Indo-Australian Trade Links And The Income Tax Hurdles

By

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1.1.1 Abstract

Of late, there is a significant awareness of the possible improvement of the bilateral trade relations between India and Australia. Several Australian companies appear to be eager to invest in India particularly, in the key sectors, such as mining, agri-business, infrastructure and power. Yet, trade statistics indicate that the potential has not been fully realized. Despite the opening up of the Indian economy and the lowering of tariffs by Australia, India accounts for only a negligible proportion of Australia's trade. And growth of this trade has also been marginal.

Among the several factors responsible for the low magnitude and slow growth of the bilateral trade, differences in the respective income tax systems could be a major one. Although several countries have been adopting policies aimed at progressively liberalizing trade and international investment, this process has stopped short of addressing the fundamental distortions which arise as a result of the inherent incompatibility of differing tax systems including the differing extent to which they rely on indirect or other forms of taxation, apart from direct taxes on business profits, as a means of raising revenue. This paper aims at a comparative analysis of income tax systems in the two countries with a view to highlight the aspects that are relevant for fostering the trade between the two countries. The paper also appraises the existing double taxation agreement between the two countries.

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This paper aims at a comparative analysis of income tax systems in the two countries with a view to highlight the aspects that are relevant for fostering the trade between the two countries. It also aims at taking a closer look at the Double Tax Avoidance Agreement between India and Australia. Section 1 examine the income tax system in India, section 2 examines the Australian income tax system, and section 3 assesses the adequacy of the double taxation agreement between the two countries.

2. The Indian Tax System.

2.1 The Basic Features.

The direct-Indirect tax mix has important implications on the cross-country investments. Where the host government raises revenue through indirect taxes such as taxes on consumption this will have the effect of increasing business costs, and as a

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2. The Indian Tax System.

2.1 The Basic Features.

The direct-Indirect tax mix has important implications on the cross-country investments. Where the host government raises revenue through indirect taxes such as taxes on consumption this will have the effect of increasing business costs, and as a consequence will reduce before tax profits. On the other hand where direct taxes are levied on business profits, this will have the effect of reducing after tax profits.

For example, consider the two positions, (a) Profits are subject to direct taxes at the rate of 50%, and (b) no direct taxes levied on business profits, instead revenue is raised by indirect taxes that increase costs by an amount equal to the direct taxes in (a). Although before tax profits in (a) are double those in (b), the net of tax returns are the same. This illustrates the importance of comparing net of tax returns when appraising any potential investment.

Table 1. Impact of Direct-Indirect tax mix - an example.

	Example (a)	Example (b)
Turnover	1000	1000
Costs	800	900
Profits before tax	200	100
Less direct taxes (50%)	100	
Profits after tax	100	100

In the light of the above, let us now have a closer look at the Indian direct and indirect tax systems. The dependence on indirect taxes in India, as is well-known, is very high. Over 80 percent of the government revenue comes from the indirect taxes. Although the effective income tax burden on the return on investment can be equal between Australia and India, the high indirect tax component adds to the costs of production and distribution. Therefore, any comparison of the income tax differential and the role of the double taxation agreement should take this fact into consideration.

The Major direct taxes presently levied in India include direct taxes such as income tax, wealth tax, and gift tax.

2.2 Income Tax.

As a general rule countries impose tax on the worldwide profits of resident companies and charge non-resident companies to tax only in respect of profits which arise from a source within their jurisdiction. Accordingly, where a company is resident in one country but derives profits from a source within some other country (from a branch or whatever) both the investing company's country of residence and the source-country of the profits could claim, in principle, the right to tax those same profits. The resultant double taxation would reduce returns from overseas investment discouraging it.

Income tax in India is levied on corporates, firms, and individuals, and includes tax on capital gains. It is important to understand the concept of 'corporate residence', especially as definitions tend to vary, depending upon the jurisdiction. Because of the variety of definitions of corporate residence, it is possible for a company to be regarded as resident in two jurisdictions. It is for this reason, the double tax agreement contains the "tie-breaker" clause based on effective management of the company.

An Indian company is always resident in India. A foreign company is resident in India only if during the previous year, control and management of its affairs is situated wholly in India. The tax incidence varies according to the residential status of the assessee. Residents are taxed only on world wide income, while non-residents are taxed only on income received in India or which accrues or is deemed to accrue in India.

A foreign collaborating company would not be a resident in India by virtue of section 6(3) of the Income-tax Act, 1961 as the control and management of its affairs would not be situated wholly in India. In accordance with section 5(2) the foreign company will be liable to Indian tax on all income received from whatever source in India. There is some vagueness regarding income accruing or arising through or from any business connection in India. According to Section 9(1)(i), all income is deemed to be accruing in India provided where operations of the enterprise are partly carried out in India and partly abroad, only the income as could be reasonably attributed to the operations carried out in India are deemed to arise in India. Income does not arise only by virtue of purchasing of goods for the purpose of export. Further the collection of news for transmission out of India does not give rise to Indian income if the company does not have a shareholder who is a citizen or resident of India.

Dividends, interests, royalties and fees for technical services paid to non-residents attract withholding tax. Long term capital gains, that is, gains on transfer of assets held for more than three years (one year case of shares and listed securities) attract lower capital gains tax. Long term capital gains on transfer of shares in Indian companies acquired in foreign currency are neutralized for exchange differences and are not indexed for inflation. Other long term capital gains are indexed for inflation.

The main source of income of a company is generally from "business". A company would also earn income from under the following heads: (a) income from house property, (b) income from capital gains, and © income from other sources. Taxable income is calculated according to the rules for each class of income and then aggregated to determine total taxable income. While calculating income from business or profession, expense incurred wholly and exclusively for business purposes are generally deductible. These include depreciation on fixed assets, interest paid on borrowings in the financial year etc. Certain expenses are however, specifically disallowed or the amount of deduction is restricted. These expenses include: Entertainment expenses, Interest or other amounts paid to a non-resident without deducting without tax, Corporate taxes paid, Indirect general and administrative costs of a foreign head office.

There are also provisions allowing Set-Off and carry forward of Losses. Business losses incurred in a tax year can be set off against any other income earned during that year, except capital gains. Unabsorbed business losses can be carried forward and set off against business profits of subsequent years for a period of eight years; the unabsorbed depreciation element in the loss can however, be carried forward indefinitely. However, this carry forward benefit is not available to closely-held (private) companies in which there has been no continuity of business or shareholding pattern. Also, any change in beneficial interest in the shares of the company exceeding 51 per cent disqualifies the private company from the carry forward benefit.

Thus the taxability of a company's income in India depends on its domicile. Indian companies are taxable in India on their worldwide income while foreign companies are taxable on income that arises out of their Indian operations, or, in certain cases, income that is deemed to arise in India. Royalty, interest, gains from sale of capital assets located in India (including gains from sale of shares in an Indian company), dividends from Indian companies and fees for technical services are all treated as income arising in India.

The corporate tax rates at present, are 46% for Indian companies and 55% for branches of foreign companies. These include the surcharge of 15% of the amount of tax payable is levied on domestic companies, if taxable income exceeds Rs.75,000. The long term capital gain tax for foreign companies is 20% while that of the Indian companies is 34.5%. As regards payment to foreign companies, the withholding tax rate on dividends and interest is 20% on gross, and on royalties and fees for technical services it is 30% on gross.

A liberal regime exists for Foreign Institutional Investors (FII) investing in shares through stock exchanges in India. FIIs are taxed at 20% on income from listed securities, 30% on short term capital gains.

The income is computed after allowable deductions, according to the provisions of sections 30 to 40D of the Income-tax Act. Important among the allowable deductions are as follows.

1. Rent, rates, taxes, repairs and insurance for building (30).
2. Repairs and insurance of machinery, plant and furniture (31).
3. Depreciation (33)
4. Investment allowance (32A).
5. Investment Deposit Account (32AB).
6. Development Allowance (33A).
7. Reserves for Shipping Business (33AC).
8. Expenditure on Scientific Research (35)
9. Expenditure on Acquisition of Patent Right or Copy Right (35A).
10. Expenditure on Know-how (35AB).
11. Expenditure for promoting social/ economic wefare (35AC).
12. Expenditure for Rural Development Program (35CC).
13. Expenditure for Conservation of Natural Resources (35CCB).
14. Amortization of certain preliminary expenses (35D).
15. Expenditure on prospecting for certain minerals (35E).
16. Certain other expenditures (36).

Insurance premia for stock and stores [36(1)(i)], employees' health insurance [36(1)(ib)], bonus or commission to employees [36(1)(ii)], interest on borrowed capital [36(1)(iii)], contributions to provident or superannuation fund [3691)(iv)], gratuity fund [3691)(v)], bad debts [36(1) (vii)], and so on.

2.2.1 Depreciation on the basis of Block of Assets (33).

A group of assets falling within a class of assets, being buildings, machinery plant or furniture, in respect of which the same percentage of depreciation is prescribed. The rates of depreciation are enumerated in Rule 5 of Income tax Rules 1952. Briefly, the general rule for computing the block of assets in respect of any previous year (commencing on or after 1-4-1988), is the aggregate of the written down values of all assets falling within that block of assets and adjusted, (a) by the increase of the actual cost of any asset falling within that block, acquired during the previous year, and (b) by the reduction of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so however, that the amount of such reduction does not exceed the written value as so increased. If the asset is used for less than 180 days the deduction would be only 50%. If the cost of the asset is less than Rs 5000, the entire cost is eligible for depreciation.

Table 2. Rates of depreciation.

Block of Assets	Range of Depreciation allowance (%)
Buildings	5 - 20
Furniture and Fittings	10 - 15
Machinery and Plant	25 - 40
Special categories	100
Ships	10 - 20

2.2.2 Other Deductions.

1. Development Allowance (33A). [50% of the cost of planting of new tea bushes, or 30% of the cost of replanting].
2. Reserves for Shipping Business. (33AC)
3. Expenditure on Scientific Research. (35).
4. Expenditure on Patent Right or Copyright (35A).
5. Expenditure on Know-how (35AB).
6. Expenditure for promoting social welfare (35AC).
7. Expenditure to institution carrying rural development programs. (35CCA).
8. Expenditure for conservation for natural resources (35CCB)
9. Certain preliminary expenses for starting a unit (35D).
10. General Deductions. (37).

2.2.3 Important amounts not deductible.

1. Interest payable outside India.
2. Excessive payments made to relatives etc.
3. Expenditure in excess of Rs 10,000 paid through means other than crossed cheque or bank draft.

2.3 Individual income tax.

Taxation of individuals is determined by their residential status. An individual is 'resident' if he stays in India in the fiscal year (April 1 to March 31) either: for 182 days or more, or for 60 days or more (182 days or more for NRIs) and has been in India in aggregate for 365 days or more in the previous four years. An individual who does not satisfy either of these requirements is a 'non-resident'. A resident individual is considered to be 'ordinarily resident' in any fiscal year if he has been resident in India for nine out of the previous ten years and, in addition, has been in India for a total of 730 days or more in the previous seven years. Residents who do not satisfy these conditions are called individuals 'not ordinarily resident'. Taxability of individuals is summarized in the table below.

Table 3. Taxability according to the Residential status.

	Status	Indian income	Foreign income
i	Resident and ordinarily resident	Taxable	Taxable
ii	Resident but not ordinarily resident	Taxable	Not taxable
iii	Non-Resident	Taxable	Not taxable

Remuneration for work done in India is taxable irrespective of the place of receipt. Remuneration includes salaries and wages, pension, fees, commissions, profits in lieu of or in addition to salary, advance salary and perquisites. Allowances, deferred compensation and tax equalization are also taxable. Perquisites are taxes beneficially. Individual tax rates are as given in the following table.

Table 4. Individual income tax rates.

Taxable income slab (Rs.)	Rate (%)
Upto 40,000	Nil
40,001 - 60,000	20
60,001 - 120,000	30
120,001 upwards	40

Spouses are treated separately for tax purposes and their income is not normally clubbed. However, income of all minors, except handicapped minors, is clubbed with the income of their parents unless the income is derived from manual work or an activity involving skill, specialized knowledge and experience. The Finance Act, 1994 has increased the income tax exemption limit, and abolished surcharge on income tax for individuals.

To widen the tax base, the union budget for 1995-95, made a new provision in the Income-Tax act subjecting the sums payable by way of fees for professional or technical services to the requirement of deduction of income-tax at source at the rate of 10%. There will be no deduction of tax at source where the aggregate of payments or credits during the financial year is below Rs.22,000 or where payments are made by individuals and HUF's.

2.4 Special provisions relating to income of non-resident Indian individuals.

When the income of an NRI consists only of investment income or income from long-term capital gains, the tax payable is at the rate of 20 per cent. Capital gains on transfer of assets acquired in foreign exchange is not taxable in certain cases. Non-resident Indians are not required to file a tax return if their income consists of only interest and dividends, provided taxes due on such income are deducted at source. The tax rate on such income is 20 per cent. It is possible for non-resident Indians to avail of these special provisions even after becoming residents by following certain procedures laid down by the Income Tax act.

2.5 Taxation of Corporate Profits and Shareholders.

The fundamental issue of any tax system is the extent to which the principle double taxation is accepted as part of the logic of the system or alternatively the extent to which the tax system tries to integrate, fully or in part, the tax liability of the company with the personal tax liability of the shareholder. Different tax systems adopt differing approaches to this issue. India follows the Classical System and accordingly dividends are subject to both the corporation income tax and individual income tax.

3. The Australian Tax System.

3.1 Main federal Income taxes of Australia

The following are the main federal taxes of Australia: Income tax, capital gains tax and the fringe benefits tax.

3.2 Income tax

Companies are subject to tax on income at a rate of 36%. Until 1987, a classical system of taxation was used whereby a dividend paid by a company to an individual shareholder was subject to "double tax" Inter-corporate dividend rebates were generally available (subject to certain exceptions) for dividends paid between companies. In 1987, The classical system of taxation applying to companies was replaced by a dividend imputation system which provided a credit for tax paid by a company. The credit was given to shareholders in respect of dividends paid to them (no imputation credit was given for foreign tax paid by the company or its foreign subsidiaries).

Foreign earnings of Australian resident companies, which were subject to foreign tax, were basically exempt from Australian tax (except in relation to interest and royalties upon which foreign tax was limited by the terms of a double taxation agreement - such income was subject to Australian tax and a tax credit was given for the foreign tax). In 1982 a set of specific transfer pricing rules were introduced. In 1987, A foreign tax credit system replaced the general exemption for foreign earnings (from 1 July 1987). The foreign tax credit system allowed as a credit foreign tax paid on foreign income up to the amount of Australian tax payable on the foreign income. An indirect credit was introduced for tax paid by a non-resident company on the profits out of which a dividend was paid to an Australian resident company holding at least 10% of the shares in the company declaring the dividend. Again in 1990, non-portfolio dividends (that is, dividends paid to a shareholder with a holding of 10% or more) were exempted from taxation where they were received by Australian resident companies from foreign companies resident in "listed" countries (commencing 1 July 1990). Listed countries broadly comprise countries with tax systems comparable to Australia.

3.3 The Personal Income tax.

Table 5. Individual income tax rates in Australia.

Taxable income ($)	Tax ($)	% on excess
5,400	Nil	20
20,700	3,060	34
38,000	8,942	43
50,000	14,102	47

A Medicare levy of 1.5% applies to most residents where taxable income exceeds $12,870. Non-residents pay tax at 29% from $1 to $20,700 and thereafter at the same rates as above.

3.4 The Concept of Income.

Probably the most important taxation concept is that of "income". This concept is important since the Income Tax Assessment Act generally seeks to tax "income" amounts (and not capital amounts) - the capital gains tax provisions are a specific exception to this broad statement.

An Australian resident taxpayer's assessable income includes the taxpayer's gross income derived directly or indirectly from any sources in the world (section 25). It specifies that only the Australian sourced income of non-residents is taxable in Australia.

A taxpayer is considered to be a resident of Australia if the person is a resident of Australia according to the general legal meaning of that term (in very broad terms, the taxpayer dwells permanently or for a considerable time in Australia or has a usual place of abode here); or is "domiciled" here, unless the person's permanent place of abode is outside Australia; or has been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the person's usual place of abode is outside Australia and the person does not intend to take up residence here. It should be noted however, that the definition of residence may be affected by relevant Australian tax treaties.

As in the case of India, the Taxation Act contains no definition of the term "Income", except giving some guidance for the meaning in Section 6(1) which defines "income from "personal exertion" and "income from property". "Income from personal exertion" is defined to include income consisting of: earnings; salaries and wages; commissions; fees; bonuses; pensions, superannuation allowances, retiring allowances and retiring gratuities; allowances and gratuities received in the capacity of employee or in relation to any services rendered; the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person; and any amount received as a bounty or subsidy in carrying on a business. "Income from property" is defined by section 6(1) of the Tax Act as merely being "all income not being income from personal exertion".

Australia normally taxes only: 1. the worldwide income of residents; and 2. the Australian-sourced income of non-residents. This formulation gives rise to the two basic issues of the international tax laws: residence and source. Since residents are taxed in Australia on their worldwide income, they may encounter the situation where they are subject to tax both overseas and in Australia on the same income. Where such double taxation occurs, there are three methods by which the Australian tax burden could be relieved: 1. Australia could exempt the income from Australian tax; 2. Australia could tax the income, but give a credit for foreign tax paid; or 3. Australia could tax the income, but a deduction may be allowed for the foreign tax paid.

Australia uses a mixture of exemption and credit mechanisms. Australia also has controlled foreign company, transfer or trust, and foreign investment fund rules. These three (extremely complicated) regimes are methods by which the Commonwealth Government has sought to restrict the scope to defer the payment of Australian tax by Australian residents investing abroad. In very broad terms, the regimes seek to tax Australian residents on a current basis in respect of income earned overseas which is not repatriated to Australia. The regimes are aimed broadly at investment overseas through companies and trusts.,

The following are the relevant principles (in summary form) regarding the taxation of non-residents in respect of their Australian source income: Section 25(1) taxes the Australian sourced income of non-residents; Section 23® provides that foreign sourced income of non-residents is exempt from tax; Sections 160L(2) and 160T provide that only "taxable Australian assets" of non-residents are subject to capital gains tax in Australia; Different rates of tax apply to non-residents (a flat rate structure is relevant for non-residents, since progressive rate structures are normally only effective where the rates apply to a taxpayer's total worldwide income - not just a taxpayer's Australian source income); Since it is difficult to collect assessment taxes from non-residents, withholding taxes at flat rates (at least for passively earned income) are often used; Non-residents are subject to tax in Australia on their Australian source income on an assessment basis (taking into account relevant deductions) unless that income is subject to Australian withholding tax; and, Australia imposes final withholding taxes on interest, dividends and royalties (no account is taken of relevant deductions).

4. Salient Features of the Double Tax Agreement between Australia and India.

India has more than 40 comprehensive tax treaties with different countries. Most of these provide for lower withholding tax from dividends, interests, royalties, and fees for technical services. Some treaties exempt from capital gains on transfer of shares in Indian companies under prescribed circumstances. All comprehensive treaties exempt remuneration received by expatriate from his foreign employer if he is in India for less than 183 days provided some specified conditions art fulfilled.

The latest agreement between the government of Australia and the government of the republic of India for the avoidance of double taxation and the prevention of fiscal evasion applies to persons who are residents of one or both of the States. Under this, the taxes covered are:(a) in Australia: the income tax, and the resource rent tax in respect of offshore projects relating to exploration for or exploitation of petroleum resources, imposed under the federal law of the Commonwealth of Australia; (b) in India: (i) the income tax including any surcharge thereon; and (ii) the surtax (abolished since) imposed on chargeable profits of companies, and any identical or substantially similar taxes in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any substantial changes which have been made in the laws of their respective States relating to the taxes to which this Agreement applies.

4.1 Concept of Residence.

Article 4 of the agreement defines "Residence" as follows: (1) For the purposes of this Agreement, a person is a resident of one of the Contracting States if the person is a resident of that Contracting State for the purposes of its tax. However, a person is not a resident of a Contracting State for the purposes of this Agreement if the person is liable to tax in that State in respect only of income from sources in that State.

In the "tie-breaker" clause where, by reason of the provisions of paragraph (1), an individual is a resident of both Contracting States, then the status of that person shall be determined in accordance with the following rules: (a) the person shall be deemed to be a resident solely of the Contracting State in which a permanent home is available to the person; (b) if a permanent home is available to the person in both Contracting States, or in neither of them, the person shall be deemed to be a resident solely of the Contracting State with which the person's personal and economic relations are closer (center of vital interests). For the purposes of this paragraph, an individual's citizenship of a Contracting State as well as that person's habitual abode shall be factors in determining the degree of the person's personal and economic relations with that Contracting State. (3) Where, by reason of the provisions of paragraph(1), a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the Contracting State in which its place of effective management is situated.

4.2 The Concept of "Permanent Establishment".

Generally, the double taxation agreements consider the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on. It includes especially: (a) a place of management; (b) a branch; © an office; (d) a factory; (e) a workshop; (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; (g) a warehouse in relation to a person providing storage facilities for others; (h) a farm, plantation or other place where agricultural, pastoral, forestry or plantation activities are carried on; (i) premises used as a sales outlet or for receiving or soliciting orders; (j) an installation or structure, or plant or equipment, used for the exploration or exploitation of natural resources; (k) a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than 6 months.

In addition, the Indo-Australian agreement considers an enterprise to have a permanent establishment in one of the Contracting States and to carry on business through that permanent establishment if: (a) substantial equipment is being used in that State by, for or under contract with the enterprise; (b) it carries on activities in that State in connection with the exploration for or exploitation of natural resources in that State; or © it furnishes services.

The Article is emphatically states that an enterprise shall not be deemed to have a permanent establishment merely by reason of: (a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise; (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display; © the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; or (e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4.3 Taxable Business Profits.

Article 7 deals with the Business Profits. (1) The profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to: (a) that permanent establishment, or (b) sales within that other Contracting State of goods or merchandise of the same or a similar kind as those sold, or other business activities of the same or a similar kind as those carried on, through that permanent establishment.

Further, in the determination of the profits of a permanent establishment, there shall be allowed as deductions, in accordance with and subject to the limitations of the law relating to tax in the Contracting State in which the permanent establishment is situated, expenses of the enterprise, being expenses which are incurred for the purposes of the business of the permanent establishment (including executive and general administrative expenses so incurred), whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

Article 9 deals with collaborative arrangements between the companies in the two countries as Associated Enterprises. The collaborations is defined as an enterprise of one of the Contracting States participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the Contracting States and an enterprise of the other Contracting State. Where profits on which an enterprise of one of the Contracting States has been charged to tax in that State are also included, by virtue of paragraph (1) or (2), in the profits of an enterprise of the other Contracting State and charged to tax in that other State, and the profits so included are profits which might have been expected to have accrued to that enterprise of the other State if the conditions operative between the enterprises had been those which might have been expected to have operated between independent enterprises dealing wholly independently with one another, then the first mentioned State shall make an appropriate adjustment to the amount of tax charged on those profits in the first mentioned State. In determining such an adjustment, due regard shall be head to the other provisions of this Agreement and for this purpose the competent authorities of the Contracting States shall if necessary consult each other.

4.4 Overseas Investment Dividends Interest and Royalty Relief.

Although the majority of jurisdictions grant relief for interest incurred in making or acquiring domestic investments, only a minority grant full relief for interest incurred in making or acquiring an overseas investment.

Those jurisdictions which grant relief do so to avoid discriminating against overseas investment. On the other, jurisdictions which deny relief in such circumstances invariable so in order to prevent the erosion of the revenue base. This erosion would occur where the jurisdiction in question either grants exemption in respect of overseas income or allows relief for underlying taxes attributable to the overseas income and underlying taxes would eliminate or substantially reduce any liability which would otherwise arise in the home country. In UK for example, such relief is available for interest incurred in acquiring overseas investments.

Under Article 10 of the agreement, dividends paid by a company resident of one of the Contracting States to a resident of the other State may be taxed in that other State at equal to or less than 15 per cent of the gross amount of the dividends. Similarly Article 11 seeks to bring in the Interest arising in one of the Contracting States, being interest to which a resident of the other Contracting State is beneficially entitled, at the same 15 per cent of the gross amount of the interest. Similarly, under Article 13 royalties arising in one of the Contracting States, are allowed to be taxed in that other State. But the tax shall not exceed: 10 percent of the gross amount of the royalties in general

Under Article 16 allows taxing the Directors' Fees and similar payments derived by a resident of one of the Contracting States as a member of the board of directors of a company which is a resident of the other Contracting State.

4.5 Methods of Elimination of the double taxation.

Tax systems commonly adopt one of the two basic approaches in order to overcome or reduce the problem of double taxation which would other arise where a company is engaged in business across borders. The first and less common approach involves the country of residence of the invest exempting from tax profits which arise outside its jurisdiction; the so-called "exemption" method. The second approach involves the investing company's country of residence giving relief for overseas taxes suffered by offset or "credit" of the foreign tax against the corresponding domestic liability. This may be granted either by way of the provisions of the double tax treaty or unilaterally.

An important aspect of the double taxation agreement is the methods of elimination of the double taxation (Article 24). Here it is agreed that in the case of Australian companies operating in India will be allowed the tax credits under the Indian taxation. Where an Indian company pays a dividend to a Australian company the credit shall include the Indian tax paid by the Indian company in respect of profits out of which the dividend is paid. The Indian tax paid shall take into account the tax liability net of the deductions under sections 10 (4), 10 (15) (iv), 10A, 10B, 80HHC, 80HHD or 80I of the Income-tax Act, 1961.

The other aspects of the double taxation agreement follow the established conventions.