

Tax Hotline

November 10, 2005

SECOND PROTOCOL TO INDIA-ITALY TAX TREATY

The Union Cabinet gave its approval for signing the second Protocol amending the Double Taxation Avoidance Convention ("DTAC") between India and Italy with a view to boosting trade and investment. The provisions stated in the Protocol would be effective only after the Protocol is signed and notified by both the countries.

Some of the provisions of the proposed Protocol include substitution by Italy of local income tax with a regional tax on productive activities and broadening the scope of Permanent Establishment ("PE") to include rendering of services and insurance. Further, the Protocol inter-alia also deals with reduction in the withholding tax rates for dividends, interest and royalties, and tax treatment of business profits, air transport and shipping.

The main provisions of the Protocol are summarized below:-

(A) ARTICLE 2 (TAXES COVERED):

Italy will substitute the local income tax with IRAP tax (Regional Tax on Productive Activities).

(B) ARTICLE 5 (PERMANENT ESTABLISHMENT):

A new clause has been introduced in paragraph 2 of Article 5 of the DTAC to provide that rendering of service through employees or other personnel will also constitute a PE, if these activities continue for more than six months in any twelve-month period. A separate paragraph to treat an 'insurance enterprise' as having a PE has also been introduced, if it collects premium and insures risks in the other contracting state.

(C) ARTICLE 7 (BUSINESS PROFITS):

Where an enterprise of a contracting state sells goods or merchandise or carries on a business in the other contracting state through a PE, the profits of the PE shall be determined only on the basis of that part of receipts which is attributable to the actual activity of the PE and not on the total amount received by the enterprise.

(D) ARTICLE 8 (AIR TRANSPORT) AND ARTICLE 9 (SHIPPING):

A new provision in Article 8 and Article 9 has been introduced so that profits from the operation of aircrafts or ships in international traffic shall include profits derived from the use or rental of containers if such profits are incidental to the operations in international traffic.

(E) ARTICLE 10 (ASSOCIATED ENTERPRISE):

A new paragraph is proposed to be added so as to facilitate giving benefits of the transfer pricing adjustment carried out by one state in the other state. Such adjustment shall be made in accordance with the Mutual Agreement Procedure provided for by Article 26 of the DTAC and this paragraph (E) of the said proposed Protocol. This would eliminate any discrepancy/ disagreement in regard to the computation of such transfer pricing benefits for adjustment purposes.

(F) ARTICLE 11 (DIVIDENDS), ARTICLE 12 (INTEREST), ARTICLE 13 (FEES FOR TECHNICAL SERVICES AND ROYALTY):

The withholding tax rates are proposed to be brought down to 10 per cent in the case of dividends, interest and fees for technical services. As per the current provisions of the DTAC, the withholding tax rate on dividends, interest and fees for technical services are 15%/ 25%(depending on the level of shareholding), 15% and 20% respectively.

(G) ARTICLE 15 (INDEPENDENT PERSONAL SERVICES) AND ARTICLE 16 (DEPENDENT PERSONAL SERVICES):

It has been provided that the number of days for the purpose of tax residence in the case of personal services shall be an aggregate of 183 days in any twelve-month period commencing or ending in the fiscal year concerned. As per the current provisions of the DTAC, the number of days for the purpose of tax residence in the case of personal services is an aggregate of 183 days in the relevant fiscal year.

(H) ARTICLE 25 (NON-DISCRIMINATION):

The Income Tax Act, 1961 distinguishes between domestic companies and foreign companies and the tax rate applicable to the former is lower. The reason for this variance in tax rates is that a domestic company pays dividends and consequently pays a dividend distribution tax, which a PE of a foreign company is not required to pay. The proposed Protocol clarifies that this difference in tax rates shall not be considered to be discriminatory in terms of the DTAC.

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(I) NEW ARTICLE (COLLECTION ASSISTANCE):

A new Article on Collection assistance is proposed to be added in the DTAC as Article 28 to ensure assistance in collection of taxes covered by this Convention by both the contracting states.

-Khushboo Baxi & Nishchal Joshipura

Source: **Press Information Bureau**, dated November 3, 2005

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