

Interest Paid to Overseas Companies Taxable in India

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Overseas companies receiving interest on borrowings utilised in India are liable to receive such interest subject to applicable withholding taxes in India.

In a recent ruling the Authority for Advance Rulings (AAR) has held that interest on debentures paid to an investor, who is a resident of Mauritius, is subject to withholding tax in India, unless it is specifically exempted.

The AAR had been approached by an Indian company for ascertainment of its liability to deduct tax at source for payment of interest on partly-convertible debentures to a company incorporated in Mauritius. The Indian company argued that the interest income payable was exempt from tax in India owing to Article 11(4) of the Indo-Mauritius tax treaty. In terms of Article 11(4) of the treaty, interest arising in Country A derived and beneficially owned by any person who is a resident of Country B shall be exempt from tax in Country A subject to and to the extent approved by the Government of Country A provided that the transaction giving rise to the debt claim has been approved in this regard by the Government of Country A.

It was contended by the Indian company that all conditions laid down under Article had been met as (a) the recipient of interest was a resident of Mauritius and beneficial owner of the debentures, and (b) the Indian company had obtained Reserve Bank of India approval for payment of interest on debentures, which approval amounted to approval by the government.

The AAR, however, held that Reserve Bank of India's approval was under the Foreign Exchange Regulation Act whereas tax exemption under Article 11(4) can be granted only by the finance ministry. In the absence of any tax exemption accorded under Indian tax laws or the tax treaty, the Indian company was obliged to deduct tax at source at the prevailing rates in force. Mere approval from the Reserve Bank of India for the issue of such securities to a non-resident does not imply approval for tax exemption, the AAR said. Alishan Naqvee has substantial experience in areas of transactional law and dispute resolution and he regularly authors articles on Indian legal issues.