Tax Hotline

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WORKING GROUP RECOMMENDS TAX REFORMS FOR TAXATION OF NON-RESIDENTS IN INDIA

The Working Group on Non-resident Taxation ("The Group") set up by the Finance Ministry and headed by the Director-General of Income Tax (International Taxation), Vijay Mathur, has made certain recommendations to the Government regarding taxation of Non-residents in India. We summarise hereunder some of the important recommendations as reported in the press.

Foreign companies are currently taxed at the rate of 40% (excluding surcharge) on their profits as opposed to the tax rate of 35% (excluding surcharge) levied on domestic companies. The Group has recommended removal of this disparity. The Group has however recommended introduction of branch profit distribution tax on foreign companies similar to that existing in other countries such as the US.

The Group further recommends the removal of "resident but not ordinarily resident" status available to those taxpayers who were not taxed on their foreign sourced incomes for nine years subsequent to their becoming tax resident in India.

The Indian Income Tax Act ("ITA") envisages the concept of "business connection" which is wider than the concept of Permanent Establishment ("PE") under the tax treaties. However, business connection has not been defined under the ITA and is interpreted based on judicial precedents. The Group now proposes to specifically provide for "dependent agency PE" concept within the ambit of business connection.

The Group has tried to remove the anomaly in taxation of "fees for technical services" received by a non-resident while carrying on business in India through a PE. Currently, such fees for technical services are taxed on gross basis. The Group recommends that in such situations, the PE should be allowed deduction for expenditure "wholly and exclusively" incurred for the purposes of earning the fees.

The Group has also recommended the introduction of "Controlled Foreign Corporation" regulations and has highlighted two approaches adopted by various countries in this respect. In the first category controlled foreign corporation rules are made applicable to specific types of incomes while the other approach involves applying such rules to controlled corporations that are residents of identified tax havens or low-tax jurisdictions.

It is expected that while framing the upcoming Budget for the year 2003, the Union Finance Minister would consider the recommendations of the Group.

Source: The Economic Times, dated January 16-17, 2003.

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