate of 10 percent of the gross amount in the Contracting

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- State in which it arises.
- As regards profits attributable to a PE, the protocol to the India – Kuwait DTAA specifically provides that any sales, business or supplies executed outside the Contracting State in which the PE is situated shall not be taken into consideration in determining profits of the PE.

- Lokesh Shah & Shefali Goradia

Source:

- *Notification no 282/2007 dated November 28, 2007 (for India – UAE DTAA)*
- *Notification no 277/2007 dated November 27, 2007 (for India – Kuwait DTAA)*

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