

In Re: Abdul Razak A. Meman, in Re:

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Court : Authority for Advance Rulings

Decided On : May-09-2005

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Judge : S S Quadri, K Singh, A Narang

Appellant : In Re: Abdul Razak A. Meman, in Re:

Judgement :

Appellants: In Re: Abdul Razak A. Meman, In Re: Mrs. Akila A. Meman, In Re: Manish Bhatia Syed Shah Mohammed Quadri, J. (Chairman) and K.D. Singh and A.S.Narang, Members Income Tax Act, 1961 - Sections 2(31), 2(42), 4(1), 90, 90(1), 90(2), 91, 112, 245Q(1), 245R and 245SS; Finance Act, 1997; Municipal Law Union of India and Anr. v. Azadi Bachao Andolan and Anr., (2003) 263 ITR 706 (SC); CST v. Indra Industries, (2001) 248 ITR 338 (SC); In Re: Emirates Fertilizer Training Company WLL, (2005) 272 ITR 82 (AAR); IRC v. Exxon Corporation, 56 Tax Cases 237; CIT v. P.V.A.L. Kulandagan Chettiar (Dead) through LRs (2004) 267 ITR 654 (SC); Her Majesty The Queen v. Crown Forest Industries Ltd. and The Government of the USA, (1995) 2 SCR 802; K.P. Varghese v. ITO (1981) 131 ITR 597 (SC); Commr.

of Revenue v. Exxon Corporation, 56 Tax Cases 237; In Re: Cyril Eugene Pereira, (1999) 239 ITR 650 (AAR); In Re: Mohsinally Alimohammed Rafik, (1995) 213 ITR 317 (AAR) Double taxation relief--AGREEMENT WITH INDIA AND UAE Applicability of treaty to Non-Resident Indian Individuals living in UAE Held: Indo-UAE treaty does not apply to Non-Resident Indian Individuals who are living

in UAE and liable to capital gains tax on transfer of shares, debentures and other securities, however, they are eligible for concessional rate of tax in respect of interest or dividends on bonds and deposits with banks in view of CBDT Circular No. 734, dated 24-1-1996.

1. The applicants in these three applications, under Section 245Q(1) of the IT Act, 1961 (for short "the Indian Act"), are citizens of India.

They are non-resident individuals. Inasmuch as the facts and the questions in these applications are similar, we would refer to the facts and the questions in the first mentioned application, In re, Mr.

Abdul Razak A. Meman, UAE, which will be representative of other cases.

2. The applicant says that he has been working with Abu Dhabi Islamic Bank from August, 1999 (asst. yr, 2000-01). He claims to be a resident of UAE and a non-resident in India. He has been receiving dividends and interest income from investments made in shares, debentures, etc. of Indian companies. He is also receiving interest which accrues to his NRI account and other accounts from the banks in India. He is regularly selling and intends to sell his shares, debentures, etc. in Indian stock market which would yield short/long-term capital gains. He is proposing to invest moneys from out of his NRO/NRE/FCNR account, in shares, debentures and other securities of movable nature in India with the intention to hold them as short-term/long-term investments within the meaning of the Indian Act. He claims that he is entitled to the benefit of the provisions of the India-UAE treaty (Double Taxation Avoidance Agreement). To have a clear position of his tax liability in India he seeks advance rulings of the Authority on the following questions:

(1) Whether the applicant, an individual, residing in the UAE is entitled to claim the benefit of the provisions of the tax treaty entered into between India and UAE.

(2) Whether in terms of Article 13(3) and Article 4 of tax treaty between India and UAE, the applicant, an individual Indian national residing in UAE, is liable to capital gains tax in India on the transfer effected in India of movable assets in the nature

of shares, debentures and other securities

(3) Whether the applicant is liable to capital gains tax on the transfer effected in India of movable assets in the nature of shares, debentures and other securities r/w Section 112 of the IT Act 1961, and the provisions of the tax treaty between India and UAE

(4) Whether in terms of Article 13(3) r/w Article 4 of tax treaty between India and UAE, the applicant is liable to capital gains tax on the transfer effected in India of movable assets in the nature of shares, debentures and other securities: (a) acquired prior to the coming into effect of the tax treaty between India and UAE; (c) after his becoming a non-resident but from out of non-repatriable funds in India.

(5) Whether in terms of Act (article) 10 of the tax treaty between India and UAE, the income received/receivable by the applicant in India by way of dividend is liable to tax in India at 15 per cent.

However, as per Finance Act, 1997, dividend income is totally exempted from tax in the hands of recipient. Therefore, whether dividend income is totally exempted in the hands of the applicant, (Abdul Razak Meman in AAR/637/2004, Mrs. Akila A. Meman in AAR/638/2004 and Mr. Manish Bhatia in AAR/640/2004), for dividend income.

(6) Whether in terms of Article 11 of treaty between India and UAE, income received/receivable by the applicant in India by way of interest on debentures/bonds and deposits with bank and companies is liable to tax in India at 12.5 per cent 3. In the comments of the Director of IT (International Taxation), Mumbai (hereinafter referred to as "the CIT"), the following aspects have been highlighted. As per Section 245N of the Indian Act, the applicant is entitled to advance ruling when a transaction has been undertaken or is proposed to be undertaken but the applicant has not furnished any concrete facts, therefore, the application is liable to be" rejected as being academic in nature. The principal question, it is submitted, is whether the applicant is a resident of UAE within the meaning of the term in Article 4 of the treaty. The facts furnished by the applicant

are inadequate therefore the application is liable to be rejected. Individuals are not subjected to income-tax or capital gains tax in UAE, therefore, the applicant is not entitled to the benefit of the treaty, in view of the ruling of the Authority in the case of Cyril Eugene Pereira, In re (1999) 239 ITR 650 (AAR) (for short Pereira's case). On the above facts, the applicant is not entitled to the benefit of the treaty and consequently Articles 10, 11 and 13 of the treaty do not apply to him.

4. In somewhat similar backdrop, the Authority in Mohsinally Alimohammed Rafik, In re (1995) 213 ITR 317 (AAR) (for short Rafik's case), purporting to interpret Article 4(1) of the treaty liberally, held that the treaty applies to individuals residing in UAE even though they are not liable to pay tax therein under the UAE Decree. This ruling is said to have been followed in more than 60 cases by various Benches of two Hon'ble Members as well as three Hon'ble Members.

However, in Cyril Eugene Pereira (supra) having considered its earlier ruling in Rafik's case (supra), the Authority took a diametrically opposite view holding that an individual residing in UAE (a nonresident in India) is not a taxable unit under the UAE Decree so he will not be entitled to claim benefit of the treaty. The applicant drew support from the Rafik's case (supra) and the CIT placed heavy reliance on Pereira's case (supra).

5. Mr. S.E. Dastur, learned senior counsel appearing for the applicant, has, in support of the ruling in Rafik's case (supra), contended that the treaty allocates jurisdiction between the Contracting States for the purpose of levy of tax and limits rate of tax leviable under the treaty and accordingly the jurisdiction to tax capital gains on transfer of movable properties is allocated to UAE (Article 13); the jurisdiction to tax dividends of companies and interest, is allocated to the State of residence of the recipient of such dividends while maintaining the jurisdiction of the source State to tax at the specified rate (Articles 10 and 11, respectively); the principles governing the interpretation of the treaty, it is argued, are different from those of the interpretation of a statute, and the approach should be to make the provisions of the treaty effective and not to render them non est or of no consequence; the interpretation should result in breathing life into it and not to make it a dead letter. In the interpretation of the treaty, it is contended, the

principle of *contemporanea expositio* will apply and reliance is placed on (1) Circular No. 734 dt. 24th Jan., 1996 of the Central Board of Direct Taxes (CBDT), and (2) the press notes issued by the CBDT when India entered into treaty with UAE as well as the press note issued when a similar treaty was entered into with the Government of Qatar, to persuade us to hold that notwithstanding the fact that an individual is not a taxable unit under the UAE Decree, the treaty will nonetheless apply to the applicant. It is asserted that unless the treaty is so construed as to include an individual physically residing in UAE as a resident within the meaning of Article 4(1) of the treaty, Article 4(2) will become redundant and many provisions of the treaty particularly Articles 14 to 21 will be rendered inoperative and meaningless because they *ex facie* deal only with individuals and if the contention of the Department is sustained an individual cannot claim benefit of any of the provisions of the treaty, not even Article 7; so also Clause (b) of Article 10(2) and Article 28 will be rendered inoperative and similar treaty entered into between Government of India and the Government of Oman, will also be of no consequence insofar as individuals are concerned.

Mr. Pradip Mehrotra, Addl. DIT, Mumbai, has appeared for the CIT and argued that the treaty is for an indefinite period, therefore, the possibility of the Government of UAE enlarging the tax base in future by including individuals was kept in view in drafting the treaty and in that background its provisions have to be interpreted; he would submit that a treaty provision may have an unequal effect; the applicant being an individual is not a taxable unit under the UAE Decree as on date so he is not a resident of UAE within the meaning of the treaty as such he cannot take advantage of Articles 10, 11 and 13 of the treaty.

6. It may be mentioned at the outset that out of the aforementioned questions, the first question in all the applications is common and any ruling of the Authority on it may have a bearing upon rulings on the other questions which relate to income by way of dividends (Article 10), interest (Article 11) and capital gains (Article 13). We, therefore propose to deal with the first question here.

7. Section 90 of the Indian Act empowers the Central Government to enter into an agreement with the Government of any country outside India for purposes

specified in Sub-section (1) thereof, which, inter alia, include avoidance of double taxation of income, prevention of fiscal evasion and granting of relief in respect of income-tax chargeable under the Indian Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment. Sub-section (2) of Section 90 provides that in relation to the assessee to whom such agreement applies, the provisions of the Indian Act shall apply to the extent they are more beneficial to that assessee. In exercise of the power conferred under Section 90 of the Indian Act, the Government of Republic of India entered into agreement with Government of the United Arab Emirates (for short the 'UAE') for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains on 29th April, 1992 which was brought into force on 22nd Sept., 1993 and was notified on 18th Nov., 1993 (referred to in this ruling as "the treaty"). The applicability of the treaty to the applicant is the core issue. There is plethora of authority for the proposition that it is not for Courts (much less for this Authority) to sit in judgment over the wisdom of terms of the treaty [see ABA *infra*].

8. Before we embark upon construing the relevant provisions of the treaty, it will be necessary to note, albeit briefly, the principles governing the interpretation of a tax treaty.

Prof. J.G. Starke in "Introduction to International Law" Tenth Edn. at p. 478. summarized the general principles as follows: (1) Grammatical interpretation, and the intention of the parties.

Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked inconsistency with other portions of the treaty, or would clearly go beyond the intention of the parties, it should not be adopted.

(2) Object and context of treaty. If particular words and phrases in a treaty are doubtful, their construction should be governed by the general object of the treaty, and by the context; Article 31, para 1 of the Vienna Convention lays down that a treaty should be interpreted by reference to its 'object' and 'purposed.' The context need not-necessarily be the whole of the treaty, but the particular portion in which

the doubtful word or phrase occurs. However, for the purposes of interpretation, it can include the preamble and annexes to the treaty, and related agreements or instruments made in connection with the conclusion of the treaty (Vienna Convention, Article 31, para 2).

(3) Reasonableness and consistency. Treaties should, it is held, be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law. xxxxxxxx (4) The principle of effectiveness. This principle, particularly stressed by the Permanent Court of International Justice, requires that the treaty should be given an interpretation which 'on the whole' will render the treaty 'most effective and useful', in other words, enabling the provisions of the treaty to work and to have their appropriate effects.

(5) Recourse to extrinsic material. Normally, the interpreting Tribunal is limited to the extent of the treaty. However, the following may be resorted to, provided that clear words are not thereby contradicted: The following propositions from "Basic Principles of International Taxation" At pp. 21 and 23 (Principles of International Tax Law).

authored by Prof. Roy Rohatagi are also worth noticing: (i) tax treaties tend to be less precise and require a broad purposive interpretation; (ii) the purpose is not the same as the subjective intention of Contracting States. It refers to the goals of the treaty as reflected objectively by the treaty as a whole.

In regard to unequal effect of a provision of a treaty, Michael Edwardes-Ker Tax Treaty Interpretation--The International Tax Treaties Service at p. 7. has this to say: When State A imposes a tax which the other State B does not impose (the situation contemplated above by W.S. Fisher Q.C. in Mathewson) a tax treaty may seek to limit the application of this tax--and thus increase the chances of equality of effect. Nevertheless, even though this tax only exists in State A, the tax treaty will typically still be expressed in reciprocal terms--so that if and when the other treaty signatory State B does introduce such a tax, this treaty will also limit its application in State B. Similarly, States may include a provision in a tax treaty to

negate the application of a feature of State A's tax law which is only present in State A. If, as is usual, this provision is expressed in reciprocal terms, it will only become reciprocal in effect when State B subsequently enacts a comparable feature.

The fact that a reciprocally expressed tax treaty provision may only have effect in one State does not rob this provision of any of its force." The principles in regard to the interpretation of the treaties between the sovereign States, referred to above, are too well-settled to admit elaboration of the subject here. Nevertheless we would do well in reproducing the relevant passage from the decision of the Hon'ble Supreme Court in *Union of India & Anr. v. Azadi Bachao Andolan and Anr.* (2003) 263 ITR 706 (SC) at p. 751 (referred to in this ruling as ABA), which refers to several authorities on interpretation of treaties and is useful for the present discussion.

The principles adopted in interpretation of treaties are not the same as those in interpretation of statutory legislation. While commenting on the interpretation of a treaty imported into a municipal law, Francis Bennion observes: With indirect enactment, instead of the substantive legislation taking the well-known form of an Act of Parliament, it has the form of a treaty. In other words the form and language found suitable for embodying an international agreement become, at the stroke of a pen, also the form and language of a municipal legislative instrument. It is rather like saying that by Act of Parliament, a woman shall be a man. Inconveniences may ensue. One inconvenience is that the interpreter is likely to be required to cope with disorganized composition instead of precision drafting. The drafting of treaties is notoriously sloppy usually for very good reason. To get agreement, politic uncertainty is called for.

..... The interpretation of a treaty imported into municipal law by indirect enactment was described by Lord Wilberforce as being 'unconstrained by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptance'. This echoes the optimistic dictum of Lord Widgery, C.J. that the words 'are to be given their general meaning, general to lawyer and layman alike..... the meaning of the diplomat rather than the lawyer'.

[see Francis Bennion, *Statutory Interpretation*, p. 461 (Butterworths, 1992, Second Edn.)].

An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including one for double taxation relief, is that treaties are negotiated and entered into at a political level and have several considerations as their bases. Commenting on this aspect of the matter, David R. Daw's in *Principles of International Double Taxation Relief* [see David R. Daw's, *Principles of International Double Taxation Relief*, p. 4 (London, Sweet and Maxwell, 1985)], points out that the main function of a double taxation avoidance treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions. It is observed (vide para 1.06): The benefits and detriments of a double tax treaty will probably only be truly reciprocal where the flow of trade and investment between treaty partners is generally in balance. Where this is not the case, the benefits of the treaty may be weighted more in favour of one treaty partner than the other, even though the provisions of the treaty are expressed in reciprocal terms. This has been identified as occurring in relation to tax treaties between developed and developing countries, where the flow of trade and investment is largely one way.

Because treaty negotiations are largely a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient *quid pro quo* is obtained by both sides.' 'Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally.'" "The experts appointed in the early twenties by the League of Nations... described this method as a classification of items of income and their assignment to the Contracting States. In English, the treaty rules which perform this particular function might thus be called 'classification and assignment rules'. This expression may not be clear enough, though, to show that both Contracting States are simultaneously 'assignees' of the 'assignment'. Further, the term cannot be translated adequately into other

languages.

Therefore, for discussion on an international level, at least, the term 'distributive rule' (Verteilungsnorm) may be suggested. The present commentary being destined for international use, the term 'distributive rule' was adopted by its authors." para 45d-p. 27.

"DTCs establish an independent mechanism to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected, or are at least theoretically possible. In other words, the Contracting States mutually bind themselves not to levy taxes, or to tax only to a limited extent, in cases when the treaty reserves taxation for the other Contracting State either entirely or in part. Contracting States are said to 'waive' tax claims : see BFH BStB1. II 785, 789 (1972), or, more illustratively, to divided 'tax sources', the 'taxable objects' (Steuerobjekt) among themselves".para 45c-p. 26.

The Hon'ble Supreme Court has clearly laid down in ABA (supra) at p.

715 that the treaty provides for allocation of taxing jurisdiction to different-contracting parties, in respect of different heads of income.

10. There is no confabulation as to the principles of interpretation of treaties. The complexity, it may be pointed out, is encountered, not infrequently, in the application of the principles to facts of each case and this case is no exception.

Be that as it may, in the light of the abovementioned principles, we shall endeavour to construe the relevant provisions of the treaty.

"Whereas the annexed agreement between the Government of the United Arab Emirates and the Government of the Republic of India for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and on capital has entered into force on the 22nd Sept., 1993, after the notification by both the Contracting States to each other of the completion of the proceedings required by laws for bringing into force of the said agreement in accordance with para 1 of Article 30 of the said agreement: The Government of the Republic of India and the Government of the United Arab Emirates Desiring to promote mutual

economic relations by concluding an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital." These recitals indicate that the purpose of entering into treaty is to promote mutual economic relations by concluding an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.

This agreement shall apply to 'persons' who are 'residents' of one or both of the 'Contracting States'.

A perusal of this article which deals with 'treaty subject', shows that the treaty applies to 'persons' [as defined in Article 3(e)] who are residents (as defined in Article 4) of one or both of the Contracting States [defined in Article 3(c)]. A reference to Article 2, Clauses (c), (e) and (g) of Article 3 and para 2 of Article 3 and Article 4 are apposite and are quoted here: 1. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital including taxes on gains from alienation of movable or immovable property as well as on capital appreciation.

(c) the terms "a Contracting State" and "the other Contracting State" mean UAE or India as the context requires; (e) the term "person" includes an individual, a company, and any other entity which is treated as 'taxable unit' under the taxation laws in force in the respective Contracting States; (g) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively, an enterprise carried on by a resident of a Contracting State and an enterprise, carried on by a resident of the other Contracting State; 2. As regards the application of the agreement by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of that State concerning the taxes to which the Agreement applies.

Two important expressions "a Contracting State" and "the other Contracting State" are defined in Clause (c) of Article 3 as meaning UAE or India as the context may require. In Clause (e) of Article 3, the term 'person' is defined to include an individual, a company, and any other entity, which is treated as taxable unit under the taxation laws in force in the respective Contracting State. This is an inclusive

definition; it takes in its fold natural as well as artificial person--(1) individual, (2) a company, and (3) any other entity which is treated as "taxable unit" under the taxation law in force in India, and in UAE. Here we are concerned with an 'individual'. Under the Taxation Law in India (the Indian Act), an 'individual' is a taxable unitSection 4(1) r/w Section 2(31) of the Act. The taxation in force in UAE is the UAE Tax Decree of 1969 (for short the "UAE Decree"), which came into force on 1st Jan., 1969.

Clause (4) of Article 2 of the UAE Decree defines the term "person" to mean a body corporate wherever established and the expression "person liable", as defined in Clause (3) thereof, means a body corporate wherever established which would not be exempt from the responsibility of paying income-tax imposed on it. Ergo it is clear that an 'individual' is excluded from the definition of 'person' under UAE Decree.

11. It is a common ground that under the UAE Decree, an individual is not a taxable unit. However, Mr. Dastur has contended that it is not a condition for treaty entitlement that a person (within the meaning of Article 3) should be a taxable entity under the law of the State concerned; he relied on the following passage from Vogel's Double Taxation Conventions.

"The question whether a person [within the meaning of Article 3(1)(a)] may be a taxable entity under the law of the State concerned, is not a condition for treaty entitlement."[(Para 24a, p.

229--Klaus Vogel on Double Taxation Conventions (Third Edn.)].

In our view, reliance on the above quotation is misconceived. From a perusal of the context in which the quote occurs, it is evident that Vogel was referring to a person defined in Article 3(1)(a) of OECD which reads as under: "The term 'person' includes an individual, a company and any other body of persons." It may immediately be noticed that the definition of the term 'person' in the treaty is differently worded. The words "which is treated as taxable unit under the taxation laws in force in the Contracting States" are not part of the definition of 'person' in OECD. It would be a distortion of Article 1 r/w Clause (e) of Article 3 of the treaty

to assert that irrespective of whether any individual is a taxable unit or not, he would be a treaty subject and would be entitled to the protection of the treaty. An individual can be a treaty subject only if he satisfies the requirement of being a resident of one or both of the Contracting States and an individual who is not a resident of any of the Contracting States cannot be treated as a treaty subject much less can he claim the protection under or benefit of the treaty.

12. The expressions "enterprise of the Contracting State" and "enterprise of the other Contracting State", as defined in Clause (g) of Article 3 mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State.

13. The pivotal term in the present discussion is 'resident'; however except for the limited purpose of Articles 20 and 21 [see Article 20(5)] it is not defined in the treaty. Though the title of Article 4 is resident, what is defined in Article 4 is the expression 'resident of a Contracting State', which is in the following terms: 1. For the purposes of this agreement the term 'resident of a Contracting State' means 'any person' who, under the laws of that State, 'is liable to tax therein' by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature.

2. Where by reason of the provisions of para 1 an individual is a resident of both Contracting States, then his status shall be determined as follows: (a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests); (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either, he shall be deemed to be a resident of the State in which he has an habitual abode: (c) if he has an habitual abode in both States or in either of them, he shall be deemed to be a resident of the State of which he is a national; (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of para 1, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which its place of effective management is situated.

Article 4 of the treaty is the germane provision whose true interpretation would set at rest the controversy in these applications.

Para 1 of Article 4 says that for the purpose of this treaty, the expression 'resident of a Contracting State' means any person who under the law of that State is liable to tax therein by reason of domicile, residence, 'place of management', 'place of incorporation' or 'any other criterion of similar nature'. A plain reading of the second part of the para 1 suggests that the tax liability of a person in a Contracting State may arise by reason of either his domicile or residence or place of management or place of incorporation or any other criterion of similar nature in that State. The words 'any other criterion of similar nature' have to be construed ejusdem generis. Insofar as an individual is concerned, the nexus for the tax liability in the concerned State may appropriately be either domicile or residence. The other criterion viz., place of management, place of incorporation, or any other criterion of similar nature are more relevant for a person other than an individual. It may be useful to point out that Article 4(1) of the treaty is verbatim the same as Article 4(1) of OECD. Prof.

Vogel 3rd Edn. pp. 228-229 of Double Taxation Conventions. in his commentary of Article 4 OECD states: "(a) The first sentence of Article 4(1) establishes a person's residence for the purposes of the Convention by referring to such criteria of domestic law as attract taxation according to the rules applicable to persons specifically connected with the State in question, viz.

In case the Contracting States themselves or their political sub-divisions are subject to a tax on income or capital, the 1995 addition to the first sentence clarifies that they are also 'resident' in the Contracting State as meant by the treaty." Philip Baker poses the question about the relevance of the second part of para 1 of Article 4 and answers it lucidly as follows: "What is the relevance of the phrase 'by reason of his domicile, residence, place of management or any other criterion of a similar nature' It seems that the Model intends to refer to criteria

which are generally recognized in public international law (or international tax law) as justifying a State imposing comprehensive taxation--that is, taxation on worldwide income--on a person. The domicile or residence of a person in a State or the location of the place of management in a State are all well-recognised criteria for the imposition of worldwide taxation." Para 4B.06 (Article 4).

It will not be out of place to refer to the decision of the Supreme Court of Canada in *Her Majesty The Queen v. Crown Forest Industries Ltd. & the Government of the United States of America* [(1995) 2 SCR Crown Forest Industries Ltd. v. Canada 802 (Report of the Canada Supreme Court)]. There the respondent--Crown Forest Industries Limited--rented barges from Norsk, a Bahamian company. Norsk had its office and place of business in United States of America. It claimed relief for purpose of deduction of tax which was applicable if Norsk was resident of USA within the meaning of Canada and the United States Income Tax Convention, 1980 (for short the 'Convention').

Article XII of the Convention provided for withholding of 10 per cent tax for purposes of the residents. If the claim of Norsk of being a resident of USA was upheld, the rate of tax applicable would be 10 per cent otherwise the rates tax applicable to non-residents was 25 per cent. Article IV of the Convention which is identical with Article 4 of the treaty, provides that a "resident of Contracting State" is any person or entity who, under the laws of that State is liable to tax therein by reason of domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. The claim of Norsk under Article XII of the Convention was disallowed by the Minister who ordered fresh assessment applying the rate 25 per cent for the withholding tax.

The order of the Minister was challenged before the Federal Court (Trial Division). It was held that Norsk was the resident of the United States--a Contracting State. That decision was upheld by the Federal Court of Appeal. Further appeal by the Her Majesty the Queen to the Supreme Court of Canada was allowed. The Court observed as follows: "The basis of Norsk's liability for taxation in the United States emanates from the fact that it conducts a trade or business which is effectively connected with the United States and has income arising from that business which

is also effectively connected with the United States. Although the fact that its 'place of management' is located in the United States is one factor contributing to the finding that its trade or business is connected with the United States, it does not constitute the basis for Norsk's tax liability in the first place. A factual proposition which merely informs domestic tax liability cannot constitute a residency criterion under the Canada-United States Income Tax Convention (1980). The only way for Norsk to benefit from residency status under the Convention is if source taxation on a business effectively connected with the contracting party constitutes a criterion similar to the other enumerated criteria in Article IV (residence, place of management, place of incorporation, domicile). It is not similar, since all of the other criteria constitute grounds for taxation on worldwide income, not just source income. The parties to the Convention intended only that persons who were resident in one of the Contracting States and liable to tax in one of the Contracting States on their 'worldwide income' be considered 'residents' for purposes of the Convention. Norsk is therefore not a 'resident' of the United States for the purposes of Article IV of the Convention." This decision also makes it clear that for the purpose of availing the benefit of the treaty a person must be a resident of a Contracting State under the treaty and that the taxable entity should be effectively connected to the enumerated criteria under Article IV, namely, domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. Mr.

Dastur would contend that the phrase "by reason of domicile, residence, place of management, place of incorporation or any other criteria of a similar nature" is of great significance and indicates that if and when the tax liability would arise in future he should be taxable on the basis of any of the criteria.

In other words, his contention is that it is immaterial if there is no law in UAE which taxes the income of an individual as on date but if the liability is imposed in future based on the connection of his domicile, residence, place of management or any other criteria of a similar nature, the requirement of para 4(1), will be satisfied. We are afraid, we cannot accede to the contention of the learned counsel. In our view para 4(1) postulates existence of tax liability in praesenti by reason of domicile, residence, place of management, place of incorporation or any other criteria of a

similar nature on the date of making the claim under the law of the State, of which a person is claiming to be the resident. Where, however, the tax liability of a person in the concerned State is to arise in future, the person would become resident as and when the tax net of the State is so spread as to cover such person.

In support of his contention that treaty protection cannot be denied even when a person is not a taxable subject for the purposes of domestic law, Mr. Dastur relied on the following observation of Prof. Vogel: "It is not the purpose of Article 4, however, to deny treaty protection 'through the back door', if a 'person', within the meaning of the treaty happens not to be a 'person', i.e., a taxable subject for the purposes of domestic tax law."P. 95, para 25a.

We do not think that it is a correct reading of the said observation. The first thing to note is that Prof. Vogel was referring to a 'person' within the meaning of the treaty and secondly it would not be apt to make use of an observation out of context. The very next sentence "Anyone not liable to tax in his State of residence because he has no income or capital or because he is exempt from tax--e.g., on account of his activities for public benefit--may nevertheless be 'resident' there (and thus entitled to treaty protection)" explains the point that by the words "not to be a person", i.e., a taxable subject. Prof. Vogel meant a person not liable to tax in his State of residence because he has no income or capital or because he is exempt from tax. The said observation does not refer to a person who is not liable to tax because the person is not a taxable unit under the domestic tax law of the State.

14. It is worthwhile to clarify that the expression 'liable to tax in a State' simply means that the net of the law of taxation of that State covers that person and not that he must pay the tax in that State. The following observation of the Hon'ble Supreme Court of India in ABA (supra) elucidates the point: "In our view, the contention of the respondents proceeds on the fallacious premise that liability to taxation is the same as payment of tax. Liability to taxation is a legal situation; payment of tax is a fiscal fact. For the purpose of application of Article 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax. If this were not so, the DTAC would not

have used the words, 'liable to taxation', but would have used some appropriate words like 'pays tax'." The Hon'ble Supreme Court has also referred to the commentary of Philip Baker to bring out the import of the phrase "liable to tax" employed in Article 4(1) which reads as under: "It seems clear that a person does not have to be actually paying tax to be 'liable to tax'--otherwise a person who had deductible losses or allowances, which reduced his tax bill to zero would find himself unable to enjoy the benefits of the Convention. It also seems clear that a person who would otherwise be subject to comprehensive taxing but who enjoys a specific exemption from tax is nevertheless liable to. tax, if the exemption were repealed, or the person no longer qualified for the exemption, the person would be liable to comprehensive taxation." (emphasis, italicized in print, supplied) It is thus clear that 'liable to tax' connotes that a person is subject to one of the taxes mentioned in Article 2 in a Contracting State and it is immaterial whether the person actually pays the tax or not.

15. Having regard to the principle outlined in Article 32 of the Vienna Convention on the Law of Treaties Article 32 Supplementary means of interpretation--Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: and in view of the fact that the applicability of the treaty to individuals has been the centre of controversy for over a decade, we called for and perused the records relating to the discussions between the parties to the treaty held in February, 1992, which led to the signing of the treaty. They are adumbrated in the notes of the discussions. They indicate that on behalf of the Federal Government of UAE it was pointed out that Article 124 of the UAE Constitution conferred a right on the Federal Government to tax income and it also empowered the local Governments to tax income. The notes further disclose that the UAE Government was in the process of codifying tax laws for both individuals and corporations on the recommendation of the International Monetary Fund and it was estimated that the process would take 2 to 3 months. For reasons best known to the Government of UAE, the intended codified tax law covering individuals and corporations is not enacted till date. It is evident that the parties proceeded on the assumption that a new codified

law bringing individual within the income-tax net of UAE was in the pipeline and the same would be enacted within about three months. This explains as to why the definition of the expression 'resident of a Contracting State' was adopted as in Article 4(1) of the OECD Model without any modification unlike in the case of French Republic-UAE Convention between the Government of the French Republic and the Government of the United Arab Emirates for the avoidance of double taxation signed on 19th July, 1989.; Canada-UAE treaty; Convention between the Government of Canada and the Government of the United Arab Emirates for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital signed on 9th June, 2002. Federal Republic of Germany-UAE Agreement between the Federal Republic of Germany and the United Arab Emirates for the Avoidance of Double Taxation with respect to Taxes on Income and Capital and for the fostering of economic relations signed on 9th April, 1995. which specifically cover individuals. They are as under: 1. For the purposes of this Convention, the term "resident of a State" means: (b) in the case of the United Arab Emirates, any person domiciled, established or having its place of management in the United Arab Emirates, including the State of the United Arab Emirates, its political sub-divisions and local authorities.

1. For the purposes of this Convention, the term "resident of a Contracting State" means: (i) an individual who is a national of the United Arab Emirates, provided that the individual has a substantial presence, permanent home or habitual abode in the United Arab Emirates and that individuals personal and economic relations are closer to the United Arab Emirates than to any other State; 1. For the purposes of this agreement, the term "resident of a Contracting State" means: (b) in the case of the United Arab Emirates, an individual who has his domicile in the United Arab Emirates and is a national of the United Arab Emirates and a company which is incorporated in the United Arab Emirates and has its place of effective management there.

We have also perused the written copies of the speeches delivered by Shri Manmohan Singh, Hon'ble Minister of Finance (as he then was) and His Highness Sheik Hamdan Bin Rashid Al-Maktoum, Minister of Finance and Industry in the

presence of His Highness Sheik Zayed Bin Sultan Al-Nahyan, the President of the UAE. It is clear from the speech of the Hon'ble Finance Minister of India that the business community and financial community of the UAE were invited to take full advantage of the new liberal climate for foreign investment in India and it was hoped that frequent and more intensive contacts between the business and financial communities of the two countries would make an important contribution to the flow of trade and investment. It is useful to reproduce the following excerpts of the speech of the Hon'ble Minister of Finance and Industry, UAE: "The signing of the Agreement on Avoidance of Double Taxation on Income and on Capital between the Government of the United Arab Emirates and the Government of the Republic of India today represents a significant milestone in the bilateral relationship between our two countries, a step which UAE businessmen truly welcome as yet another sign of the constantly improving the investment and business climate in the Republic of India which we consider as an excellent place to invest in. However, the signing of the agreement shall open new opportunities for co-operation in the investment fields with its different instrumentalities. Since it grants a package of bilateral taxation benefits and reliefs for the private and public sectors in both countries." 16. There can be little doubt that while interpreting treaties, regard should be had to material contemporanea expositio. This proposition is embodied in Article 32 of Vienna Convention, referred to above, and is also referred to in the decision of the Hon'ble Supreme Court in K.P: Varghese v. ITO (1981) 131 ITR 597 (SC).

For this purpose reliance is placed on Press Notes (F. No.501/3/89-FTD) issued by CBDT on 29th April, 1992 [(1992) 196 ITR (St) 26) and Press Note, PIB Press Releases, New Delhi, dt. 7th April, 1999 [(1999) 237 ITR (St) 32]. The first mentioned press note relates to Indo-UAE treaty while the second relates to Indo-Qatar treaty. We shall reproduce the first mentioned press note which was issued contemporaneously with the signing of the treaty.

Agreement between the Government of the Republic of India and the Government of the United Arab Emirates 1. An Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital between India and the United Arab Emirates was signed today the

29th April, 1992 by Shri Manmohan Singh, Finance Minister, on behalf of the Government of India and H.E. Hamdan Bin Rashid Al-Maktoum, Minister of Finance and Industry on behalf of the Government of United Arab Emirates. This agreement supplements an earlier agreement between the two States for the avoidance of double taxation of income from international air transport signed on 3rd March, 1989. [See (1990) 181 ITR (St) 13] 2. The agreement generally provides for taxation of enterprises of one of the States in the other States only if it maintains a permanent establishment or fixed base. The permanent establishment principle frees from taxation in the source country casual business transactions which do not involve the presence of the enterprise for a considerable period of time.

3. The agreement provides for total exemption of shipping profits in the country of source and seeks to reduce the rate of taxation of investment incomes in order to encourage flow of capital, technology and technical service from one country to the other to their mutual advantage and benefit. It also provides for concessional treatment to students, teachers, artists and athletes. This agreement will stimulate to a large extent the promotion of mutual economic relations." A perusal of the press note indicates that para 3 thereof is relevant for the present discussion. It says, inter alia, that in order to encourage flow of capital, technology and technical service from one country to the other to their mutual advantage and benefit, the agreement seeks to reduce the rate of taxation of investment incomes and also provides for concessional treatment to students, teachers, artists and athletes. The fact that the press note was issued contemporaneously with the signing of the treaty suggests that both (the treaty as well as the press note) proceeded on the assumption that the intended codification of tax law by the UAE covering taxation of income of individuals and corporations was in the offing and that would result in individuals becoming taxable units and consequently residents of a Contracting State within the meaning of the treaty. Be as it may, a careful reading of the press note, does not in any way support the contention that individuals actually residing in UAE are covered by the treaty. The same analysis would equally apply to the press note issued contemporaneously with the signing of the treaty between India and Qatar.

We shall advert to Circular No. 734, dt. 24th Jan., 1996 which reads as under:
"Subject : Applicable rates of taxes under the DTAA between India and the United Arab Emirates.

1. It has been represented by some non-resident Indians in the United Arab Emirates (UAE) that the banks and the UTI, have been deducting tax at source on interest and dividend incomes at rates higher than those provided in the DTAA between India and the UAE. This has forced the non-resident Indians to seek remedy by way of refunds. It also appears that in each of such cases where refund was due and where a decision on the applicability of the DTAA was involved, they had been advised to file a petition before the Authority for Advance Rulings.

2. The Board in its Circular No. 728 (F. No. 500/12/95-FTD), dt.

30th Oct., 1995, have already clarified that in case of a remittance to a country with which a DTAA is in force, tax should be deducted at the rates provided in the Finance Act of the relevant year or at the rates provided in the DTAA, whichever is more beneficial to the assessee.

3. Once again it is clarified that in respect of payments to be made to the nonresident Indians at the UAE, tax at source must be deducted at the following rates: (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 per cent of the shares of the company paying the dividends.

(b) 15 per cent of the gross amount of the dividends in all other cases.

(a) 5 per cent of the gross amount of the interest if such interest is paid on a loan granted by a bank carrying on a bona fide banking business or by a similar financial institution.

(b) 12-1/2 per cent of the gross amount of the interest in all other cases.

4. It is essential that the above rates which are enshrined in the DTAA between India and the UAE are strictly adhered to so as to avoid unnecessary harassment of the taxpayers." Para 1 of the circular bespeaks that it was issued to clarify the

rate of tax applicable for deduction at source under Section 195 of the Indian Act as complaints from and representations of NRIs in UAE were received stating that banks and UTI were deducting tax at source at the rates higher than that provided in the treaty and that in cases requiring refund of tax, they were advised to approach the Authority for Advance Rulings for a decision on the applicability of the treaty to them. In para 2 reference is made to Circular No. 728, dt. 30th Oct., 1995, which clarified the position that in case of remittance to a country with which a DTAA is in force, tax should be deducted at the rates provided in the Finance Act of the relevant year or at the rates provided in the DTAA, whichever is more beneficial to the assessee. Para 3 again clarifies that in respect of payments to be made to the non-resident Indians at the UAE the tax must be deducted at source at the following rates: (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 per cent of the shares of the company paying the dividends.

(b) 15 per cent of the gross amount of the dividends in all other cases.

(a) 5 per cent of the gross amount of the interest if such interest is paid on a loan granted by a bank carrying on a bona fide banking business or by a similar financial institution.

(b) 12-1/2 per cent of the gross amount of the interest in all other cases.

These rates correspond to the rates mentioned in Articles 10(2), 11(2) and 12(2), respectively of the treaty. Para 4 enjoins strict adherence of the rates enshrined in the DTAA between India and UAE to avoid unnecessary harassment of the taxpayers. We have given our anxious consideration to the contents of the circular. It is not possible to accept the contention that the circular is the clearest possible acceptance of the position that the treaty applies to nonresident Indian individuals physically staying in UAE. Had the Board accepted that position it would have simply said that the treaty applies to individuals residing in UAE which would have resulted in applying all the provisions of the treaty including capital gains (Article 13) to NRIs residing in UAE. Instead the Board extended the benefit of the reduced rate of taxation mentioned in Articles 10(2), 11(2) and 12(2) of the treaty which is, to some extent, in accord with the press note and the object of entering

into treaty and inviting investments from NRIs abroad. Nothing was stated in the circular about 'capital gains' dealt with in Article 13 of the treaty. This is because the Board was conscious of the fact that individuals residing in UAE were not taxable unit under the UAE Decree and were persons to whom the treaty did not apply because the anticipated UAE codified law covering individuals had not seen the light of the day. We would, however, emphasize that as the circular confers the benefit of reduced rate of tax under Articles 10(2), 11(2) and 12(2) of the treaty on the NRIs residing in UAE, the CIT cannot wriggle out of this position for the simple reason that it is well-settled that IT authorities are bound to give effect to the contents of the circular [see *CST v. India Industries* (2001) 248 ITR 338 (SC) and *ABA* (supra)].

17. Another submission of Mr. Dastur is that the applicants must be treated as residents of UAE based on the residence certificates issued by the UAE authorities in favour of the applicants. The applicant produced a certificate of residence issued by the UAE authorities. The certificate reads as follow: "The Ministry of Finance and Industry hereby certifies that, pursuant to the Convention between the Government of the United Arab Emirates and the Republic of India for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect Taxes on Income and Capital. Mr. Meman Abdul Razak Abderaheman Passport No. : U784939, is qualified in terms of the above said Convention as a resident of the UAE. This certificate is valid from the date hereof and continuing for a period of one year.

Issued in Abu Dhabi, this Sunday 6th Feb., 2005, without any responsibility whatsoever of Ministry of Finance and Industry.

It is true that Hon'ble Supreme Court in *ABA* (supra) upheld the stand of the Revenue in giving effect to certificates issued by the Mauritius authorities in view of Circular No. 789 (F. 500/60/2000-FTD) dt. 13th April, 2000 issued by the CBDT. It must be pointed out here that for giving effect to Indo-Mauritius treaty, the CBDT had issued Circular No. 789, dt. 13th April, 2000. In para 2 thereof it is specifically provided that whenever a certificate of residence is issued by the Mauritius authorities such certificate will constitute sufficient evidence for accepting the

status of residence in Mauritius as well as beneficial ownership for applying the treaty accordingly. No such circular is issued by the Board in regard to Indo-UAE treaty. Further, the said circular is not in general terms and it cannot be treated as governing the Indo-UAE treaty. Therefore, the certificates filed in these applications cannot be treated on par with the certificates issued by Mauritius authorities by virtue of the said circular of 13th April, 2000.

There is no provision in the treaty or tax laws of the Contracting States providing for issuance of a certificate of residence. For these reasons, the said certificates of residence issued by the UAE authorities have no legal effect and cannot be taken as proof of residence of the applicants in UAE for the purpose of the treaty.

It sounded astounding to Mr. Dastur that the applicant would not be a resident either in India or in UAE. There is nothing surprising about it. Philip Baker in the Commentary of OECD at para 4B.01 remarks : "it is thus possible for a person to be a resident in both Contracting States under the two domestic laws involved (or resident in neither State)." He cited the decision of the Lower Court of Amsterdam, dt. 25th Nov., 1971 (Case No. 312 of 1971) holding that the taxpayer was not resident in the Netherlands despite a stay of two and a half years. We are in accord with the view expressed by the learned author.

18. It is now necessary to refer to the rulings of the Authority in the aforementioned two cases. In Rafik's case (supra), the applicant was residing in Dubai alongwith his wife and children. He was working there as manager of a firm of chartered accountants. He had a place to abode in India and paid visits to India occasionally. The income arising to the applicant in India included dividends of shares held by him in Indian companies, interest from the deposits in banks and capital gains arising out of disposal of shares and securities in Indian companies.

Similar questions as in the present application were addressed to the Authority to seek its ruling. The then Hon'ble Chairman of the Authority (sitting single) held that to claim the benefit of Articles 10, 11, and 13 of the treaty, the applicant had to be a "resident of a Contracting State"--Dubai, within the meaning of Article 4 of the treaty. It was concluded that under Article 4(1) the applicant could claim to be resident of UAE only if he was actually subjected to income-tax in the UAE under

the UAE Decree and as there was no tax on income of individuals thereunder the applicant could not be treated as a resident of UAE. But then on the ground that the applicant would be deprived of the benefit of the treaty, it was opined that Article 4 should not be narrowly construed and purporting to interpret the treaty more liberally and reading it as a whole it was held that even if the applicant was not a resident under para (1) of Article 4, he would be resident of Dubai under para 2 of Article 4, and, therefore, he would be entitled to take benefit of Articles 10, 11 and 13. Further as the applicant was liable to tax in India on his Indian income, he was a resident in India and could claim the benefit under Article 1 of the treaty being resident of one of the Contracting States. In our view, once it is accepted that there is no provision in UAE Decree to tax the income of individuals, as a necessary corollary it follows that individuals could not be residents in UAE within the meaning of para (1) of Article 4. There could therefore be no occasion to invoke para 2 of Article 4 which is meant to be applied as a tie breaker only when an individual is found to be a resident in both the Contracting States under para (1) of Article 4 of the treaty. Under the scheme of the Indian Act, both residents as well as non-residents are liable to tax, so mere payment of tax by an individual-assessee would not make him a resident in India within the meaning of Section 6 of the Indian Act.

There can be little doubt that a tax treaty should be given liberal interpretation to make it workable but that would only mean ironing out the creases, as it is called, which would be within the realm of interpretation but then doing violence to the language of the treaty as to re-write its provisions, would fall within the domain of distortion and no principle of interpretation of treaties would justify such a course. The applicant who is not a tax entity under the UAE Decree cannot under the guise of liberal interpretation of Article 4(1), be enabled to avail the benefit of Articles 10, 11 and 13 of the treaty.

For these reasons, with great respect to the then learned Chairman, we regret, we are unable to agree with either the reasoning or the ruling in Rafik's case (supra).

19. On similar facts in Pereira's case (supra), a three Members Bench of the Authority overruled the ruling in Rafik's case (supra). It concurred with the view in

the Rafik's case (supra) that Article 4(1) of the treaty defining the expression 'resident of a Contracting State' would mean a person who is liable to tax in the State by reason of his domicile, residence, place of management or place of incorporation and as individuals as such were not liable to pay tax under UAE Decree, they could not be treated as residents of UAE thereunder. It was, however, held that if an applicant was liable to pay tax only in one country he could not access to the treaty which was meant for relieving tax payers from the burden of double taxation and not for absolving a taxpayer from the obligation to pay tax imposed by only one country. It was emphasized that neither Section 90 nor 91 of the Indian Act would postulate granting relief where there was no tax law in force in a foreign country for levying tax on the same income, which is taxable under the Indian IT Act. If a taxpayer pays tax or is liable to pay tax under the laws in one country alone, he cannot claim benefit from a non-existent burden of double taxation under the DTAA. DTAA is meant only for the benefit of the taxpayers who are liable to pay tax twice on the same income. Individuals falling under Clauses (a), (b), (c) and (d) of para 2 of Article 4 must be person who are liable to pay tax in both the Contracting States. There is no other criteria laid down for determination of residence other than liability to pay tax under Article 4. Any entity which does not pay tax in the UAE will not be a person under the treaty and that position is made doubly clear by Article 4 which says that the 'resident of a Contracting State' means any person who under the laws of that State is liable to pay tax therein. Such a liability may arise by reason of domicile, residence, place of management, place of incorporation or any other similar criteria. If an individual does not have to pay any tax on the income in the UAE because there is no local tax leviable on the income of the individuals, no question of granting relief under the treaty in respect of such income can arise in the course of assessment of his income in India. Any person who does not pay tax under the laws of a Contracting State cannot be treated as a resident of that State and to hold otherwise will make the definition of 'resident' meaningless and that would also defeat the whole purpose of the agreement and make the agreement ultra vires Section 90 of the Indian Act. The agreement is made applicable to any non-existing tax in the UAE and that the agreement will apply to any taxes on income or capital in addition to the taxes mentioned in para 2 of Article 2 as and when such taxes are imposed.

Accordingly, it was concluded that as the applicant was not liable to pay tax in the UAE, he could not be treated as a 'resident' of UAE and he could not invoke the provisions of the DTAA seeking application of lower rate of tax in respect of his income by way of dividends from Indian companies, interest on investments in India and capital gains on transfer of moveable assets in India, which should be taxable in accordance with the provisions of the IT Act. However the aforementioned Circular No. 734, dt. 24th Jan., 1996 was not referred to in that ruling. In regard to the ruling in Rafik's case (supra), it was observed that there were compelling reason for not following the view taken therein. It may be noticed that there is concurrence of opinion in Rafik's case (supra) and Pereira's case (supra) on the construction of Article 4(1) of the treaty to the extent that as individuals are not taxable entity under UAE Decree therefore individuals actually residing in UAE, will not be resident of UAE with which we are in respectful agreement. Nonetheless in great deference to the learned Members of the Authority in Pereira's case (supra), we have some reservation in regard to observations dealing with applicability of lower rate of tax embodied in the treaty to the individuals-residents of UAE and that the agreement would be ultra vires Section 90 of the Indian Act and such other conclusions which run counter to the observations of the Hon'ble Supreme Court in ABA's case (supra). We have concluded above, that payment of tax by persons in both the States is not the criteria to claiming benefit of the treaty.

Whereas a result of the parties allocating jurisdiction to tax income arising from a source falls within the competence of one State, it is inconsequential for the other State whether persons residing therein are in fact paying the tax in that State having jurisdiction to tax income under that head: The criteria fixed under the treaty is liability of a person to be taxed; if the liability exists under the tax law in force in a Contracting State it is immaterial whether that person has in fact paid the tax or has enjoyed exemption, if any.

20. It would be apposite to refer to the following comment of Philip Backer on Pereira's case (supra) para 4b.07 [art. 4(1)].: "The later position of the Authority seems more correct since 'liable to tax' must surely mean liable to one of the taxes which are the subject-matter of the Convention. If a State imposes no tax, then it is

hard to see how one can ever be liable to that tax (until such a tax is enacted--always assuming the Convention then applies to that tax)." (emphasis, italicized in print, supplied) Mr. Dastur is critical of this comment and submits that an order can be either correct or wrong; it cannot be more correct or less correct than the other. The discussion of the aforementioned two cases by the learned author shows that he merely referred to the ruling in Rafik's case (supra) and made no comment on it. The above noted comment on the ruling in Pereira's case (supra) suggests he regarded it as "superior of the two" The New Shorter Oxford English Dictionary (Third Index Edn.) Vol. I cl. (1) p. 1829. in other words "the" correct ruling.

21. Mr. Dastur then argued that the Hon'ble Supreme Court approved the ruling of the Authority in Rafik's case (supra) and disapproved the ruling in Pereira's case (supra); he invited our attention to the following observation of the Supreme Court in ABA (supra): "Having perused the order of the Advance Rulings Authority, we regret that we are not persuaded" We may indicate that in the context of Philip Baker commentary of OECD Model Convention on interpretation of Article 4(1), the Hon'ble Supreme Court having quoted a passage therefrom and having referred to Sections 245R and 245S of the Indian Act, made the following observation in regard to both the rulings: "Interestingly, Baker refers to the decision of the Indian Authority for Advance Rulings in Mohsinally Alimohammed Rafik, In re (1995) 213 FTR 317 (AAR). An assessee, who resided in Dubai claimed the benefits of the UAE-India Convention of 29th April, 1992, even though there was no personal income-tax in Dubai to which he might be liable. The Authority concluded that he was entitled to the benefits of the Convention. The Authority subsequently reversed this position in the case of Cyril Eugene Pereira, In re (1999) 239 ITR 650 (AAR) where a contrary view was taken." We have noted above that in Rafik's case (supra) the Authority took the view that a person who is not liable to tax in UAE, would be entitled to the benefit of the treaty. Indeed, that view runs counter to the following observation of the Hon'ble Supreme Court: "There is substance in the contention of Mr. Salve, learned counsel for one of the appellants, that the expression 'resident' is employed in the DTAC as a term of limitation, for otherwise a person who may not be 'liable to tax' in a Contracting State by reason of domicile, residence, place of management or any other criterion of a similar nature may also claim the benefit of the DTAC. Since the purpose of

the DTAC is to eliminate double taxation, the treaty takes into account only persons who are 'liable to taxation' in the Contracting States. Consequently, the benefits thereunder are not available to persons who are not liable to taxation and the words 'liable to taxation' are intended to act as words of limitation." In the face of this observation, among others, it is not possible to hold that the Hon'ble Supreme Court approved the ruling of the Authority in Rafik's case (supra).

From the above discussion, as the UAE Decree stands now, it follows that the applicant, who has settled in UAE, does not satisfy the requirements of the expression "resident of a Contracting State" so he cannot be treated as a resident of UAE within the meaning of Article 4(1) of the treaty. Had the proposed codified tax law come into force an individual would have become a resident within the meaning of Article 4(1) of the treaty and Article 4(2) would have become applicable to him. In the result, we have reached the same conclusion as was recorded by the Authority in Pereira's case (supra) but for different reasons.

For the aforementioned reasons, para 2 of Article 4, which inter alia, provides that where by reason of the provisions of para 1 an individual is a resident of both Contracting States then his status shall be determined on the basis of criterion laid down in Clauses (a) to (d) thereof, stands explained. In view of this conclusion the applicant cannot claim benefit of provisions of the treaty. We shall presently discuss the effect of application of the reduced rate of taxation in arts, 10(2), 11(2) and 12(2) of the treaty. In regard to concessional treatment of students (Article 20), teachers (Article 21), artists and athletes (Article 17), it may be noted that the term 'resident' is defined in Article 20(5) for the purposes of Articles 20 and 21 which do not pose the same problem as Article 4(1) of the treaty. For the purpose of Article 17, the definition of the expression 'resident of a Contracting State' is not pertinent. It is unnecessary to discuss other articles of the treaty. Suffice it to say that the comment that the treaty is unworkable insofar as individuals are concerned, may not be entirely correct as individuals who are resident in India 'are benefited but residents of UAE are not [see Michael Edwardes-Ker (supra) in regard to unequal effect of treaty]. We conclude our discussion of Article 4(1) recording our agreement with the following commentary of Philip Baker: "The article is thus linked to the definitions of 'person' in Article 3 and of 'resident of a

Contracting State' in Article 4.

Though brief, the article is of vital importance. Those who cannot demonstrate that they come within the definitions of a person and a resident of a Contracting State are not able to claim the benefit of the Convention." Now the polemic which remains to be resolved is, how will an individual--investor who is physically residing in UAE be treated in India for tax purposes vis-a-vis Articles 10, 11 and 13 of the treaty Whereas Mr. Dastur would argue, "being a resident of UAE" and in view of the provisions of the treaty, the following income arising to the applicant in India, will be taxable only in terms of the aforementioned articles of the treaty.

The contention of the CIT is that an individual physically residing in UAE, irrespective of the period of his stay there, is not a resident of UAE within the meaning of the expression in Article 4(1) so he cannot get the benefit of Articles 10, 11 and 13 of the treaty.

We have already held above that by virtue of Article 1 the treaty applies to persons who are residents of one or both of the Contracting States. The term person includes an individual who is a taxable entity under taxation laws in force in one or both the Contracting States.

Individuals are not taxable entity in UAE so they are not "residents of Contracting State" postulated in Article 4(1) of the treaty. However, applying principle of liberal interpretation pleaded by Mr. Dastur, it may be stated that the preamble of the treaty contains a direction of the Central Government that all the provisions of the treaty should be given effect to in the Union of India. This means that IT authorities are bound to give effect to the provisions of the treaty in regard to, Inter alia, Indian companies and banks, etc., resident in India. What would then be the position of an individual who has set up his abode in UAE and receives dividends of shares held by him in Indian company and/or receives interest from banks in India and/or receives capital gains by disposing of shares held by him in Indian company relating to their taxation Are the IT authorities free to assess tax on the income arising under different heads in India under the Indian Act or are they bound to give effect to the provisions of the treaty We shall now examine the relevant articles of the treaty. Article 10 of the treaty deals with the dividends and Article 11

deals with interest.

Insofar as they are material for our purpose, they read as follows: 1. Dividends paid by a company which is a resident of a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State, that other State. 2. However, such dividends may also be taxed in the Contracting State in which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed (a) 5 per cent of the gross amount of the dividends if the interest is paid on a company which owns at least ten per cent of the shares of the company bona fide banking business or by a similar financial institution; and (b) 12.5 per cent of the gross amount of the dividends in all other cases.

of the interest in all other cases.

It is manifest that paras 1 and 2 of Articles 10 and 11 are similarly worded. Para 1 of Article 10 says that dividends paid by a company which is a 'resident of a Contracting State' (which in the context means India) to a resident of the other Contracting State (which in the context would be UAE) may be taxed in that other State, that is UAE. The expression "resident of a Contracting State", as has been noted above, is defined in para 1 of Article 4 of the treaty. The expressions "resident of the other Contracting State" and "the resident of UAE" are not defined either in Article 3 or Article 4 of the treaty, though the expressions "a Contracting State" and the "other Contracting State", have been defined in Clause (c) of para 1 of Article 3; so also the expressions the enterprise of a Contracting State and the enterprise of the other Contracting State, have been defined in Clause (g) of para 1 of Article 3. It has already been noticed above that the term "resident" is not defined for the purposes of the treaty; the definition of the term contained in para 5

of Article 20 is for the limited purpose of Articles 20 and 21 of the treaty. It is worth mentioning that para 2 of Article 3 says that in the application of the treaty by a Contracting State, any term not defined therein shall have the meaning assigned to it under the laws of that State concerning the taxes to which the treaty applies except when the context otherwise requires. In the instant case, India, a Contracting State, is applying the treaty, so the terms not defined therein, would have the meaning assigned to them in the Indian Act. Section 2(42) of the Indian Act defines 'resident' to mean a person who is resident in India within the meaning of Section 6 thereof which embodies the definition of expression "resident in India" and not "resident". Obviously, in the setting of Article 10(1) of the treaty, it can safely be said that the context otherwise requires. Therefore, the meaning of the term 'resident' has to be adopted as understood by English speaking persons.

In "The New Shorter Oxford English Dictionary" (Edn. 1993), the term 'resident' is defined to mean, inter alia, residing, dwelling or having an abode in a place, staying regularly in or at a place for the performance of official duties or to work, study, etc. The expression a 'resident' of the other Contracting State for the purpose of UAE, should be understood as a person residing, dwelling or having an abode in UAE or a person staying regularly in UAE for the performance of official duty or study. The interpretation we have placed on the expression 'resident' of the other Contracting State, would fit in the context as also in the light of the object of the treaty underlined in the speeches of the Hon'ble Finance Minister of India and His Highness Sheik Hamdan Bin Rashid Al-Maktoum, Minister of Finance and Industry in the presence of His Highness Sheik Zayed Bin Sultan Al-Nahyan, the President of the UAE, the preamble of the treaty as well as the press notification issued contemporaneously with the signing of the treaty.

In support of the above interpretation of Articles 10 and 11 of the treaty we drew support from the judgment of the High Court Justice (Chancery Division) in the case of Commr. of Revenue v. Exxon Corporation 56 Tax Cases 237, relied upon by Mr. Dastur. In that case, Esso Holding Co. (for short 'Esso') was incorporated in USA; it was a U.K. resident, for tax purpose. Exxon Corporation (for short 'Exxon') was also incorporated in USA which was resident of USA for tax purposes. Exxon was the holding company of Esso which paid dividends in U.K. to its holding

company-Exxon. The Special Commr. held that in view of Article XV of the agreement entered into between the USA and the U.K. for Avoidance of Double Taxation and Fiscal Evasion, the dividends paid by Esso to Exxon were exempted. The Revenue was in appeal before the High Court (Chancery Division) against the order of the Special Commr.. The question of taxability of dividends in the hands of Exxon was an issue before the High Court. Article XV of the agreement was in the following terms: "Dividends and interest paid by a corporation of one contracting party shall be exempt from tax by the other contracting party except where the recipient is a citizen, resident, or corporation of that other contracting party. This exemption shall not apply if the corporation paying such dividend or interest is a resident of the other contracting party." The article comprises of two sentences; the first sentence contains two parts and the third part is in the second sentences. By virtue of first part of the first sentence dividends and interest paid by Esso-USA (resident of U.K.)--a corporation of one contracting party--shall be exempt from tax by the U.K.--other contracting party.. The second part contains an exception to the said exemption where the recipient is a citizen, resident, or corporation of that other contracting party which would mean that the exception to the exemption will be attracted where the recipient of dividends, (here-Exxon) is a citizen, resident or corporation of the other contracting party, U.K. The second sentence (the third part) provided that the exemption should not apply if the corporation paying such dividends or interest (Esso) is a resident of the other contracting party (U.K.). Goulding, J. who decided the appeal, posed the question whether the expression, a resident of the other contracting party, in the second sentence of Article XV of the Convention should or should not be interpreted in accordance with respective definition of the expressions 'resident of U.K.', and 'resident of U.S.A.', set out in paras I(g) and I(h) of Article II of the Convention or whether it should be treated as term not otherwise defined for the purposes of Article II, para 3 of the Convention. It was observed that the first sentence of Article XV contained a phrase, 'similar to' but not identical with the expression under the scrutiny; viz., citizen, resident or corporation of that other contracting party.

It was contended for the assessee before the learned Judge that the expression 'resident of U.K.' was defined in Article II(1)(g) of the Convention to mean any person other than United States corporation, therefore, Esso was expressly

excluded from the meaning of that expression and, therefore, the second sentence of the article was not a bar for claiming exemption. The contention of the Revenue was that the expression resident of the other contracting party, appearing in the second sentence was not otherwise defined in the Convention and therefore, it should be understood under the tax laws of the U.K. If it was so understood the exemption would not apply. The learned Judge concluded as follows: "At this point two alternatives are open to me. That commended by Mr. Potter is to continue to read Article XV according to the plain natural meaning of its words and to simply accept the consequence that the second sentence of the article has, either probably or certainly, failed to achieve whatever purpose its framers intended.

..... The other course, urged on me by Mr. Nolan, is to say that the broad policy behind the second sentence is clear, namely, to deny exemption to dividends paid to an American company by a subsidiary trading and controlled in this country and merely incorporated in a transatlantic jurisdiction. I am then entitled, says Mr. Nolan, to read the sentence in a way, even if not the most natural way, that will give it some practical effect rather than none

..... I think on a general consideration of the scheme of the Convention, that Mr. Nolan is right in saying that the intended purpose of the second sentence of Article XV can be discerned.

Accordingly, although it seems to me that upon a plain meaning of the words used, the expression "resident of the other contracting party" in the sentence does import residence definitions..... I must nevertheless give it a different construction, so that it does not fail of effect. In coming to this conclusion I bear in mind that the words of the Convention are not those of a regular Parliamentary draftsman but a text agreed upon by 'negotiation between the two Contracting Governments. Although I am thus constrained to do violence to the language of the Convention, I see no reason to inflict a deeper wound than necessary. In other words, I prefer to depart from the plain meaning of language only in the second sentence of Article XV, and I accept the consequence (strange though it is) that similar words mean different things in the two sentences." It must be pointed out here that in the case of Exxon Corporation (supra), both Esso and Exxon were

treaty subject to whom the Convention admittedly applied. The question was meaningful interpretation of Article XV of the agreement. In the instant case, the applicant is not a treaty subject and he cannot avail the benefit of the treaty so the decision in Exxon Corpn. case (supra) will be of no assistance to the applicant.

Now para 2 of the said articles provides that such dividends and interest may also be taxed in the Contracting State of which the company paying dividends or interest is a resident (India--the source State) and according to the laws of that State (India) but if the recipient is a beneficial owner of the dividends or interest the tax so charged shall not exceed (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 per cent of the shares of the company paying the dividends; (b) 15 per cent of the gross amount of dividends, in all other cases. So far as 'interest' is concerned, it is provided the tax so charged shall not exceed (a) 5 per cent of the gross amount of the interest if such interest is paid on a loan granted by a bank carrying on a bona fide banking business or by a similar financial institution; and (b) 12.5 per cent of the gross amount of the interest in all other cases.

It is true that in view of allocation of jurisdiction to levy income-tax on dividends and interest, both the source State (India) and the State of the recipient of the said income (UAE) are entitled to tax the same. For the purpose of para 2 it is immaterial whether the UAE is actually levying any such tax on dividends/interest because that is not precondition of the said para. A plain reading of para 2 suggests that the source State (India) has also the power to tax the dividends but at the rates specified therein. Irrespective of how the dividends/interest would be treated for tax purposes in the other Contracting State (UAE), India can tax them only at the specified concessional rates on fulfilment of the conditions enumerated therein.

For purposes of levying tax at the specified concessional rate mentioned in para 2, the residential status of the individual/recipient has no relevance. The conditions which are required to be verified by the CIT in giving effect to Article 10(2) of the treaty are : (1) whether the company paying the dividends is a resident of India; (2) whether the recipient of the dividends is the beneficial owner of the dividends. If

the beneficial owner of the dividends is a company owning 10 per cent shares of the company paying the dividends, the concessional rate of tax is 5 per cent but if the recipient of the dividends is other than the company owning 10 per cent of the shares of the company paying the dividends, the rate of tax prescribed is 15 per cent. Similar would be the position in regard to Article 11(2) of the treaty. We cannot conclude this aspect without pointing out that the analysis of Articles 10 and 11 would be material, where the treaty is applicable to the applicant.

The above discussion apart, it has been pointed out above that the IT authorities are bound to give effect to the Circular issued by the CBDT No. 734, consequently irrespective of his residential status under the treaty, the applicant would be entitled to the benefit of concessional rates Contained in the circular which are mere reproduction of the rates specified in para 2 of both the Articles 10 and 11 of the treaty.

The only topic which remains to be considered is the taxability of capital gains arising to the applicant from the alienation of shares in Indian companies. Here para 3 of Article 13 of treaty is relevant, which is in the following terms: 3. Gains from the alienation of any property other than that mentioned in paras 1 and 2 shall be taxable only in the Contracting State of which the alienator is a resident." Inasmuch as gains arising to the applicant are from properties not covered by paras 1 and 2 of Article 13, para 3 of Article 13 is attracted. A plain reading of para 3 suggests that gains from the alienation of any property other than that mentioned in paras 1 and 2 will be taxable only in the Contracting State of which the alienator is a resident. The treaty by applying the principle of allocating the jurisdiction to tax income arising under various heads, between the Contracting States, allocated the jurisdiction to tax capital gains arising from the alienation of shares, debentures, etc. held by an alienator, to the State in which the alienator resides. Admittedly, the alienator, the applicant, is not a resident of India within the meaning of Section 6 of the Indian Act. Adopting the meaning of the term 'resident', discussed above, the applicant who is the alienator, is in that sense a resident in UAE. Therefore, in a case where treaty is applicable, irrespective of the fact whether the capital gains is taxed in UAE or not, the CIT cannot tax the same on the ground that it will result in double non-taxation.

However, in the instant case as the applicant is not a treaty subject, he cannot claim the benefit of Article 13 of the treaty.

In support of the claim of the applicant that the applicant is not liable to pay tax on the capital gains arising from the disposal of the immovable property-shares, debentures and other securities--in India, Mr. Dastur relied upon the ruling of the Authority in Emirates Fertilizer Training Company WLL, In re (2005) 272 ITR 82 (AAR). On a perusal of the ruling it is evident that applicability of the treaty to the applicant therein was not in issue. Indeed the parties proceeded on the footing that the treaty was applicable to the applicant therein. In that background, having regard to para 3 of Article 13 and in the light of decision of the Hon'ble Supreme Court in CIT v. P.V.A.L. Kulandagan Chettiar (Dead) through LRs (2004) 267 ITR 654 (SC), it was ruled that capital gains arising from alienation of shares in Indian companies held by the applicant would not be taxable in India. That case cannot be an authority in the present case as it has been held here that the applicant is not entitled to the benefit of the treaty.

Before bidding adieu to these applications, we would observe that the intention of the parties to the treaty as reflected in the speeches delivered by Shri Manmohan Singh, Hon'ble Minister of Finance (as he then was) and His Highness Sheik Hamdan Bin Rashid Al-Maktoum, Minister of Finance and Industry in the presence of His Highness Sheik Zayed Bin Sultan Al-Nahyan, the President of the UAE as well as in the press note was to extend the benefit of the treaty to the individual also. It is only due to the fortuitous circumstance of the anticipated codified tax law not coming into force in UAE, the individuals have to be denied the benefit of the treaty. The situation cries out for favourable consideration of these circumstances to take such steps as are necessary to extend the benefit of Article 13(3) also to the non-resident Indians who are physically residing in UAE and who have invested in shares, debentures, etc. in India on the strength of the press notification.

question No. (1): the applicant, an individual, residing in UAE is not entitled to claim the benefit of the provisions of the treaty entered into between India and UAE; question No. (2): in terms of Article 13(3) and Article 4 of the tax treaty

between India and UAE, the applicant, an individual Indian national, residing in UAE, is liable to capital gains tax in India on the transfer, effected in India, of moveable assets in the nature of shares, debentures and other securities; question No. (3): in view of our ruling on question No. 2, no ruling need be given on this question; question No. (4): the first part of the question is covered by the ruling on question No. 2; (a) and (b): the factors like acquisition of moveable assets in the nature of debentures and other securities prior to coming into effect of the treaty between India and UAE or the applicant becoming non-resident, is irrelevant for purposes of taxation of capital gains; (c) for purposes of taxation of capital gains, it is immaterial whether the applicant acquired the moveable assets after becoming a non-resident or from out of non repatriable funds in India; question No. (5): the learned counsel for the applicant has submitted that this question is not pressed, therefore, no ruling need be given on this question; question No. (6): in terms of Article 11 of the treaty between India and UAE r/w Circular No. 734, dt. 24th Jan., 1996 issued by the CBDT, income receivable by the applicant in India by way of interest or dividends on bonds and deposits with banks and companies are liable to be taxed at the rates mentioned in the circular at 12.5 per cent of the gross amount of the interest received.

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