(vii) Switzerland :

Income-tax in Switzerland is not charged on income derived by an individual from a personal business abroad or on profits derived by a company from a permanent establishment abroad. The exempt income is, however, included in total income for the purpose of determining the rate of tax payable on other income. Dividends from foreign subsidiary companies are liable to tax. Persons resident in Switzerland are liable to income-tax on other income from abroad except income from real property. *Relief from double taxation is granted by allowing foreign tax as a deduction from the income.*

(viii) France :

In France income-tax is not charged on profits made by foreign branches of French undertakings, whether the profits are remitted to France or not, or on dividends received by companies from foreign subsidiaries. The proportional tax is, however, charged on dividends paid by French companies even if those dividends are paid out of profits earned abroad. But relief from proportional tax on such dividends is granted where the company carries on business on overseas territories forming part of the French Union : (1) If no tax on distribution of profits is levied in the overseas territory in question and more than 50 percent of the company's profits originates there, the rate of proportional tax is halved. (2) If a tax on distribution of profits is levied in the overseas territory, double taxation is to be avoided by agreement between the two taxation authorities, who are to apportion the tax between them. *Double taxation relief is provided by allowing foreign tax as a deduction from the income.*

(ix) Belgium :

Persons resident in Belgium are liable to income-tax on income arising abroad, *but at less than the ordinary rates.* The income-tax on business profits is charged on profits from

abroad at only one-fifth of the ordinary rate, provided the profits are taxed abroad. The income-tax on investment income is charged on income from abroad at the reduced rate of 12 per cent. The ordinary rate is 30 per cent on dividends and 18 per cent on interest. But upon personal income the complementary personal tax (comparable to personal super-tax) *is charged on foreign income at the full rate.*

(x) United States :

United States citizens (whether resident in the United States of America or not), resident aliens and United States corporations, are in general liable to income-tax on all income from abroad. Exemption applies to (1) income earned abroad by individuals who are bona fide foreign residents or to income upto $ 20,000 earned abroad by individuals who are abroad for 17 out of 18 months; (2) The tax rate on Western Hemisphere Trade Corporations is 14 points lower than the normal rate. The tax credit for foreign income taxes allowed under domestic legislation since 1918, has been extended by successive enactments. Since 1951, a United States corporation *may claim credit for foreign taxes paid not only by itself and its foreign subsidiaries but also by a foreign corporation in which it holds a participation of at least 10 per cent* and by subsidiaries of such foreign corporations in which the latter holds at least 50 per cent control.[12] The Internal Revenue Code of 1954 has further increased the maximum amount of foreign tax which can be credited against the United States tax. According to this provision the taxes paid on the profits in one foreign company can now be *credited against the full amount of United States tax allowable to such profits.*[13]

(b) Member Countries :

(i) India :

India provides unilateral relief in respect of income accru-

12 Section 902, *United States Internal Revenue Code.*

13 Section 904 (9) *United States Internal Revenue Code.*

ing or arising outside the taxable territories.[14] Thus a resident of India who has income accruing or arising in any other country, on which he has paid that country's as well as Indian income-tax is entitled to unilateral relief at the rate of the lower of the two taxes, provided that the income is not deemed to accrue or arise in India under the special provisions of the Indian Act. The effect of this provision is that relief is now available on all foreign income, except such portion of this income as (i) is deemed to accrue in India and (ii) remittances out of such income earned in prior years where such income has not been taxed in those years on the accrual basis. Double taxation relief is provided by *deducting foreign tax otherwise payable on the income. The credit is limited to the tax payer's average rate of Indian tax.*

(ii) Pakistan :

Simliar relief is available in Pakistan under the Pakistan Income-Tax Act, 1922, according to which if a person proves that he has paid income-tax on the same income in Pakistan as well as in a foreign country with which there is no agreement for the avoidance of double taxation, he is entitled to relief of the tax equal to one-half of the amount of the tax paid by him in Pakistan on the doubly taxed income or one-half of the tax payable in the other country, whichever is less. Like India which adopted[15] broad measure of unilateral relief from double taxation, Pakistan also adopted similar measure under Finance Act, 1954.[16] *Foreign tax, under the laws of Pakistan, is deductible from Pakistan tax otherwise payable on the income. The "Credit" is limited to the tax-payer's average rate of Pakistan tax.*

(iii) Japan :

Under the Income-Tax law of Japan, if a resident pays

14 Section 49 D of *Indian Income—Tax Act*, 1922 (XI of 1922)

15 Income-Tax Amendment Act of 1935, Section 24.

16 Finance Act No. 1 of 1954, Section 11, Sub-sec. 4. The Minister of Finance, in his budget speech described this expanded relief as an inducement to Pakistan firms, especially in the banking and insurance fields to open foreign branches.

tax identical to the income-tax on the income derived from sources within another country, the amount of tax imposed by the law of such other country is credited against the income-tax computed under the Japanese law. The amount of credit is referred to as "*the amount of credit for foreign tax.*"[17].

(iv) Ceylon :

"Under the present law Ceylon taxes (a) all income arising in Ceylon irrespective of the country where the owner resides; and (b) all income arising to a resident of Ceylon whether from Ceylon or abroad."[18] *Ceylon taxes foreign income (after deduction of the foreign tax) like any other income except in the case of income arising in the Commonwealth countries.* In the case of Commonwealth countries (except India and United Kingdom with whom Ceylon has double taxation agreements) Ceylon *reduces its tax on income charged both in Ceylon and another Commonwealth country on reciprocal basis.*[19]

(v) Iraq :

Under the Income-Tax Law of Iraq, tax is charged (i) "on the income of the resident secured within or outside Iraq without consideration to the *place of its receipt;* (2) On the income of the non-resident *accruing* in Iraq even if *he does not receive* it within Iraq."[20] The Iraq law makes a distinction between income earned by a non-resident by *trading in Iraq and* by trading *with Iraq.* Iraqi tax is chargeable in the former case and not in the latter. However, under certain circumstances, a non-resident is liable to Iraqi tax through a resident in respect of income derived through him from sources within Iraq.[21] *Foreign tax under Iraqi Income-Tax Law is allowed as a deduction from income.*

17 Article 15 (8)—Income-Tax Law of Japan.

18 Taxation Commission Report, 1955.

19 *Ibid.*

20 Art. 5 (1) and (2) Law No. 95 of 1959 on Income-Tax.

21 Art. 21, *Ibid.*

No tax is charged on income produced outside of Iraq from (i) "non-Iraqi pensioner resident outside Iraq in relation to pension, salaries due to him for services rendered in Iraq" and (ii) "non-Iraqi resident whatever his period of residence in Iraq, may be if he was employed by a juristic person in Iraq or was a specialist and employed in an industrial project which enjoys the rights of exemption in accordance with the encouragement of Industrial Projects Law."[22]

(vi) **U. A. R., Burma and Indonesia :**

Under the tax laws of U. A. R., Burma and Indonesia, foreign taxes are allowed as a deduction from income. In the case of Indonesia, however, companies are exempt from tax on income from a business enterprise or real property abroad.[23]

EFFECTIVENESS OF UNILATERAL RELIEF

The provision of unilateral relief in the domestic tax laws of important capital-exporting countries like U. S. A. and U. K. gives effective relief from international double taxation arising out of international investments. In fact the existence of unilateral tax credit legislation in the major capital exporting countries of the world appears to be one of the reasons for the underdeveloped countries "remaining outside the network of international tax agreements."[24] But inspite of all that, unilateral relief could not afford complete relief from double taxation because beingu nilateral in character it could deal with the problem of pouble taxation only in a general fashion. The unilateral legislation could not also provide for the "broad variations in legal concepts of many countries (such as "residence, domicile", "Source of income") and pefinitions of taxes which are to be considered analogous and, therefore,

22 Art. 1 (13-d and e) and Art. 5 (4). *Ibid.*

23 Report of the Commission on Taxation of International Chamber of Commerce. (See Appendix V)

24 United Nations., *International Tax Agreements*—Vol. II (New York; 1951)

credited against each other."[25] Thus, for instance, the tax credit systems of the United Kingdom and the United States of America give credit for overseas taxes against home income-tax liability only when the laws and policies of the home country, as to the source of income, indicated that the income in question arises in the overseas country whose income-tax has been paid. The United Kingdom will not allow credit, say for Indian income-tax against company income which the United Kingdom considers to arise in the United Kingdom and which India considers as "deems to arise in India," Similarly, the U. S. A. will not allow credit for Indian income-tax against company income of a U. S. company which India considers to be subject to its taxes but which the U. S. A., under its own rules, considers to arise, for example, in Ceylon.

In view of the limited applicability of unilateral legislation "there is an obvious logic of solving the fundamentally reciprocal problem of double taxation through bilateral treaties."[26] The Economic and Social Council of the United Nations also called on Member Governments in its resolution to conclude bilateral agreements which were specially suited, "for assuring concrete co-ordination among the diverse national tax systems expressed in the complex and detailed tax legislation and regulations of the various countries of the world."[27] As the revenue needs of underdeveloped countries increase, broad new tax measures are likely to be adopted in such countries. "The unilateral tax relief, limited to a narrowly defined income-tax, may well fail of its purpose."[28]

(2) **International Agreements :**

PRINCIPLES OF ALLOCATION OF TAX JURISDICTION

(a) **General Practice :**

The bilateral agreements concluded by various countries

25 United Nations. International Tax Agreements, Vol II (New York : 1951).

26 *Ibid.*

27 Resolution 226 D (IX) of 22 July 1949, sponsored by the Fiscal Commission.

28 United Nations. International Tax Agreements, Vol. II (New York 1951)

of the world do not use any uniform method of giving relief from double taxation. Some agreements follow the principle of exclusive allocation of taxing power to one of the contracting States on the basis of source, residence etc.; some use a combination of different methods, viz. exemption, reduction and tax credit, and some provide for the specific allocation of sources of income between the two countries, each country taxing the income arising from the sources allocated to it, either wholly or partly.

(b) Countries of Continent of Europe :

In their tax agreements with respect to income and property taxes, the countries of the Continent of Europe use the system of allocation under which the exclusive taxing power over each type of asset and income is allocated to one of the contracting States in conformity with certain tax criteria such as residence, domicile, source or situs based on the notion of economic allegiance.

Thus as a rule, commercial and industrial enterprises and income derived from them are taxable where such business is carried on (usually only if carried on through permanent establishment),[29] income from sea and air navigation at the seat of the enterprise (often only if the ships or airliners are registered in the same country)[30] income from movable property and the income therefrom in the country where the property is located, earned income (often income from profession) where the income carrying activity is exercised. As indicated, the rule of exclusive allocation of taxing power does not apply in the case of taxation of income from movable capital. Here the country of origin frequently retains the right to tax the income in accordance with its legislation concurrently with the country

29 Sweden-Switzerland, 16, 10. 1948 Articles 3 &4(1); France-Netherlands, 30, 12, 1949, Article IV (1).

30 Sweden-Switzerland. 16. 10. 1948. Article 4(5); Denmark-Norway, 22-11-1957 Article 8 (1).

of source.[31] In several agreements, this double taxation is mitigated either by a limitation on the rate of the tax that may be levied at source, or by a flat rate reduction of the tax levied by the country of domicile,[32] or by the allowance of a deduction by the same country of taxes paid abroad.[33] On the basis of the same principle of economic allegiance, general power to levy personal income-tax is usually reserved to the tax-payer's country of residence. All categories of income and property, not specifically allocated in such agreements to either of the countries, are assigned by a residuary clause to the tax-payer's home country.[34]

In addition, the general clause in many of these agreements provides that the country of residence may include in its personal income and property tax base even those items which are reserved to the taxing power of the other country, for the sole purpose, however, of applying to the items under its own tax jurisdiction the higher tax rate which would be appropriate to the tax-payer's total income (and property) both foreign and domestic.[35] This provision serves to give effect to progressive tax rates in the case of tax-payers whose assets and income are distributed among several countries. A typical clause of this type is that contained in Article 9 of the Agreement between Norway and Sweden of 21 June 1947 :

> "The State in which the tax-payer is deemed to be domiciled is entitled, when assessing the tax, to apply the scale of taxation that would have been applicable if the income and capital which, under this convention, are tax-

31 France-Netherlands, 30. 12. 1949. Articles VIII and IX.

32 Canada-Netherlands, 2. 4. 1957. Articles VII to IX.

33 Sweden-Switzerland, 16. 10. 1948, Article 9 (by way of reimbursement)

34 Sweden-Switzerland, 16. 10 1948, Article 2 (1); Finland-Sweden, 21. 12. 1949 Article 3 (1).

35 Canada-Netherlands. 12. 4. 1957, Art. XVIII.

able only in the other State, had also been taxable in the former State."[36]

Many of these agreements contain provisions for the prevention of fiscal evasion under which the contracting governments lend each other administrative assistance in the assessment of taxes through the exchange of information and (with the exception chiefly of the United Kingdom agreements) in the collection of taxes through aid in the enforcement of tax claims.[37]

The primacy of the country of the tax-payer's domicile, however, has not found universal acceptance.[38] Capital importing countries, especially in Latin America, have shown a preference for giving primary taxing power to the country of the source of the income. Their position was incorporated in Article IX of the 1943 Mexico draft of the League of Nations Model Tax Conventions which provides for taxation of dividends in the country where the income producing capital is invested.[39] In pursuance of this principle most countries of Latin America tax most types of income of their residents only to the extent to which it arises from sources within the country.[40]

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36 See also Hungary-Sweden Art. 13, France-Sweden Art. 13, Denmark-Germany, Art. 15, Denmark-Iceland, Art. 4, DenMark-Norway, Art. 8, Norway-Sweden, Art. 9, France-Sevre, Art. 37, "United Nations 1948 XVI. 2. The volume contains a cumulative index including all agreements published in the League of Nations Collection of International Agreements (6 vols.)

37 New Zealand-Sweden, 16.4.1956 Article XX. Canada-Netherlands, 12.4.1957, Article XIX.

38 Ke-Chin Wang: "International Double Taxation of Income: Relief through International Agreements 1921-44." in *Harvard Law Review*, Vol. 59, 1945, pp. 73.

39 Art. VIII of the London Model provides for taxation in the country where the distributing corporation has its seat, i.e., frequently the capital exporting country. See London and Mexico Model Tax Conventions. League of Nations publication No. C.88. M.88. 1946. II. A ; November 1948.

40 See, *e.g.*, Ecuador, United Nations, doc. E/CN. 8/46/Add.1, p. 6, Argentina, Art. 1 of the Income Tax Law No. 11, 682 of Dec. 1946, Venezuela, Art. 1 of the Law on Income Tax of 1 November 1949.

It may, however, be stated that despite its apparent clarity and simplicity the "allocation system" allowed by the countries of Continent of Europe creates many complex questions of application. One of the most difficult problems relates to the taxation of income from business activities carried on in more than one country.[41] The principle of taxation of business income at the place where it is carried on, requires a splitting up of the international operations of one enterprise in accordance with criteria designed to allocate to each country that portion of the total profits which can be related more particularly to the operations of the enterprise in that country.

Most tax agreements use the concept of the "permanent establishment", under which an enterprise will be taxable in a country other than that of its domicile only if its operations in the former were carried on through a permanent establishment located therein. Where the operation of an enterprise in a country other than that of its domicile takes the form of merely *isolated or occasional transactions*, profits derived therefrom are allocated to the country of domicile and taxable by it alone.[42] Considered as permanent establishments are "head offices, branches, mines and oilwells, plantations, professional premises and other fixed places of business having a productive character.[43]

The allocation system is appropriate chiefly among countries which find themselves at an approximately equal level of economic development, and are principally engaged in exchanges of trade. Under such conditions each contracting country is likely to give up substantially the same amount of

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41 This has been the subject of a valuable study by the League of Nations under the direction of Mitchell B. Carroll, entitled Taxation of Foreign and National Enterprises (5 vols), League of Nations publication 1932. II. A. 3, 1933, II. A. 18-21.

42 Article IX, London and Mexico Model Tax Conventions for the prevention of the Double Taxtion of Income, doc. cit. (note b).

43 *Ibid.*, Article V., Protocol.

tax revenue which its citizens gain through the corresponding relinquishment of taxing authority on the part of the other country.

(c) The Anglo-American Agreements :

The Anglo-American agreements use different methods for the control of international double taxation. Instead of the allocation of tax jurisdiction among the co-contracting governments (like the other countries of Continent of Europe), the Anglo-American agreements use a combination of various tax relief methods, especially tax credit, reduction and exemption. The pivotal tax credit clause itself is firmly anchored in the unilateral relief legislation of these countries. Under it the the country of residence (and, in the case of the United, States country of nationality) retains paramount taxing power over all the tax-payer's income, foreign or domestic, subject, however, to the tax-payer's right to take credits against his home country's tax on account of taxes paid abroad on his foreign income. With this important relief reserved to the tax-payer, all other provisions in the agreement are rather complementary. Since they mostly limit the taxing power of the country of source, they bring relief less to the tax-payer than to the treasury of his home country by reducing the credit it has to give ; the tax-payer benefits chiefly when the foreign tax exceeds the maximum credit allowable under the legislation of his home country.

This system serves especially well for capital exporting countries which want to eliminate tax deterrents to the foreign investment and trading activities of their residents and citizens yet, expecting no important *quid pro quo* from capital importing co-contracting governments, keeping to reserve full power to tax their residents or citizens.

The Anglo-American agreements some times provide for a *reduction* in the tax imposed by the country of source on such

typical foreign income items as *dividends* and *royalties*.[44] Thus, for instance, under Article XI of the Agreement between Canada and the United States of 4 March 1942, the maximum rate of withholding tax for income of non-residents is 15 per cent. Article VII of the Agreement between Sweden and the United States of 23 March 1939, fixed the maximum tax rate for dividends of non-residents at 10 per cent. In Article VI of the Agreement between the United Kingdom and the United States of 16 April 1945, the maximum rate for the United States tax is in principle fixed at 15 per cent, while the United State dividends are exempt from the surtax. Under article IX of this Agreement, the same limitation applies to royalties from mines and natural resources and to rentals from real property. The advantage of this device over the simple credit method is threefold : it limits the tax loss of the crediting country, thereby permitting a more supple division of tax revenue between the contracting governments ; it enables the country of source to preserve its withholding tax system in effect even as to non-residents, without thereby completely swallowing up the crediting country's tax base ; and it may facilitate the detection of tax evasion, so widespread in the field of foreign security income, by keeping the income under the active and interested control of both tax administrations.[45]

Special types of income such as that derived from shipping and transport are often exempt altogether from taxation in the country of source.[46]

44 United Kingdom-Canada, 5, VI. 1946 Article VI., United States-United Kingdom, 16. IV. 1945, Arts. VI & IX.

45 This device is fundamentally different from the unilateral practice on the part of certain countries of taxing dividends remitted abroad at a lower rate than those received by resident stockholders (See e.g. for Ecuador: United Nations doc. E/CN. 8/16/Add. 1, pp. 7-8). In these cases, the reduction is intended not as a relief to the tax authority in the other country, but as an incentive to the foreign investor who may or may not benefit from credit legislation at home.

46 United Kingdom-Canada, Art. V.

AGREEMENTS CONCLUDED BY MEMBER COUNTRIES

(i) Between Member Countries :

A simplified pattern of allocation is followed in the agreements concluded between India-Pakistan and India-Ceylon under which some kinds of income (personal income, income from securities, income from movable and immovable property etc.) are exclusively taxable in one of the contracting countries on the basis (source, situs, accrual) laid down in the Schedule to these agreements. Other kinds of income which by their very nature fall under the tax jurisdictions of both the contracting countries (goods manufactured in one country and sold in the other) are partly taxable by one country and partly by the other according to an agreed proportion. Any income derived from a source or transaction not mentioned in the agreements is taxable only by the country in which the income actually accrues or arises.[47]

In case any country charges more than what is specified in the schedule to these agreements, that country allows "an abatement equal to the lower of this amount of tax attributable to such excess in either country."[48] The agreements also provide relief from double taxation in respect of income "accruing or arising" elsewhere and chargeable to tax in both the countries. In such cases each country allows an "abatement equal to one half of the lower amount of tax attributable in either country to such doubly taxed income."[49]

The agreements concluded between India-Japan and Japan-Pakistan use a combination of various methods, viz. exemption, reduction and tax credit, for the purpose of providing relief from double taxation. Thus income, such as salaries, wages and pensions paid by one of the contracting States to its

47 See Schedule to the Agreements between India-Pakistan and India-Ceylon.

48 India-Ceylon, Article III; India-Pakistan, Article IV.

49 *Ibid.*, Articles IV and V.

national is exempt from tax of the other State (if the individual has not been admitted to the other State for permanent residence). Exemption from tax is also provided by the country of source in respect of income from interest on loans or dividends received by the Government and the financial institutions (Government-owned) of one of the contracting States from sources within the other States.[50] The bulk of the income comes under the system of tax credit.

An important feature of the agreement between India and Japan is the scheme for affording credit for tax spared. Under this scheme, the amount by which Indian tax has been reduced by certain special incentive measures designed to promote economic development is deemed to have been paid by the tax payer and credit for that amount is allowed against Japanese tax.[51]

These agreements also contain provisions for the exchange of information for the prevention against tax avoidance in relation to the tax. In order to ensure that the exemption, reduced rates of tax or any other benefit granted under the agreement are not enjoyed by persons not entitled to such benefits, the agreement between Japan and Pakistan further provides "that each of the contracting States may collect the tax imposed by the other contracting State (as though such tax were the tax of the former State)."[52]

(ii) Member countries and the other countries :

The agreements concluded by India and Ceylon with Scandinavian countries[53] use a system of allocation under which exclusive taxing power over each type of income (e.g. industrial

50 Japan-Pakistan, Art. VIII.

51 India-Japan, Art. XI (3-b).

52 Japan-Pakistan, Art. XV.

53 Statement refers to the agreements concluded by Ceylon with Sweden and by India with Sweden, Denmark, and Norway.

and commercial profits, dividends, interest, royalties and pensions) is allocated to the country in which the source of income is located. There is a straightforward provision in all these agreements under which income from sources within one of the contracting States which is subject to tax under the law of that State and under the provision of the agreement is exempt from tax of the other contracting State. Relief from double taxation is thus provided for by an *ab initio* segregation of areas of taxation.[54]

The rule of exclusive allocation of taxing power is, however, subject to qualification in respect of income derived from the operation of ships and aircraft (only income from the operations of ships in agreements with India). Income, in such cases, is subject to tax in both the countries, but the tax so charged is reduced by each country according to a certain proportion.

In its agreements with Sweden, Norway and Denmark, Japan uses the system of tax credit for granting relief from double taxation though Sweden and Norway use (in the same agreements) the system of tax exemption and reduction. In the case of agreement with Sweden while Japan includes all items of income in its tax base which are subject to tax in Japan as well as in Sweden and allows Swedish tax as a credit against its own tax, Sweden exempts all income which is derived from sources within Japan except income from interest, royalties and dividends. Relief from double taxation in such cases is provided for by reducing the tax charged on these items.

As a general rule, certain types of income, such as that derived from the operation of ships and aircraft, is exclusively taxable at the seat of the enterprise. Salaries, wages and pensions paid in the discharge of governmental functions out of public funds of one of the contracting States is also exempt from the tax of the other State.

54 India-Sweden, Art. XVII. India-Denmark, Art. XVII. India-Norway Art. XVII. Ceylon-Sweden, Article XIV.

The agreements concluded by some of the Member Countries[55] with United States of America and United Kingdom generally follow the principles of exemption, *reduction* and *tax credit* already discussed in the section dealing with the Anglo-American system of granting relief from double taxation.

The Japan-United States Convention provides for exemption by the country of source of income derived from the operation of ships and aircraft. Such income is taxable only in the country where the ships or aircraft are registered. Salaries, wages, pensions and similar compensation paid by the Government of one of the contracting States to its nationals is also exempt from tax of the other State where services are rendered. Religious, charitable, scientific or other literary institutions organised under the laws of one of the contracting States are exempt from tax in the other State under the convention between Japan and United States. The country of residence under this convention reserves exclusive taxing power in respect of income from pension and annuity derived by a resident of one of the contracting States from sources within the other State.

With respect to other types of income, viz., interest, royalties and dividends these agreements set a limit on the amount of tax that can be charged by the country of source. In Japan-United States Convention this limit is 15 per cent on income derived from interest and royalties. The Pakistan-United States Convention altogether exempts income from royalties from taxation in the country of source.[56]

In its Convention with Pakistan, United States allows against its own tax on income earned by its corporation in Pakistan, a credit not only for taxes actually paid in Pakistan,

55. Refer to the Conventions between Japan-United States and Pakistan-United States and agreements between Ceylon-United Kingdom and Burma-United Kingdom.

56. Japan-United States, Arts. VI and VII. Pakistan-United States, Art. VIII.

but also for the tax which would have been paid in Pakistan but for the tax concession given by that country.

Under the double taxation agreements between Ceylon-United Kingdom, Burma-United Kingdom and Pakistan-United Kingdom certain income (e.g., Government salaries) is exempt from tax in the country where the recipient of the income resides and other income (e.g., non-Government pensions) is exempt in the country where the income arises[57] but the bulk of income (including industrial and commercial profits) come under the system of tax credit. Under this system each country gives credit against its own tax for the other contracting country's tax paid on income arising within the territory of that other contracting country. The result is that the recipient of income bears a total tax on that income equal to the higher of the taxes imposed thereon by two countries.

CONCLUSION

The foregoing discussion leads to the conclusion that in order to solve the problem of double taxation in an effective way there should be agreements between the contracting States about the *principles governing tax liability*. The tax agreement must spell out the activities which should be taxed in the country of "residence" or those that should be taxed in the country of "source."

It may, however, be stated that the general viewpoint appears to be more favourably inclined towards *taxation at source* of the following types of income :

(1) Income from real property;

(2) Income from mortgages of real property;

57. Ceylon-United Kingdom, Arts. X and XII, Burma-United Kingdom, Arts. VIII and X, Pakistan-United Kingdom, Arts. VIII and X.

(3) Royalties from immovable property or from the operation of mine, quarry or other natural resources;

(4) Gains derived from the sale or exchange of real property;

(5) Income from any industrial or commercial or agricultural business or from any other gainful activity;

(6) Compensation for labour or personal services;

(7) Income derived by any person engaged in the practice of a profession.

The source of income in respect of (1) to (4) is considered to lie in the country where the property is situated; in respect of (5) in the country where such activities are carried on (usually in the country where the permanent establishment is situated); in respect of (6) in the country where services are performed; and in respect of (7) in the country where the tax payer concerned has a permanent establishment in which or from which he renders his services.

While the right to tax of the country of source seems to be generally accepted with respect to the types of income enumerated above, there is a difference of approach on other questions, particularly on the question of taxation of royalties, interests and dividends. "The revenue interests" of the capital exporting countries "are best served by taxation of income from capital at home of the creditor or beneficiary," those of the capital importing countries by taxation at home of the debtor or rather, the place where the investment is used. The practical solution of the problem depends, in most cases, on the extent to which each of the contracting State is willing to limit its right of taxation in order to facilitate international investment.[58]

Experience has, however, led the developed and the under-developed countries to generelly agree to:

(i) the exemption, complete or partial of royalties on copyrights, patents, etc. interest and dividend payments;

58. League of Nations Fiscal Committee—Second Regional Tax Conference, Mexico D. F., July 1943.

(ii) the taxation of shipping or airline corporations in the country of residence or registration;

(iii) the exemption of remuneration of servants of a foreign government for their services to that government. (This exemption also applies to pension and other compensation in respect of past services);

(iv) the exemption of remuneration of temporary visitors for their personal services in the country of source. (A temporary visitor has been defined as a visitor whose main abode is abroad and who is present in the country for less than 183 days in the fiscal year); and

(v) the exemption of private pensions and life annuities in the country of source.

It is generally admitted that the country in which income arises has the right to tax that income in priority to any claim by the country where the owner resides.[59] When it comes to the exercise of their residual power to tax residents on income derived from abroad, the countries of residence use different methods, viz., tax exemption, tax credit etc. for granting relief from double taxation.

Some times it is argued that if the problem of allocation of taxes between the contracting States is resolved, double taxation is completely eliminated under the exemption method.[60] But this is not the case with tax credit method which involves intricate procedure of calculating foreign tax to be credited against home tax.[61] Whatever may be the merits of the exemption system, it has not found general acceptance because the tax legislators aimed primarily at taxing all income accruing to their residents and were not impressed by the fact that the income had already been taxed. The absolute need for relief has not been admitted if it affected the immediate yield of the home tax.

59. See Appendix-V. Report of the Commission on Taxation of I.C C.
60. *Ibid.*
61. For details, *Ibid.*

In the case of Member Countries, it might be argued that exemption system, if adopted by these countries, will facilitate the expansion of trade and business abroad and will also assist them in competing in the world markets. The psychological effect of exempting foreign income would be to develop trade and business abroad with corresponding augmentation of invisible exports and exchange resources.[62]

Despite these attractions the exemption method may not be generally acceptable to the member countries who want to deter capital flight and encourage the investment of the scarce domestic savings in their national enterprises.[63]

However, the most satisfactory way of granting relief from double taxation under the agreements seems to be the system which provides for specific allocation of sources of income between the two countries, each country taxing the income arising from the source allocated to it either wholly or partially, as agreed upon. The advantage of this method which is called the *Double Taxation Avoidance Agreement Method* is that the taxation of the same income by more than one country is avoided *ab initio* and no need therefore arises for any relief from double taxation.[64] This is the system which has been followed in the agreements concluded between India and Pakistan and India and Ceylon.

62. *Taxation Enquiry Commission's Report*, Vol. II, (India : 1953 - 54).
63. *Taxation Enquiry Commissions Report* Vol. II. (India : 1953-54).
64. *Ibid.*

III. MEMORANDUM SUBMITTED BY THE U. A. R. DELEGATION

At the Fourth Session, Tokyo (1961)

There is double taxation whenever the State imposes more than one tax on the same revenue for the same period. Although double taxation is undesirable according to rules of equity since it is oppressive to businessmen, yet it still finds its way in the majority of legislations relating to taxes.

In Act No. 14 of 1939 relative to taxes imposed on incomes derived from movable capitals, commercial and industrial profits and professional earnings—which is the basic law of taxes in Egypt—there is no provision prohibiting double taxation.

Moreover, the explanatory note of the said Act admits the possibility that a certain source of income may fall under numerous taxes.

Double taxation is either local or international. It is local when it does not extend to persons resident outside the territory of the State imposing the tax, or to capitals existing abroad, and is international if one income is subject to numerous taxes imposed by the laws of two or more States at the same time.

The legislator often avoids double taxation in its two forms or lightens it, either in the law imposing the tax or in a subsequent law. This may either be by annulling the law imposing the tax or by granting total or partial exemptions from the said tax. The exemptions may be limited or unlimited in time.