DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA) IN INDIA

Double taxation may arise when the jurisdictional connections, used by different countries, overlap or it may arise when the taxpayer has connections with more than one country. A person earning any income has to pay tax in the country in which the income is earned (as source Country) as well as in the country in which the person is resident. As such, the said income is liable to tax in both the countries. To avoid this hardship of double taxation, Government of India has entered into Double Taxation Avoidance Agreements (DTAAs) with various countries. DTAAs provide for the following reduced rates of tax on dividend, interest, royalties, technical service fees, etc., received by residents of one country from those in the other. The Double Tax Avoidance Agreement (DTAA) is essentially a bilateral agreement entered into between two countries. The basic objective is to promote and foster economic trade and investment between two Countries by avoiding double taxation.

OBJECTIVES

- Protection against double taxation: These Tax Treaties serve the purpose of providing protection to tax-payers against double taxation and thus preventing any discouragement which the double taxation may otherwise promote in the free flow of international trade, international investment and international transfer of technology;
- Prevention of discrimination at international context: These treaties aim at preventing discrimination between the taxpayers in the international field and providing a reasonable element of legal and fiscal certainty within a legal framework;
- Mutual exchange of information: In addition, such treaties contain provisions for mutual exchange of information and for reducing litigation by providing for mutual assistance procedure; and
- Legal and fiscal certainty: They provide a reasonable element of legal and fiscal certainty within a legal framework.

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DIFINATION

Double taxation is the enforced duty of two or more taxes on the same, property or monetary transactions. Double taxation may occur when the legal authority associations, used by different nations, overlap or it may occur when the taxpayer has links with more than one country.

WHAT IS DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA)?

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WHAT IS DOUBLE TAXATION AVOIDANCE AGREEMENT?

A person earning any income has to pay tax in the country in which the income is earned (as Source Country) as well as in the country in which the person is resident. As such, the said income is liable to tax in both the countries. To avoid this hardship of double taxation, Government of India has entered into Double Taxation Avoidance Agreements (DTAAs) with various countries. DTAAs provide for the following reduced rates of tax on dividend, interest, royalties, technical service fees, etc., received by residents of one country from those in the other.[3] Where total exemption is not granted in the DTAAs and the income is taxed in both countries, the country in which the person is resident and is paying taxed, the credit for the tax paid by that person in the other country is allowed.

Where tax relief has been given by one country, the country of residence generally allows credit for the tax so spared, to avoid nullifying the relief. If the rate prescribed in the Indian Income-tax Act, 1961 is higher than the rate prescribed in the Tax Treaty then the rate prescribed in the Tax Treaty has to be applied. In other words, provisions of DTAA or Indian Income-tax Act, whichever are more favourable to an individual would apply. Thus In order to avail the benefits of DTAA, an NRI should be resident of one country and be paying taxes in that country of residence. India has entered into DTAA with around 65 countries. These treaties are based on the general principles laid down in the model draft of the Organisation for Economic Cooperation and Development (OECD) with suitable modifications as agreed to by the other contracting countries.

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Thus in case there is a DTAA between India and United States of America, an NRI should be a resident of USA and paying taxes there. In case of income earned in India by NRI, tax paid in India is allowed as credit against tax paid in USA.

WHO ARE THE SUBJECTS OF SUCH AGREEMENT?

A typical DTA Agreement between India and another country usually covers persons, who are residents of India or the other contracting country, which has entered into the agreement with India. A person, who is not resident either of India or of the other contracting country, would not be entitled to benefits under DTA Agreements.

International double taxation has adverse effects on the trade and services and on movement of capital and people. Taxation of the same income by two or more countries would constitute a prohibitive burden on the tax-payer. The domestic laws of most countries, including India, mitigate this difficulty by affording unilateral relief in respect of such doubly taxed income (Section 91 of the Income Tax Act). But as this is not a satisfactory solution in view of the divergence in the rules for determining sources of income in various countries, the tax treaties try to remove tax obstacles that inhibit trade and services and movement of capital and persons between the countries concerned. It helps in improving the general investment climate.

The need for Agreement for Double Tax Avoidance arises because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. Double taxation occurs when an individual is required to pay two or more taxes for the same income, asset, or financial transaction in different countries. Double taxation occurs mainly due to overlapping tax laws and regulations of the countries where an individual operates his business.

In such a case, the two countries have an Agreement for Double Tax Avoidance, in which case the possibilities are:

- The income is taxed only in one country.
- The income is exempt in both countries.

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- The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

In India, Under Section 90 and 91 of the Income Tax Act, relief against double taxation is provided in two ways:

UNILATERAL RELIEF

Under Section 91, an individual can be relieved from double taxation by Indian Government irrespective of whether there is a DTAA between India and the other country concerned. Unilateral relief to a tax payer may be offered if:

- The person or company has been a resident of India in the previous year.
- In India and in another country with which there is no tax treaty, the income should have been taxed.
- The tax have been paid by the person or company under the laws of the foreign country in question.

BILATERAL RELIEF

Under Section 90, the Indian government offers protection against double taxation by entering into a DTAA with another country, based on mutually acceptable terms.

SUCH RELIEF MAY BE OFFERED UNDER TWO METHODS:

- *EXEMPTION METHOD:* This ensures complete avoidance of tax overlapping.
- *TAX CREDIT METHOD* This provides relief by giving the tax payer a deduction from the tax payable in India.

DTAA CAN BE OF TWO TYPES.

A. *COMPREHENSIVE DTAA*: Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time a treaty covers wealth tax, gift tax, surtax etc. too. DTAA Comprehensive Agreements with respect to taxes on income with following countries :

1	Armenia	36	Namibia
2	Australia	37	Nepal

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3	Austria	38	Netherlands
4	Bangladesh	39	New Zealand
5	Belarus	40	Norway
6	Belgium	41	Oman
7	Brazil	42	Philippines
8	Bulgaria	43	Poland
9	Canada	44	Portuguese Republic
10	China	45	Qatar
11	Cyprus	46	Romania
12	Czech Republic	47	Russia
13	Denmark	48	Saudi Arabia
14	Egypt	49	Singapore
15	Finland	50	Slovenia
16	France	51	South Africa
17	Germany	52	Spain
18	Greece	53	Sri Lanka
19	Hashemite Kingdom of	54	Sudan

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	Jordan		
20	Hungary	55	Sweden
21	Indonesia	56	Swiss Confederation
22	Ireland	57	Syria
23	Israel	58	Tanzania
24	Italy	59	Thailand
25	Japan	60	Trinidad and Tobago
26	Kazakstan	61	Turkey
27	Kenya	62	Turkmenistan
28	Korea	63	UAE
29	Kyrgyz Republic	64	UAR (Egypt)
30	Libya	65	UGANDA
31	Malaysia	66	UK
32	Malta	67	Ukraine
33	Mauritius	68	USA
34	Mongolia	69	Uzbekistan
35	Morocco	70	Vietnam

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71 Zambia

B. *LIMITED DTAA*: Limited DTAAs are those which are limited to certain types of incomes only, e.g. DTAA between India and Pakistan is limited to shipping and aircraft profits only. DTAA Limited agreements – With respect to income of airlines/merchant shipping with following countries:

1. Afghanistan
2. Bulgaria
3. Czechoslovakia
4. Ethiopia
5. Iran
6. Kuwait
7. Lebanon
8. Oman
9. Pakistan
10. People's Democratic Republic of Yemen
11. Russian Federation
12. Saudi Arabia
13. Switzerland
14. UAE
15. Uganda
16. Yemen Arab Republic

When an Indian person makes a profit or some other type of taxable gain or receives any income in another country, he may be in a situation where he will be required to pay a tax on that income in India, as well as in the country in which the income was made. To protect Indian tax payers from this unfair practice, DTAA ensures that India's trade and services with other countries, as well the movement of capital are not adversely affected. Acting under the authority of law,

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CHOICE OF BENEFICIAL PROVISIONS UNDER DTAA/TAX LAWS

The Provisions of DTAA override the general provisions of taxing statute of a particular country. It is now well settled that in India the provisions of the DTAA override the provisions of the domestic statute. Moreover, with the insertion of Sec.90 (2) in the Indian Income Tax Act, it is clear that assessee have an option of choosing to be governed either by the provisions of particular DTAA or the provisions of the Income Tax Act, whichever are more beneficial.

For example under DTAA between Indian and Germany, tax on interest is specified @ 10% whereas under Income Tax Act it is 20%. Hence, one can follow DTAA and pay tax @ 10%. Further if Income tax Act itself does not levy any tax on some income then Tax Treaty has no power to levy any tax on such income. Section 90(2) of the Income Tax Act recognizes this principle.

MODELS OF DTAA

There are different models developed over a period of time based on which treaties are drafted and negotiated between two nations. These models assist in maintaining uniformity in the format of tax treaties. They also serve as checklist for ensuring exhaustiveness or provisions to the two negotiating countries.

OECD Model, UN Model, the US Model and the Andean Model are few of such models. Of these the first three are the most prominent and often used models. However, a final agreement could be combination of different models.

OECD MODEL- Organization of Economic Co-operation and Development (OECD) Model Double Taxation Convention on Income and on Capital, issued in 1977, 1992 and 1995. OECD Model is essentially a model treaty between two developed nations. This model advocates residence principle, that is to say, it lays emphasis on the right of state of residence to tax.

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UN MODEL- United Nations Model Double Taxation Convention between Developed and Developing Countries, 1980. The UN Model gives more weight to the source principle as against the residence principle of the OECD model. As a correlative to the principle of taxation at source the articles of the Model Convention are predicated on the premise of the recognition by the source country that (a) taxation of income from foreign capital would take into account expenses allocable to the earnings of the income so that such income would be taxed on a net basis, that (b) taxation would not be so high as to discourage investment and that (c) it would take into account the appropriateness of the sharing of revenue with the country providing the capital. In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either foreign tax credit or exemption as in the OECD Model Convention. Most of India's treaties are based on the UN Model.

UNITED STATES MODEL INCOME TAX CONVENTION OF SEPTEMBER, 1996.

The US Model is different from OECD and UN Models in many respects. US Model has established its individuality through radical departure from usual treaty clauses under OECD Model and UN Model.

GENERAL FEATURES OF DTAA

1) *LANGUAGE USED BY TREATIES*

Tax Treaties employ standard International language and standard terms. This is done in order to understand and interpret the same term in the same manner by both assessee as well as revenue. Language employed is technical and stereotyped. Some of the terms are explained below:

a) Contracting State - country which enters into Treaty

b) State of Residence- Country where a person resides

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c) State of Source- Country where income arises - Enterprise of a Contracting State- Any taxable unit (including individuals of a Contracting State)
d) Permanent Establishment - A fixed base of an enterprise in the state of
e) Source (usually a branch of a foreign company and in some cases wholly – owned subsidiaries as well)
f) Income arising in Contracting state - Income arising in a State of a source

One has to read the treaty carefully in order to understand its provisions in their proper perspective. The best way to understand the DTAA is to compare it with an agreement of partnership between two persons. In partnership, the words used are "the party of the first part" and in the DTAA, the words used are "the other contracting state" .One can also replace the words" Contracting States" by names of the respective countries and read the DTAA again , for better understanding.

2) *COMPOSITION OF A COMPREHENSIVE DTAA*

Double Tax Avoidance agreements are divided under following heads

Article No.	Heading	Content
1	Scope of the Convention	To whom applicable?
2	Taxes covered	Specific taxes covered
3	General definition	Persons, company enterprises, international traffic, competent authority
4	Resident	'Residence' of a contracting state who can access treaty

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5	Permanent Establishment	What constitutes P.E.? What does not constitute P.E?
6	Income from Immovable Property	Immovable property and income there from
7	Business Profits	Determination and taxation of profits arising from business carried on through P.E.
8	Shipping, Inland waterways & Air Transport	Place of deemed accrual of profits arising from activities and mode of taxation thereon
9	Associated Enterprises	Enterprises under common management and taxation of profits owing to close connection (other than transactions of arm's length nature)
10	Dividend	Definition and taxation of dividends; Concessional rate of tax in certain situations;
11	Interest	Definition and taxation of interest; Concessional rate of tax in certain situations; Taxation of interest paid in excess of reasonable rate, on account of special relationship;
12	Royalties	Definition of Royalties- what it includes and covers, and its taxation; Treatment of excessive payment of royalties due to special relationship; Country where taxable.
13	Capital Gains	Definition- Taxation aspect; Concessional rates/exemption from tax if any;

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		Country where taxable.
14	Independent Personal Services	Types of services covered; Country where taxable.
15	Dependent Personal Services	Definition Country where taxable.
16	Directors Fees and Remuneration for Top Level Managerial official	Definition Mode of Country where taxable.
17	Income earned by entertainer and athletes	Types of activities covered; Mode of Country where taxable.
18	Pension and social security payments	Country where taxable.
19	Remuneration and pensions in respect of government services	Types of remuneration and Country where taxable.
20	Payment received by students and apprentices	Taxation / Exemption of payments received by student and apprentices.
21	Other Income	Residual Article to cover income not covered under other 'Articles', mode of taxation and country where taxable
22	Capital (Tax on wealth)	Definition – made – and country where taxable
23	Method of elimination	Exemption Method / Credit Method
24	Non Discrimination	(Equitable) Basis of taxing Nationals and citizens of foreign state

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25	Mutual Agreement Procedure	Where taxation is not as per provisions of the convention, a 'person' may present his case to Competent Authorities of respective states. Procedure in such cases
26	Exchange of Information	Competent Authorities to exchange information for carrying out provisions of the convention. Methodology.
27	Assistance in collection of taxes	
28	Diplomatic agents and Consular corps (Officers)	Privileges of this category to remain unaffected
29	Territorial Extension	
30	Entry into force	Effective date from which convention comes into force; Assessment year from which it comes into force.
31	Termination	Time – Notice period – Mode.

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OVERALL PREVIEW OF THE MODEL CONVENTION

In general terms, the Articles of a convention can be divided into six groups for the purpose of analyses:

a) Scope Provisions: these include Article 1 (Personal scope), 2 (Taxes covered), 30 (Entry into force) and 31 (Termination). These provisions determine the persons, taxes and time period covered by a treaty.

b) Definition provisions: these include Article 3 (General Definitions), 4(Residence) and 5 (Permanent Establishment) as well as the definitions of terms in some of the substantive provisions (e.g. the definition of "immovable property" in Article 6(2)).

c) Substantive Provisions: these are the Articles between article 6 and 22 which apply to particular categories of income, capital gains or capital and allocate taxing jurisdiction between the two Contracting States.

d) Provisions for elimination of double taxation: this is primarily Article 23. Article 25(Mutual Agreement) could also be placed in this category.

e) Anti-avoidance provisions: these include Article 9 (Associated Enterprises) and 26 (Exchange of information).

f) Miscellaneous Provisions: this final category includes Articles such as 24(Non-Discrimination), 28 (Diplomats) and 29 (Territorial Extension).

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HOW TO APPLY DTAA

The process of operation of a double taxation convention can be divided into a series of steps, involving the different types of provisions.

1. Determine if the issue is within the scope of the convention: This involves determining firstly whether the taxpayer is within the personal scope in Article 1- that is, "persons who are residents of one or both Contracting States". This may involve confirming that the taxpayer is a "person" within in the definition of Article 3(1) (a); it will involve confirming that the taxpayer is resident of a Contracting State according to Article 4(1).
2. Check that the treaty applies to the tax in issue- is it a tax listed in Article 2 (or a tax substantially similar to such a tax).

3. Thirdly, check that the treaty is in operation for the taxable period in issue – that the treaty is in force (Article 29) and has not been terminated (Article 30).
4. Apply the relevant definitions: At this stage the relevant definition provisions (if any) can be applied. Thus, for example, if the taxpayer is a resident of both Contracting States, the tiebreakers in Article 4(2) and (3) have to be applied to determine a single residence for treaty purposes, similarly, if it is necessary to decide whether the taxpayer has a permanent establishment in a state, then Article 5 is relevant.
5. Determine which of the substantive provisions apply: The substantive provisions apply to different categories of income, capital gains or capital; it is necessary to determine which applies. This is a process of characterization. In many cases this may be straightforward; in others the task may not be easy. For example, payments, which are referred to as "royalties", may in fact fall under Article 7 (Business Profits), 12 (Royalties), 13 (Capital Gains) or 14 (Independent Personal Services). Assistance in characterizing the items can be gained from the Commentaries, case law and reports of the Committee on Fiscal Affairs
6. Apply the substantive article:

   Substantive articles generally take one of three forms

   a) The state of source may tax without limitation. Examples are: income from house property situated in that state, and business profits derived from a permanent establishment there.
   b) The state source may tax up to a maximum: here the treaty sets a ceiling to the level of taxation at source. Examples in the OECD Models are: dividends from companies resident in that state and interest derived from there.

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c) The state of source may not tax: here, the state of residence of the tax payer alone has jurisdiction to tax. Examples in the OECD Model are: business profit where there is no permanent establishment in the state of source.

7. Apply the provisions for the elimination of double taxation

   Every one of the substantive articles must be considered along with article 23 which sets out the methods for the elimination of double taxation.

ROLE OF TAX TREATIES IN INTERNATIONAL TAX PLANNING

- Facilitates investment and trade flow, preventing discrimination between tax payers; Adds fiscal certainty to cross border operations; Prevents international evasion and avoidance of tax; Facilitates collection of international tax; Contributes attainment of international development goal, and Avoids double taxation of income by allocating taxing rights between the source country where income arises and the country of residence of the recipient; thereby promoting cooperation between or amongst States in carrying out their obligations and guaranteeing the stability of tax burden.

- Tax incidence, therefore, becomes an important factor influencing the non-residents in deciding about the location of their investment, services, technology etc. **Tax treaties serve the purpose of providing protection to tax payers against double taxation and thus preventing the discouragement which taxation may provide in the free flow of international trade, international investment and international transfer of technology.** In addition, such treaties contain provisions for mutual exchange of information and for reducing litigation by providing for mutual assistance procedure.

- The agreements **allocate** jurisdiction between the source and residence country. **Wherever such jurisdiction is given to both the countries, the agreements prescribe maximum rate of taxation in the source country which is**

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generally lower than the rate of tax under the domestic laws of that country. The double taxation in such cases are avoided by the residence country agreeing to give credit for tax paid in the source country thereby reducing tax payable in the residence country by the amount of tax paid in the source country.

- These agreements give the right of taxation in respect of the income of the nature of **interest, dividend, royalty and fees for technical services** to the country of residence. However, the source country is also given the right but such taxation in the source country has to be limited to the rates prescribed in the agreement.

- So far as **income from capital gains** is concerned, gains arising from transfer of immovable properties are taxed in the country where such properties are situated. Gains arising from the transfer of movable properties forming part of the business property of a 'permanent establishment 'or the 'fixed base' is taxed in the country where such permanent establishment or the fixed base is located.

- So far as the b**usiness income** is concerned, the source country gets the right only if there is a 'permanent establishment' or a 'fixed place of business' there.

- **Income derived by rendering of professional services** or other activities of independent character are taxable in the country of residence except when the person deriving income from such services has a fixed base in the other country from where such services are performed.

- The agreements also provides for jurisdiction to tax **Director's fees, remuneration of persons in Government service, payments received by students and apprentices, income of entertainers and athletes, pensions and social security payments** and other incomes.

- It may sometimes happen that **owing to reduction in tax rates under the domestic law taking place** after coming into existence of the treaty, the domestic rates become more favourable to the non-residents. Since the objects of the

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tax treaties is to benefit the non-residents, they have, under such circumstances, the option to be assessed either as per the provisions of the treaty or the domestic law of the land.

- In order to **avoid any demand or refund consequent to assessment and to facilitate the process of assessment**, it has been provided that tax shall be deducted at source out of payments to non-residents at the same rate at which the particular income is made taxable under the tax treaties.

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