Tax Treaties

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Manifest pedagogy: Tax Treaties were in news for their conflict with Make in India, inverted duty structures, lines of credit etc. they are important for both prelims and mains. They will also help enrich your answers in paper 2 (international relations)

In news: India has pitched for wider sharing of information exchanged under tax treaties among BRICS countries.

Placing it in syllabus: Tax reforms

Static dimensions:

- What are tax treaties?
- Tax information sharing agreements
- Advance pricing and transfer pricing

Current dimensions:

- Tax agreements under BRICS
- Relevance for India

Content:

What are tax treaties?

- A tax treaty is a **bilateral two-party agreement** made by two countries to **resolve issues involving double taxation of passive and active income.**
- Tax treaties generally determine the amount of tax that a country can apply to a taxpayer's income, their capital, estate, or wealth.
- A tax treaty is also called a **Double Tax Agreement (DTA)**.
- When an individual or business invests in a foreign

country, both countries – the **source and the residence country** may enter into a tax treaty to agree on which country should tax the investment income to **prevent the same income from getting taxed twice.**

- To avoid double taxation, tax treaties may follow one of **two models:**

OECD Tax Model – The OECD Tax Convention on Income and on Capital **requires the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country.** The two involved countries will benefit from such an agreement if the flow of trade and investment between the two countries is reasonably equal and the residence country taxes any income exempted by the source country.

U.N. Tax Treaty Model – Formally referred to as the United Nations Model Double Taxation Convention between developed and developing Countries. This favorable taxing scheme **benefits developing countries receiving inward investment.** It gives the source country increased taxing rights over the business income of non-residents compared to the OECD Model Convention.

Tax information exchange agreements (TIEA):

- A TIEA is a **mutual agreement between countries that is a tax treaty variant** specifically entered into by governments to **exchange information relevant to the administration and enforcement of the domestic tax laws** of the contracting parties.
- The key purpose of this arrangement is to **promote international cooperation in tax matters** by exchanging tax related information (including that of banking and ownership).
- The **OECD is the original proponent** of TIEAs.
- They were developed by its **Global Forum Working Group on Effective Exchange of Information** to address harmful tax practices.

- The TIEA is based on international standards of tax transparency and **enables the sharing of information on request.**
- The agreement also **provides for representatives of one country to undertake tax examinations in other countries.**
- However, TIEAs are **not binding instruments** and can be terminated as stipulated in the agreements.

[gdlr_styled_box content_color="#ffffff" background_color="#1e73be" corner_color="#bababa"]As of May 2019, **India has entered into 21 TIEA arrangements** with the following countries: *Argentina, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, San Mario, Isle of Man, Jersey, Liberia, Macao Sar, Maldives, Liechtenstein, Monaco, Saint Kitts, Nevis, Seychelles and Marshall Islands.*[/gdlr_styled_box]

Advance pricing and transfer pricing:

- The Advance Pricing Agreement (APA) was **introduced in 2012 by the Central Board of Direct Taxes(CBDT)** with an aim of minimising any confusion regarding the pricing of international transactions.
- APA guidelines were included as part of the **Income Tax Act, 1961** and **rules 10F to 10T and rule 44GA** were inserted in the already existing income tax rules.
- It is an **agreement between a taxpayer and a tax authority** fixing the transfer pricing methodology to **decide the pricing of future international transactions of the taxpayer.**
- Once the APA is sealed, the methodology decided upon is applied for a certain period of time based on completion of certain terms and conditions.

Benefits:

- It checks tax evasion.

- Following the APA guidelines removes the threat of audit for an enterprise taxpayer who has business across several countries.
- Reduces the cost of administration of tax authorities and removes extra pressure on their resources.
- It brings in more transparency and clarity for a taxpayer in terms of tax risks and possible exposure to such risks.
- APAs also declare successful settlement of existing transfer pricing disputes.

Types of APA:

1. Unilateral APA
2. Bilateral APA
3. Multilateral APA

Transfer Pricing:

- It is the **charge at which one company makes available goods or finance or services to another company that is related to it.**
- The idea behind transfer pricing is that all transactions between associated enterprises or related companies should be based upon the same terms (at an Arm's length) and conditions as those between unrelated parties.
- This **Arm's Length principle** is an internationally accepted principle, accepted by domestic tax legislation of almost all countries worldwide.

Tax agreements under BRICS and its relevance for India:

- At the meeting of tax heads of BRICS nations, India has voiced for **wider sharing of information exchanged under tax treaties among BRICS countries.**
- It also underlined the need to tax emerging business

models using **digital mediums.**

- It is very much **needed for countering corruption, money laundering and terrorist financing.**
- India has called for adopting a **"whole of government approach"** in dealing with crossborder financial crimes, as they have ramifications in respect of various statutes, not only taxation.
- India also asked for **sharing of Covid-19 related tax measures** taken by respective tax administrations.
- This move is to enhance the country's understanding of the fiscal and economic impact of the pandemic.
- The **knowledge sharing** would also aid in further evaluating various possibilities in assisting the government's efforts in containing the pandemic.

Mould your thought: What is a tax treaty? Explain the importance of Tax information exchange agreements (TIEA).