A THOUGHT ON "TAXABILITY OF CAPITAL GAIN EARNED BY NRI"

(DOUBLE TAXATION AVOIDANCE OR BOTH TAXATION AVOIDANCE)

ARTICLE 13 (3)

India – UAE DTAA

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- **From 1993 till 01-04-2008**
- Article 13 of Double Taxation Avoidance Agreement (DTAA) between India and United Arab Emirates (UAE) (Indo-UAE DTAA) on capital gains was as follows;
    1) Gains derived by a resident of a contracting state from the *alienation of immovable property* referred to in paragraph 2 of Article 6 and situated in the other Contracting State may be taxed in that other state.
    2) Gain from the *alienation of movable property forming part of the business property of a permanent establishment* which an enterprise of a contracting state has in the other contracting state or of movable property pertaining to a fixed base available to a resident of a contracting state in the other contracting state for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the enterprise) or of such fixed base may be taxed in that other state.
    3) *Gains from the alienation of any property other than that mentioned in paragraph 1 and 2* ***shall be taxable only in the contracting state of which the alienator is a resident****.*
- Why one should not have thought of taking the article 13 (3) as a room for planning tax on capital gains earned in India?
- Why Indian residents should not have planned their **capital gain transactions** in a manner which would have reduced the tax liability in India by taking the advantage of article 13(3)?
- Relying on the above article 13 (3) and the case law (Dr. Rajnikant R. Bhatt vs CIT, 222 ITR 562), why the capital gain transaction might not have been planned as below?
    - Purchase and sale of the property which is not falling in the article 13 (1) and 13 (2) of Indo-UAE DTAA should be planned in the name of NRI who is a resident of any tax free country where the similar provision of article 13 (3) is applicable.
- Now the question is what were those properties which would have not fall in the category as specified in article 13 (1) & 13 (2) and could have been considered under article 13 (3)?
    - One thought could be that whether ***Share and Securities*** can be a property which can be covered under article 13 (3)? *(Yes based on decision of AAR in the case of Dr. Rajnikant R. Bhatt vs CIT, 222 ITR 562)*
    - If yes, why shares and security transactions should not be carried out in the name of NRI individual? *(Yes it was already being done till 31st March, 2008)*
    - Whether NRI individuals can freely transact the sale and purchase of shares/securities of the Indian company thru his NRE/NRO accounts or thru any other way?
- What kind of care was required if the above strategy could have been successfully made?
    - NRI individual should ensure that during the financial year his *fiscal domicile* remained situated outside India (i.e. in tax free country).
    - FEMA regulations should be considered before planning transactions of purchase and sale of property by the NRI individual.
    - Transactions should be carried out using the permissible mode of banking channels for the NRI individuals.

- **From 01-04-2008**
- To prevent the misuse of the beneficial provisions of article 13 (3) as discussed above, the government of India and the government of UAE signed a protocol during March, 2007 amending the Indo-UAE DTAA. Further the Government of India issued a notification (notification no 282/2007 dated 28 November 2007) directing that all the provisions of the protocol are to be given effect to in the Union of India with effect from April 1, 2008 which replaced the provision of article 13 (3) with the following;
    - (From 01-04-2008) Article 13… (1) … (2)…
        (3) Gains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State.
        (4) Gains from the alienation of shares other than those mentioned in paragraph 3 in a company which is a resident of a Contracting State may be taxed in that State.
        (5) Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, and 4 above shall be taxable only in the Contracting State of which the alienator is a resident.
- Based on the revised Indo – UAE DTAA, it is clear that the benefit of article 13 is no more available *(from 01-04-2008)* for avoiding the tax liability on capital gains earned on the investment in *share and securities* of Indian companies.
- However the provision of earlier article 13 (3) is still present in the article 13 (5) of the amended Indo – UAE DTAA which still gives a room for the AVOIDANCE of tax on the capital gains earned in India on the MOVABLE ASSETS which do not fall under the article 13 (1), (2), (3) and (4).
- **Conclusion:**
    - Indo – UAE DTAA has been entered into between the government of both the countries during September 1993 and Indian Government has made it effective from **18th November, 1993** by way of notification (*No. GSR 710(E)*).
    - **During 1996**, AAR has announced that the capital gain earned on the investment in the shares and securities of the Indian company by the NRI Individual (UAE resident) will be exempt from the Indian Taxes. (Dr. Rajnikant R. Bhatt vs CIT, 222 ITR 562)
    - The ambiguity as to the AVOIDANCE OF TAX IN BOTH THE COUNTRIES in respect of the capital gains earned in India has already came to the notice of the Indian Government during 1996 itself (refer case law Dr. Rajnikant R. Bhatt vs CIT, 222 ITR 562) then why Indo – UAE DTAA has been amended after so long i.e. during **April 2008**?
    - Why the Indian Government has still kept the same ambiguity of earlier article 13 (3) open in the article 13 (5) of the amended Indo – UAE DTAA?
    - There will be still some movable properties which can be identified under the article 13 (5) of the amended Indo – UAE DTAA and still the tax on capital gains earned by investment in such movable properties can be **AVOIDED IN BOTH** the country.

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