# CHAPTER 17
# A MORBID STORY OF THE INDO-MAURITIUS DTAC

**SYNOPSIS**


1. A Factual backdrop .............................. 327
2. The Section 90(1) of the Income-tax Act........................................................ 330
3. Meaning of *Avoidance of Double Taxation of Income*.............................. 334
4. The Travesty of the Personal Scope .... 335
5. Treaty shopping: the *causa proxima*...335
6. Misuse of the DTAC by the Indian residents...............................................336
7. The Phantoms of Delight.....................336
8. Recovery of taxes................................339
9. Mutual Agreement Procedure (MAP) .339


*In Liversidge v. Anderson*[1] *the majority of the Lords felt the same confidence in the wisdom and moderation of executive officials; there is, apparently, something in the tranquil atmosphere of the House of Lords which stimulates faith in human nature*

—Allen, *Law and Orders* 3rd ed. p. 297

*"I know of only one authority which might justify the suggested method of construction. 'When I use a word' Humpty Dumpty said in rather scornful tone, 'it means just what I chose to mean,*
*neither more nor less'. 'The question is,' said Alice 'Whether you can make words mean different things'. 'The question is,' said Humpty Dumpty, 'who is to be the master ---that is all."*

—Lord Atkin in *Liversidge v Anderson*[2]:

## 1. A Factual backdrop

Carla Hills, the then U.S. Trade Representative, is said to have observed when the U.S. Government enacted the Super and Special 301 of the U.S. Trade and Competitiveness Act, 1988 that those provisions were to act as a crow bar to pry open the markets of developing countries. But this alone did not satisfy the

1. (1942) A.C. 206.
2. (1942) A.C. 206,at 245.

corporate *imperium* led by the U.S. The Uruguay Round, negotiations which culminated in the Uruguay Round Final Act, dismantled "all the defences of [the developing countries] against the unrestricted entry of the U.S goods and service in their market."[3] But the impact of the corporate *imperium* had been felt much before all these happened. One instance of this is the Indo-Mauritius DTAC concluded in early eighties of the last century.

Originally a double taxation agreements had been devised in our country as a fair way of dividing tax revenues between the two sovereign States having in their respective laws authority to subject the taxpayers income to tax. In the 5th edition (1963) of Kanga and Palkhivala's *The Law and Practice of Income-Tax* there is a compilation[4] of Double Taxation Avoidance Agreements (with Pakistan, Switzerland, Sweden, Denmark, Norway, Japan, the Federal German Republic and Finland). Analysis of the various provisions in these Agreements clearly discloses a pattern in the architecture of the Double Taxation Avoidance Agreements illustrating the meaning of *Double Taxation* as understood under the Indian fiscal legislative practice. This analysis brings to light the following features :

(i) The scope of total income is comprehensively delineated in section 5 of the Income-tax Act. Section 5 explores the possibilities of taxation within the frontiers of the concept of *tax on income* occurring in entry 82 of the Union List in the Seventh Schedule to the Constitution of India.

(ii) The Avoidance of Double Taxation Agreements show that under the Indian fiscal legislative practice such Agreements are *not designed to forgo the rightful claim of the source State in the matter of taxation on the income of the non-residents*.

(iii) Such Agreements show a conscious attempt at working out the factors which are involved in the generation of *income*. How much importance is to be given to capital deployed in earning income, and how much importance should be given to the *matrix* and the locus where income is generated were taken into account. The calculus of this sort could not be mathematically precise. The art of working out the terms of agreements worked through a consensual process.

The salient features, which can constitute an indigenous Model, were analyzed by the Central Board of Direct Taxes in Circular No. 39 dated April 13, 1970 in the context of the Agreement between India and the Republic of France: to quote-[5]

> "The Agreement is based on the principles which have been adopted by India in the Agreements concluded by her so far with other West European countries. It provides, in substance, that the country in which the income from a particular

3. Muchkund Dubey, *An Unequal Treaty.*
4. Vol . II, pp-602-657.
5. Chaturvedi and Pithisaria's *Income-Tax Law* (4th ed. Vol 3) pp. 2813-2814.

> source arise will be primarily entitled to tax that income and if such income is also taxable in the home country under the operation of its laws, double taxation will be relieved by the home country. For this purpose either the income is exempted from tax in the home country of the recipient of the income or the tax charged on that income in the source country is given credit for against the home country's tax. In relieving double taxation by the latter method, the home country gives credit not only for the tax actually charged on such income in the source country but also the tax spared in that country under the special concessional provisions in her taxation laws for encouraging investment and promoting industrial development. In the Indo- French Agreement both these methods have been used."

This accords well with the lexical meaning of *avoidance of double taxation.* It is this meaning which the expressions in Section 90(1) of the Income-tax Act carry. But every attempt was made to obtain undue advantages and privileges. This was designed not only for obtaining extraordinary tax benefits, but also to provide the foreign investors a host of non-tax benefits, and the benefits of secrecy. The OECD [Organization for Economic Co-operation and Development] Model was obviously most suitable to promote these objectives. This Model promoted certain economic philosophy of the wealthy western countries striking balances in economic field for their political reasons. The League of Nations commissioned four experts on public finance to work out factors for determining source jurisdiction. The experts were Professors Bruins (Rotterdam), Einaudi (Turin), Seligman (New York) and Sir Josiah Stamp (London). Their *Report on Double Taxation* was submitted to the Financial Committee.[6] After examining several parameters they came to the conclusion that the fundamental choice was between *domicile* and *origin*. As many developing countries considered the OECD Model as unreasonably tilted in favour of the developed countries the Secretary General of United Nations set up an *ad hoc* group[7] of experts consisting of developed and developing countries. The Model Convention, which was drafted by this group, was published by the United Nations in 1980 accompanied with Commentaries.

If our executive thought it appropriate to depart from the meaning of the expression *avoidance of double taxation* the appropriate course would have been to get the law changed; or to adopt the practice of the Western countries wherein a tax treaty is legislated. But nothing of this sort was done. Nothing came to public domain which could explain this vital change. Our executive behaved almost the same way as it did when the Uruguay Round negotiations were going on. The author stresses this point as we live now in a world where most economic matters are managed through treaties: we cannot afford to be care free.

But after 1981 our Government was under constant pressure to depart from the meaning of *avoidance of double taxation*, and to fall in line with the views of

---

6. The Economic and Financial Commission of the League of Nations doc. E.F.S 73. F. 19.
7. They were from : the following countries, Argentina, Chile, France, German Democratic Republic, Ghana, India, Israel, Japan, Netherlands, Norway, Pakistan, Philippines, Sudan, Switzerland, Tunisia, Turkey, United Kingdom of Great Britain, United States of America, Sri Lanka and Brazil.

the foreign investors whose interests were protected by the OECD, and the U.S.A. Our Government fell in line. The paucity of foreign exchange was hoisted as one of the grounds for doing so. But much of the so-called crisis was stage-managed. There could have been some other ways to solve the problem. Our country could have lived with the crisis, as she has withstood many other crises before. Plea to tilt law for obtaining more and more foreign exchange was the delight of the most unscrupulous. This story is an old wives' tale. It was hoisted even in 1664 when Thomas Mun's had written his *England's Treasure of Foreign Trade or The Balance of our Foreign Trade is the Rule of our Treasure* was published. He was an employee of the East India Company, and his thesis promoted the ideas of this Company with which Clive forged the strategy of the Sponsored State. One can go through Charles Mackay's *Memoirs of Extraordinary Popular Delusions and Madness of Crowd* ( London, Richard Bentley, 1841.] to know more of it.

## 2. The Section 90(1) of the Income -tax Act

Section 90(1) of the Income-tax Act empowers (before insertion by the Finance Act 2003) the Central Government to *enter into* an agreement with the Government of any country outside India ---

(a) for the granting of relief in respect of income on which have been paid both income-tax under this Act and income-tax in that country, or

(b) for *the avoidance of double taxation of income* under this Act and under the corresponding law in force in that county, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

The Government entered into the Indo-Mauritius DTAC for reasons, which included, as its preamble says, "the encouragement of mutual trade and investment." In entering into the DTAC the Central Government exceeded its power. So the DTAC was *ultra vires*. When the author, in the proceeding of *Azadi Bachao* pleaded this point, the government, instead of reflecting over its remissness, substituted clause (a) for the existing clause (a) in sub-Section (1) of Section 90 by the Finance Act 2003 with effect from 1 April 2004. The substituted provision runs thus:

"(a) for the granting of relief in respect of---

(i) income on which have been paid both income-tax under this Act and income-tax in that country; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or…"

The insertion proves that in its absence the DTAC was, to the extent it contained stipulations to promote "the encouragement of mutual trade and investment.", without any authority of law. It was missed that by not granting it a retrospective effect, the fatal flaw of the Indo-Mauritius DTAC was not cured.

The circumstances in which the Finance Act 2003 made a substitution in Section 90(1) (a), with effect from 1 April 2004 have already been mentioned. After this change a tax treaty can be made even " to promote mutual economic relations, trade and investment, or…" Earlier, as the provision stood, it had not provided any aperture to the executive to enlarge its power beyond the frontiers of the concept of *avoidance of double taxation.* Now this substitution provides the executive an uncanalized and unguided power.. This substitution grants dangerously wide powers whose beneficiaries, in this *Pax Mercatus,* are corporate *imperium.*

It is worthwhile to examine the expression "to promote mutual economic relations, trade and investment" to see the sinister potentialities of the substituted provisions:

(i) The word mutual has been defined by the *New Shorter Oxford Dictionary* to mean "of a feeling, action, etc: experienced, expressed, or performed by each of the parties concerned towards or with regard to the other; reciprocal". The word 'economic' means, in its primary sense, "concerned with economics and with the organization of money, industry, and trade of a country, reign, or social group.'[8] 'Relations' means: " Relations are contacts between different people or groups of people and the way in which they behave towards each other, for example how they communicate or co-operate". 'Economic relations' meant one thing to the author of *The Economic Consequences of Peace,* J.M. Keynes, but entirely different to Thomas Balogh who in his *The Irrelevance of Conventional Economics* said: "The modern history of economic theory is a tale of evasions of reality." 'Economic relations' does not suggest the same to the champions of economic statism and to the proponents of economic liberalism. 'Economic relations' means something to Monnet but much different to Hayek. Even in our country there are many persons shaping our economic polices, who are either the Monnetists or the Hayekians. 'Economic relations' in the post-Bretton Woods have undergone a remarkable change, for good or bad we know not.

**8.** *Collins Cobuild English Language Dictionary.*

(ii) The words 'trade' and 'investment' have acquired tremendously wide meaning after the Uruguay Round Final Act. In TRIMs (Trade Related Investment Measures) they insisted on discussing the *trade effects* of investment measures. The widening dimensions of 'economic relations' revealed in macro economic policies in the present economic architecture are such that the word TRADE has acquired a protean malleability it never had.

(iii) Now we live in the world in which everything has been commodified. We speak of exporting *bodies* when we mean simply sending some human beings to render services outside for livelihood. Erich Fromm of the Columbia University in his *The Sane Society* says: "whereas in the nineteenth century God was dead, in the tw entieth century man is dead."[9] "Mass society, he wrote, turned men into a commodity; 'his value as a person lies in his saleability, not his human qualities of love, reason, or his artistic capacities Near the end of his book Fromm stressed the role of love, which he regarded as an 'art form', because he said, one of the casualties of super-capitalism, as he called it, was 'man's relation with his fellow men'."[10] The Harvard sociologist David Riesman in his *The Lonely Crowd* (1950) analyzed certain features of the emerging American society. He said that "the children in society became a marketing category; they are targeted by both manufacturers of children's products and the media that help sell these products." The transnational movements of individuals are, in effect, the movement of human commodity. Transactions in human beings have acquired a new respectability. A few decades back none would have treated such issues as trade\related issues, now who can doubt that in this global Market ever ything has become, or is becoming fast, a *res commercium*. 'Investment' in the framework of the Trade Related Investment Measures (TRIMS) has no limit ations.

(iv) Everything related to the growing trajectory of 'economic relations' comes within this expression. These words used in Section 90(1) (a) bring to our mind what *C.S Calverley* said, "*And as to the meaning, it's what you please'.* And W.S. Gilbert rightly said: "*The meaning doesn't matter if it's only a chatter of a transcendental kind."*

(v) Words like "to promote mutual economic relations, trade and investment" had before this phase of globalization some settled meaning. Within the widening gyre of economic forces and closer interactions brought about by the modern technology, these words have become imprecise. Besides, we are now living in the World wherein the economic realm is dominating on the political realm.

(vi) The term "international trade is defined by the Encyclopaedia Britannica to *include"* all economic transactions that are made between countries".

---

9. *The Sane Society* p. 122.
10. Peter Watson, *A Terrible Beauty* p.437.

The expression "economic relations ' too cannot be *exhaustively* defined leaving a large scope for undefined power. In Linguistics we have recognized two very common phenomena pertaining to semantic change: (I) semantic narrowing, and (ii) semantic widening. But the words by which delegated power to enter into an Agreement is granted under Section 90(1)(a) of the Income-tax Act, 1961, belong to a category which is different from both the categories mentioned: they are amorphous words with unsettled meaning.

(vii) The policy of the Income-tax Act is to explain with precision the meaning of words used in the statute so that the imposition of tax or exoneration from its charge should be in clear terms. This is the reason why non-legal terms are defined. This is done to preclude any arbitrary perception on the part of the taxpayers or tax-gatherers. To illustrate: the term "infrastructure facility" is used in Section 80-1A of the Income-tax Act. This is a general term with a settled meaning: it means "the basic structural foundations of an enterprise". Yet Section 80-1A of the Act defines it in the Explanation to Section 80-1A(4). Section 90(1) grants certain powers to the Central Government. If the power is given in words, the sweep of whose meaning endows the executive a limitless power that is not clear, then the amplitude of the grant of such a power would be unreasonable and arbitrary.

The Finance Act 2003 brought about one more change. It inserted sub-Section (3) in Section 90 with effect from 1 April 2004: to quote--

> "Any term used but not defined in this Act or in the agreement referred in sub-section 90 (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette."

The only restriction on the power of the Central Government is that it cannot stuff the terms with what is not agreeable to "the provisions of this Act or agreement". But the Central Government may empty the terms of meaning, and introduce a new one of its choice. To illustrate: the terms "*promote*" "*mutual*" "*economic*" "*relations*" "*trade*" *and* "*investment*" are not defined in this Act or in the Agreement. These words can be drained of their content as they can be made to mean anything. The substitution and insertion by the Finance Act 2003 in Section 90(1) of the Income-tax Act provide the executive a vagrant and unanalyzed power providing a vast scope for misuse. The frontierless, power brings to mind these lines of Keats:

*The same that oft-times hath*
*Charmed magic casements, opening on the foam*
*Of perilous sea, in faery lands forlorn.*

## 3. Meaning of Avoidance of Double Taxation of Income

The power conferred under section 90 (1) is a *delegated power*, which can be exercised within the frontiers prescribed under the law. It is to be exercised for promoting the purpose for which the power is delegated.. The exercise of *discretion* falls in the "condition precedent" category. The prime condition is under section 90 (1) (b) that the agreement into which the Central Government enters with the Government of any other county outside India is "*for the avoidance of double taxation of income under this Act* and under the corresponding law in force in that country." The concept of Double Taxation has been thus explained in *Black's Law Dictionary:*

> "The imposition of comparable taxes in two or more States on the same tax payer, for the same subject-matter or identical goods."

*Stroud's Judicial Dictionary* explains this concepts in the following words:

> "Whatever the precise scope of the rule against double taxation is, it must at least involve that it is the same income, that it is the same person in respect of the same piece of income that is being double taxed, whether directly or indirectly, and that the double taxation is by British assessment".

On a close analysis of the definition given in this technical dictionary following ingredients are noticed:

(i) The imposition must be of *comparable taxes*;

(ii) The incidence of tax should be on the *same tax- payer*;

(iii) The *subject matter* (or the taxable event) should be the same subject matter.

If any of the above three ingredients is missing or is unreasonably distorted there is no case of Double Taxation. Where there is no case of Double Taxation, there is obviously no question of Avoidance of Double Taxation. Without there being a *de facto* liability for Double Taxation, the power conferred under section 90 of the Income-tax Act cannot be exercised. In fact, there must be "if-then" (*protasis-apodosis*) relationship involved in a given situation. The concept of the *Avoidance of Double Taxation,* illustrated in through several early Agreements, bears the following features:

(i) the Agreements are not the vehicles for granting *exemption from taxation;*

(ii) the Agreements are to be founded on the view of law illustrative of the provisions of sections 4 and 5 of the Income-tax Act;

(ii) the benefits and burdens of taxation are equitably calibrated on the calculus of the reasonable operations of factors, including of labour and capital;

(iv) the terms of the Agreements are so (debtor) devised as to be reasonable both to *the source State* and *the State of residence*; and

The Agreements have a pronounced tilt towards the *source State*.

## 4. The Travesty of the Personal Scope

The DTAC is a bilateral contract between India and Mauritius. The bilateral character is further emphasized by reference to the concept of 'mutuality' in the preamble to the DTAC. George Schwarzenberger [11] says: "Treaties confer no legal rights and impose no legal duties on non-parties". This general principle, which is expressed in the Latin maxim *pacta tertiis nec nocent nec prosunt*, finds support in the practice of states, in the decisions of international tribunals, and now in the provisions of the Vienna Convention under Articles 34-38" [12]. There was absolutely nothing in the prepatory material of the DTAC or in it to suggest that the DTAC was meant to be used by the third-States nationals. Yet the DTAC was allowed to be availed of by the third country residents who, in breach of law, morality and propriety, masqueraded as the Mauritian residents hoisting a mysterious parchment called "Certificate of Residence" issued by the Mauritian tax authorities. It was a nauseating feat of fraud and collusion to which our Government was a party as it never did anything to prevent it: it rather patronized it!

## 5. *Treaty* shopping: the *causa proxima*

In course of investigation the Assessing Officers under the Income-tax Act found that a good number of the residents of the third States attempted to avail of the bilateral tax treaty between India and Mauritius (the Contracting States). At one go 24 Assessment Orders were passed towards the end of March 2000 holding that the Indo-Mauritius Double Taxation Avoidance Convention was abused. The tax authorities found that the third country residents set up conduit companies in Mauritius. These companies were incorporated under the Mauritian Companies Act. They obtained Certificate of Incorporation. They were even granted Certificates of Residence for the purposes of obtaining benefits under the Indo-Mauritius DTAC. They had no economic presence or impact in Mauritius. Their control and management were in countries other than Mauritius. Their theatre of operation was in India, mainly in the Indian Stock Market to earn capital gains neither taxable in India nor in Mauritius. Besides, the tax treaty had some other beneficial provisions. The Assessing Officers lifted the corporate veil of these companies to see the operative realities in order to determine liability under the Income-tax Act. They held that for the tax purposes these companies incorporated in Mauritius were to be ignored for the purpose of the tax treaty:

11. A Manual of International Law 5th ed. p.160.
12. J G Starke in his Introduction to International Law ( p. 44).

and they held further that they were chargeable to tax as non-residents *simpliciter*. Pressure was built on the Central Government by the vested interests and their lobbyists. The Central Board of Direct Taxes issued a circular directing the tax authorities to abandon what they were doing in the matter of investigation of such cases. They were directed to accept the Certificates of Residence granted by the Mauritian authorities as conclusive evidence not only for the determination of the status as residents in Mauritius but also for determination of the beneficial ownership of income earned.

## 6. Misuse of the DTAC by the Indian residents

So great was the grip of the Indian round-trippers that our Government did nothing to prevent even the real Indian residents operating through Mauritius only to gain unjust advantages under the law. To allow them to take advantage of the DTAC was a clear wrong, yet through a long-drawn governmental silence the evil was allowed to flourish. When in course of hearing before the Supreme Court it became clear that this practice was in a clear breach of the Art 4 of the DTAC, the CBDT issued a Circular on 10.2.2003 to escape a discomfiture in the Court. It referred to Circular No. 789, which had led to the filing of the PIL before the Delhi High Court, where it was clarified that "wherever the certificate of residence is issued by the Mauritian authorities, such a certificate will constitute sufficient evidence for accepting the status of residence, as well as beneficial ownership for applying DTAC accordingly." By this new Circular it was "clarified that where an assessee is a resident of both the Contracting Countries, in accordance with paragraph 1 of article 4 of the Indo-Mauritius DTAC, then," he "shall be deemed to be a resident of the Contracting State in which the place of effective management is situated."

Even before this issue was raised in course of argument before the Supreme Court the J.P.C. had adversely commented on the misuse vide CAG's comments quoted in the chapter on "The CAG on Treaty Shopping".

## 7. The Phantoms of Delight

Art 2(3) of the DTAC says:

> "The competent authorities of the Contracting States shall notify to each other any significant changes which are made within their respective taxation laws".

Mauritius became a tax haven by way of design. She could have evolved economically even without turning into a tax haven. But in the early Nineties it browsed the international scenario to find that a new chapter had began in global economic management. India had opened up its economy: and was eager to welcome foreign investments. Mauritius knew that her native resources were not sufficient to invest in India either as foreign direct investment or as portfolio investment. But it could become a good route for making investment by the residents of other countries. There are good reasons to believe that the persons who matter in government knew this: in fact, they assiduously promoted this more often by silence. Mauritius had sufficient experience of offshore banking. While her main object was to gain some financial advantages by becoming a secretive intermediary between India and the resident of other countries, it must have felt the possibilities of its offshore financial-services as Mauritius had developed wide international contacts, specially in Africa, through its trade and commerce. In 1992 Mauritius underwent great change to become tax haven. Two very significant developments in 1992 coincided, and fortunately served to make Mauritius a Tax Haven Country:—

1. The Mauritius Offshore Business Activities Act (MOBAA) came into existence in 1992 and

2. Relaxation of regulation and controls by the Indian Government on direct foreign investment into India took place in 1992, notably, on 15th September 1992; guidelines for direct investment by foreign institutional investors (FIIs) were announced.

The NRIs and the FIIs and their advisors quickly spotted the bonanza of avoiding Capital Gains Taxes (short term as well as long term) in India by making use of the Article on Capital Gains in the Double Tax Avoidance Agreement between India and Mauritius. While offshore companies are exempt from taxation in Mauritius they can at their *option*, pay a tax of between 0% and 35% As the provisions do not subject such companies to mandatory obligation, they do not subject them to liability to tax. Mauritius enacted the International Companies Act, 1994. Offshore Corporate laws were embodied in MOBAA 1992 which deals with the incorporation and regulation of Ordinary Companies and in the International Companies Act 1994 which deals with the incorporation and regulation of International Companies (ICs). An ordinary company that satisfies the requirements of the Mauritius Offshore Business Activities Act 1992 may be incorporated under the Companies Act 1984 and is registered as an offshore ordinary company. With the coming into effect of ICA 1994, existing companies holding investments in India and located in other offshore jurisdictions are able to migrate to Mauritius as " an IC" and, thereafter, convert themselves into Ordinary Companies without having any capital gains tax or stamp duty implications in India. An IC is exempted form the provisions of Income-Tax and will not be treated as a resident in Mauritius for the purposes of any tax treaty entered into by the Government of Mauritius. Only companies incorporated under the Companies Act 1984 and residents in Mauritius may access the benefits of the double tax treaties that Mauritius has entered into with various countries. The Companies Act 1984 governs the incorporation and administration of all companies formed in Mauritius other than international companies. These offshore entities in Mauritius enjoy various incentives which included tax exemption, free repatriations of profits without being vexed exchange control provisions, no withholding tax on dividends, interests, royalty and other payments made by an offshore ordinary company to the non-resident of Mauritius, and no tax on capital gains.

Mauritius developed all the features of a tax-haven which the OECD describe as these:

(a) no or nominal effective tax rates;

(b) lack of effective exchange of information;

(c) lack of transparency;

(d) absence of a requirement of substantial activities.

It is not known if the competent authorities discharged their duties in informing the Central Government to take remedial actions. Our diplomatic mission failed in discharge of its duties to inform the government it represented. And the Central Government remained indifferent to all that was happening as if such things did not matter, or it willingly allowed such things to happen.

The pre-1 July 1998 offshore ordinary companies are taxed at a zero tax rate on profits arising from offshore business activities but may elect to be taxed at any rate between zero and 35% and post 1 July 1998 offshore ordinary companies are taxed at a flat rate of 15% like any domestic incentive company but they are allowed generous foreign tax credits, including a deemed tax credit, that reduce the Mauritius tax liability to a maximum effective rate of 1.5%. The effect of para 4 of Article 13 of the Indo-Mauritius Double Taxation Avoidance Convention is to exempt from taxation the income from transactions in shares made by the residents of Mauritius. Under the present situation the NRIs and FIIs are taking full advantage of Zero tax on Capital Gains as no tax is chargeable in India and there is no tax on Capital Gains in Mauritius whose residents they pretend to be. This sort of situation is not conceivable under our Constitution and under the Income-tax Act. Article 265 of the Constitution says: "No tax shall be levied or collected except by authority of law". It is well established that the power to *exempt* from tax is a legislative power (AIR1964 Rajasthan 205 at 213). Wherever the Income-tax Act grants exemptions it does specifically, *viz*. Sections 10, 293A, 294A.

Our Competent Authorities have no competence to conduct investigations to determine proper tax liability; nor can they do that in foreign jurisdictions. The terms of our tax treaties do not permit any extra-territorial investigation as are permitted under Art. 6 of the Agreement between the Government of the U.S. and the Government of the United Kingdom of Great Britain and Northern Ireland, including the Government of the Cayman Islands for the Exchange of information Relating to Taxes. It says:

> "The requested party may, to the extent permitted under its domestic laws, allow representatives of the competent authority of the requesting party to enter the territory of the requested party in connection with a request to interview persons and examine records with the prior written consent of the persons concerned."

## 8. Recovery of taxes

Section 90(1)(d) contemplates that the DTAC could provide for the recovery of taxes. In the DTAC with Mauritius nothing was stipulated as to the recovery of tax. It is true that the recovery provisions are missing in many other treaties too. This omission is sinister for the following two reasons:

(a) There is a decision of the House of Lords in *Government of India v. Taylor*, (27 ITR 356) establishing, *inter alia* the following two propositions (a) in no circumstances will the Courts of a country directly or indirectly enforce the revenue laws of another country and therefore no State can sue in a foreign country for taxes due under the law of that State; (b) a claim for foreign taxes is not a liability which the liquidators of a company in liquidation are bound to discharge. Nobody questioned this impropriety on the part of the Central Government. Now it is good that the CAG has raised this issue in its Report 13 of 2005.

(b) It seems that the non-incorporation of tax provisions in tax treaties is a deliberate affair. The treaty shoppers and the money launderers are assured that they cannot be followed up. How can we recover taxes in Mauritius when the treaty shoppers have only a paper existence there? Even Mauritius cannot proceed against them, as its jurisdiction on the treaty shoppers does not run beyond a piece of paper.

## 9. Mutual Agreement Procedure (MAP)

Article 25 of the DTAC provides that where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident. While the PIL was being argued before the Supreme Court, the CBDT issued an Instruction No. 12/ 2002, and framed Rule to prescribe the procedure for resorting to MAP. In their understandable hurry, the government did not realize that the MAP procedure must have a statutory foundation. In the U.K. the newly introduced Section 815AA of the British Income-tax Act recognizes only by an act of legislation. As Furies drove relentlessly the tragic heroes in the Greek tragedies to their horrendous destiny, some forces were surely driving things fast in our Government.

The MAP procedure, established under the executive fiat without any statutory foundation, is illegal as it subverts the scheme of assessment and appellate control prescribed under the Income-tax Act, 1961. It makes a trespass on the legislative domain by prescribing certain limitation provisions *de hors* those in the Act. It goes to create an opaque system in a manner worse than what was done by the CBDT through it Circular No. 789 dated April 13, 2000. These instructions and the rules promote an opaque system destructive of the Rule of Law, besides promoting the possibilities of corruption and arbitrariness. Using the famous words of Lord Russell of Killowen CJ, it can be said:

> '*Parliament never intended to give authority to make such rules; they are unreasonable and ultra vires*'.[13]

The author has reason to believe that this impugned Instruction and the impugned rules were framed under the U.S. pressure to promote the interest of the *corporate imperium*. They substantially reflect the OECD approach. The Instruction bears the express impact of Article 27 of the Indo-U.S. Convention for Avoidance of Double Taxation. They substantially reflect Instruction of the "Treasury Department Technical Explanation of the United States Model Income-Tax Convention of September 20, 1996".

---

**13.** *Kruse v. Johnson* [1988] 2 QB 91 at 100.