Look before that NYSE leap

Learning The Tricks Of Tax Treaties Is Imperative To Make $ Gains

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THANKS to the Reserve Bank of India's (RBI) recent announcement permitting individuals to remit up to $25,000 yearly, you can actually dream in mega dollars — of striking it rich by investing in your favourite shares, be it listed on the NYSE or any other international bourse that catches your fancy. But like the proverbial villain in any Bollywood flick, taxes that are payable by you in India and perhaps also in the other country may dent your dreams.

Don't worry, tax treaties can come to the rescue. India has so far entered into tax treaties with around 66 countries of the world. These include US, UK, Germany, France, Japan, Singapore, among others. So go ahead, invest and make the most of tax treaties.

Some basic points must be understood. First, how does double taxation arise in any cross-country transaction, including one of mere investments abroad in shares? Double taxation occurs when one and the same person is taxed on the same income in more than one country — In 'Country A' because it is the source country from where the income is derived (such as dividends and capital gains) and in 'Country B' because it is the investor's country of residence or home country. To provide relief, tax treaties clarify which country has the right to tax, whether it would be the investor's home country or the country of source. At times, the right to tax may be given to both countries. What next? Well, tax treaties provide that the investor's home country shall grant a tax credit for the taxes paid in the other country.

Now let us come to the nitty-gritty. Most countries, including India, tax 'ordinary' tax residents on global income.

▶ Differs from treaty to treaty: P2

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THERE'S some relief in store for software exporters, although they would cease to enjoy tax deductions under 80HHE of the Income Tax Act from the coming fiscal. The MoF has decided to allow them to claim tax deduction, with retrospective effect, on profits earned from services rendered on-site.

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Tax abroad differs from treaty to treaty

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The status of 'ordinary' tax residence in India is determined based on the number of days of stay in India. Section 6(1) of the Income-tax (I-T) Act provides that an individual is an ordinary resident in India, in any tax year, if he has been in India in that year for period or periods amounting in all to 182 days or more. An individual could also be an ordinary resident, if he has been in India in that tax year for 60 days or more and has been in India for the four previous years, immediately preceding this tax year for 365 days or more.

In other words, if you are an 'ordinary' tax resident, both the foreign dividend income and the capital gains arising from sale of such foreign shares would be taxable in India in your hands. Would it also be subject to tax in the foreign country? The answer varies from tax treaty to tax treaty. And if you have coughed by taxes abroad — in the source country —, as an ordinary tax resident of India, you can claim credit here.

Let us begin with dividend tax implications. In most countries, dividends declared are not exempt in the hands of the shareholders. So, if you have invested in shares of Hitachi on the Tokyo Stock Exchange and obtained dividends, please take a peek at the relevant provision in the Indo-Japan tax treaty. The words used are that the country of which the dividend paying company is a tax resident 'may also' tax such dividend income. The Japanese company would be duty bound to withhold tax at source at the rate of 15%, which is the concessional rate prescribed in the treaty.

You being an 'ordinary' tax resident of India would also pay tax on the same dividend income in India and would then have to claim a tax credit in India for the tax withheld in Japan when filing your tax return.

Coming now to capital gains. Most countries, under their domestic laws follow a residence basis of taxation of capital gains. "If you are not a US resident, it is unlikely that you will suffer tax on capital gains, made by selling shares of US company," explains Daksha Baxi, international tax consultant at Nishith Desai Associates.

Thus, treaty laws and laws of the country of source must be read carefully. The relevant capital gain provision in the Indo-US tax treaty prescribes that India and US may tax capital gains as per their domestic laws. And US under its domestic tax laws generally does not tax capital gains arising from sale of US company shares provided the investor is not a US tax resident. Let us take another example and assume that you have made capital gains from sale of shares on the Singapore bourse.

> In most treaties, the credit given by India is limited to the taxes that are payable in India on the same income. Only if the rate in the foreign country is lower do you get a full credit

Such capital gains would be subject to tax in Singapore. Once again as you are an 'ordinary' tax resident in India, such capital gains would be your taxable income in India. The recourse, ask for a tax credit in India, for the capital gains tax borne in Singapore.

Non-ordinary residents in India, (once again determined on the basis of days stay in India) do not pay taxes in India on global income such as foreign dividend and capital gains income on sale of foreign scrips.

"If tax has been withheld in the foreign country, it is imperative for you to obtain proof, such as a withholding tax certificate. This also will help you claim that much needed tax credit in India when filing your tax return. India may or may not give a full tax credit for the foreign taxes, this again depends on the relevant treaty," states Mr Nikhil Bhatia, partner, Bharat S Raut & Co.

In most treaties, the credit given by India is limited to the taxes that are payable in India on the same income. Thus, only if the tax rate in the foreign country is lower do you get a full credit against Indian taxes. India does not grant a refund for the excess tax paid in the foreign country.

"The compliance obligations in the other country also need to be ascertained. It is likely that while the taxes withheld or paid by you against your dividend or capital gain income is the only tax liability in the other country, you may still have to file tax returns in such a country," adds Mr. Bhatia.

"Investments in other types of securities such as deep discount bonds etc. would have their own peculiar tax treatment in India and the other country," he warns.

Issues such as wealth tax, gift tax and inheritance taxes prevalent in the countries where you have invested in shares also comes to the fore. Thus, chuck away that simple one-page Saral form. Be prepared. Cool yen dividends, and dollar-based capital gains are not free. They come with a tax price. But, please make the most of tax treaties to ensure that you are not doubly taxed.