



# INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

## TAX RELIEF AND TAX PLANNING- EFFICACY OF DOUBLE TAXATION AVOIDANCE AGREEMENTS

LAKSHMI. KOLLU

Assistant Professor

School of Law, GITAM ( Deemed to be) University, Visakhapatnam, India.

### Abstract

In the context of International Taxations, including cross-border investments, eliminated double Taxation became an important consideration in doing business in India and abroad specially with the double taxation aspect became omnipresent in relations to transactions involving cross-boarder investments with those foreign entities belonging to those countries with which India does not have double taxation Avoidance Agreements. To overcome difficulties faced by investors from different countries, India in new countries entered into Double Taxation Avoidance Agreements (DTAA) with many countries. To overcome difficulties faced by investors from different countries, in recent years, India entered into Double Taxation Avoidance Agreements with many countries through the Income Tax Act 1961, in the year 2001. Another way of resolving disputes relating to taxes involving International transactions is through mutual agreement procedure through OECD MODEL.

Key Words: Central Government, Double Taxation, Foreign Collaboration, International Agreements, Tax Relief.

### Introduction

Double taxation Avoidance is an is a kind of bilateral Treaty or an agreement between the Government of India and Foreign Country or specified territory outside India which is permissible under Art 253 of Constitution of India.

India also has entered into bilateral agreements with many Countries regarding avoidance of double Taxation, including tax avoidance and tax evasion issues. Where the Central Government entered into an agreement with the Government of any country or territory which is specified outside India for granting relief of tax, tax avoidance, then the provisions of Income Tax Act, 1961 shall apply to the assessee to whom the agreement applies to the extent they are more beneficial to him. The benefit of double taxation agreement or tax treaty is applicable only after obtaining the tax residence certificate from the Government of that country or specified territory.

The Constitution does not contain any prohibition against double Taxation. A subject can be taxed twice even if the legislature evinces a clear intention to do so. There is nothing in Art. 265 from which one can spin out the constitutional vice called double Taxation.

Tax planning involves an intelligent application of various provisions of the direct tax laws to practical situations in such a manner as to reduce the tax impact on the assessee to the minimum. A proper understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations is expected at the final level.

<sup>1</sup>The Fiscal committee of OECD in the, defines the phenomenon of international juridical double Taxation as the comparable taxes are imposed in two or more states on the same taxpayer in respect of the same subject matter during indistinguishable periods’.

<sup>1</sup> <http://www.legalserviceindia.com/article/1304-Double-Taxation-Avoidance-Agreements.html>

Model Double Taxation Convention on Income and Capital, 1977

Therefore, the basic reason of international multiple Taxation is the exercise by sovereign States of their residents to tax, on the ground of 'personal jurisdiction'. On their global income including income arising or having its source in foreign countries.

## Tax planning with reference to Foreign Collaborations

Indian Citizens enter into foreign collaboration agreements with foreign parties very often. The principle areas covered by these agreements are supply of capital goods by the foreign party; supply of technical know-how by the foreign party to the Indian concern for preparation of the layout of the factory in India, installation of plant and machinery and putting those in running order, information about working processes and supply of raw materials. The tax significances of these agreements both on foreign country and Indian concerns. The Indian party must observe all the tax angles and devise a method which will saddle the foreign collaborator with minimum amount of tax in India. There is much ambit for planning while entering into foreign collaboration agreements which are very significant in the double taxation avoidance relief.

In the present epoch of International transactions across the world, the burden of Taxation is one of the important considerations for any business and commercial exchange practices in other countries. One of the most considerable results of globalisation is the visible impact of one country's tax policies on the economic system of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms. These transactions have led to double Taxation on same income.

Double tax treaties comprise of agreements between the two countries, which by eliminating double Taxation when there is imposition of two or more taxes on the same income, asset or financial transaction. It pertains to taxation by two or more countries of the same income, asset or transaction. It gives rise to possibility of double taxation to a tax payer when he is resident in one country, but a source of income arose or accrued in another country

In India person is taxed on the basis of his residential status. Likewise, it may so happen the individual is taxed on this basis or some other basis in another country on the same income. However, it is universally accepted principle that tax should not be subjected to double tax. In order to overcome such situations the Income Tax Act, 1961 has provided for double taxation relief.

The Income Tax Act, 1961 contains provisions to take care of transactions having Extra – Judicial ramifications. Such as some incomes earned abroad by resident tax payers or income earned in

## Double Taxation Avoidance Agreements

Double taxation agreements try to avoid double taxation in the case of cross-national flow of finance. Main objective of DTAA is that it provides fundamental guidelines for Taxation of income that flows from one country to the other on different types of income like profit, interest income, royalty. Etc. Each DTAA takes proper care by giving specific guidelines on how the income is to be taxed under the Source and Resident rule.

The interpretation of two tax systems belonging to different country can result in double Taxation. The determination of taxability of foreign collaborators empowers the Central Government to enter into double taxation avoidance agreement with foreign countries. Every country seeks to tax the income accrued within its territory on the basis of one or two connecting factors such as location of source, residence of taxable entity, maintenance of Permanent Establishment and so on. When same income is taxed twice in the hands of same entity would give rise to harsh consequences vitiate the economic development. Thus, Double Taxation Agreements between two countries therefore aim at eliminating or mitigating the incidence of Double Taxation. Double Taxation Agreements comprehensively provide for taxes on income, capital gains and capital, while limited double Taxation referred to income from shipping and air transport or Estates, inheritance and gifts. Nation wide agreements ensure that the taxpayers in both the countries should be treated equally and on equitable grounds, in respect of the problems relating to double Taxation.

## Double Taxation Relief

Foreign income of a person becomes liable to tax in the country in which the income is earned and also in his or her Resident country .<sup>2</sup> Taxability of such income is avoided by means of double taxation avoidance agreements entered into by Central Government of India with the Government of other countries The Double Taxation Avoidance Agreement is specifically a bilateral agreement created between two countries. The main objective is to promote and foster economic trade and investments between two countries by avoiding double Taxation. The international double taxation avoidance Agreements has adverse effects on the trade and services and on movement of capital and people. Tax levied on the same income by the two or more countries would constitute a prohibitive burden on the tax payer. Where there is a Agreement between the Government of India and the Government of Foreign Country, tax liability of Foreign individual is determined in accordance with and subject to the provisions of the agreement and the Income Tax Act, 1961, to that extent, stands superseded by such agreement.

Generally, the foreign party occurs to be a non-resident for tax purposes. A non-resident desiring to enter into collaboration Agreements should take care to design the same in a manner which obtains the maximum tax benefit to him whether under the normal tax laws in India or under any specific agreement between his country and India for avoidance of Double Taxation. The status in which possibility of tax arises in the hands of the foreign party is either that of a company, or association of persons or of an individual. In the case of unincorporated foreign associations, it is advisable to obtain a declaration as a 'company' under section 2(17)(iii) or (iv) in as much as tax liability otherwise would be considerable.

### Provisions Under Income Tax Act for Double Taxation Relief

The Supreme Court held that the judicial opinion in India has been that Section 90 is intended empower central Government to issue a notification for implementation of terms of double taxation avoidance agreement. Therefore,<sup>3</sup> the provisions of such an agreement with respect to cases to which they apply would apply even if inconsistent with the provisions of the Income Tax Act, 1961. Sec 90 enables the Central Government to enter into DTAA with the Foreign Government. The Central Government of India may enter into an agreement with the Government of any outside Country for the granting relief in respect of income on which have been paid for both Income Tax under this Act and Income Tax in that Country which led to avoid double Taxation of income under this Act and also under the law in force in that country. These agreements have been paved in exchange of information for the prevention of evasion or avoidance;

for recovery of income tax under this Act and under the corresponding law in force in that country.

For this purpose the Government of India has entered into comprehensive agreements for avoidance of double Taxation with 57 Countries. In case of difference between the Law and of the agreements the provisions of the agreement prevail over the provisions of the Act and can be enforced by the appellate authorities and the Courts.

From the view of tax planning with reference to double taxation avoidance Agreements (DTAA), the judgment of Supreme Court in the case of –

<sup>4</sup>Union of India v Azadi Bachao Andolan

Circular No..682 dated 30-3-1994 issued by the CBDT in exercise of powers under, the Government of India notified that capital gains of any resident of, Mauritius by alienation of shares by Indian Company shall be taxable in according to Mauritius taxation Laws in Mauritius and will not be liable to tax in India. Later on because of issues of show-cause notices to some FIIs functioning in India, but incorporated in Mauritius, as to why they should not be taxed on profits and dividends of India, there was a panic and to clarify the position, CBDT issued Circular NO.789, dated 13-4-2000 clarifying that FIIs which are determined as resident in

<sup>2</sup> See sec 90 of Income Tax Act, 1961

<sup>3</sup> As per Circular No. 789, Circular shall prevail even if it is inconsistent with the provisions of the Income Tax Act in so far the assessee is covered by the provisions of DTAA are concerned.

<sup>4</sup> (2003) 132 Taxman 373 (SC).

Sec 90 of the Act

Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares. The High Court quashed and set aside the Circular accepting the contention that the said circular is ultra vires the provisions of the Sections 90 and 119 and is also otherwise illegal.

## Double Taxation Avoidance Agreement between Specified Associations

<sup>5</sup>Income Tax Act provides provision that any specific association in our country may enter into an agreement with any specified association in the outside specified territory of India which may be adopted by the Central Government for granting relief of tax or as the case may be avoidance of tax by issuance of notification in the official Gazette

<sup>6</sup>The DTAA under Sec 90A intended to provide relief to the taxpayer who is resident of one of the contracting Country. Such taxpayer can claim relief by applying beneficial provisions of either the treaty or domestic Law. Taxpayers who were not residents of the contracting Country, shall be entitled to claim the relief under such agreement, if tax residence certificate obtained from the Government of that Country or a Specified Association of that Specified Territory. Thus, taxpayers should prefer to derive income from those countries with which India has entered into agreement for granting relief from double Taxation than to those countries with which no agreement exists.

The Supreme Court referred to the judgment of the Madras High Court in <sup>7</sup>M.V. Valliappan v. CIT, which concluded that the decision in Mc Dowell's Co. Ltd cannot be read with every effort at tax planning is illegitimate or illegal and must be ignored, or that every transaction which is perfectly permissible under Law, which has result of reducing the tax burden of the assessee and must be looked upon with disfavour.

### Double Taxation Relief – Indian Residents

Taxpayers deriving the income chargeable to tax both in India and in a foreign country by virtue of a business being carried on in more countries, should provide of the benefit of double taxation relief which granted under Sections 90, 90A and 91 of the Income Tax Act. In order to get the benefit of relief, prior to proceeding with business operations in a foreign country the assessee should be clear with whether India has entered into a double taxation relief agreement with that respective foreign country if so, the extent to which and the manner in which the relief has to be availed.

Taxpayers should prefer to deduce income from countries with which India has entered into double taxation avoidance agreement for granting relief as compared to those countries without such agreement. Even in cases where the income is gained from a country with which India has not entered into agreement with double taxation relief, the assessee should claim the unilateral relief available under Sec 91 by proving that he has paid tax in that country on the income which arose or accrued during that Previous Year. In such a case he would be allowed to deduction from the tax payable by him in India, a sum calculated on such income at Indian tax rate or at the rate of tax of the concerned country, whichever is the lower or at the Indian Rate of tax, if both the rates are equal. The claiming of this statutory relief would help to reduce the total incidence of tax on such doubly taxed income. Thus, provisions 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 Income Tax Act, 1961, it is very clear that assessee has an option of preference to be governed either under the provisions of DTAA or the provisions of the Income Tax Act whichever are more beneficial.

<sup>5</sup> See Sec 90A of Income Tax Act, 1961

<sup>6</sup> "Specified association" means any institution, association or body whether incorporated or not functioning under the any law for the time being in force in India and the laws of specified territory outside India and which may be notified as such by the Central Government.

<sup>6</sup> See Sec 90A(iv) of Income Tax Act, 1961

<sup>7</sup> (1988) 170 ITR 238

## Modes of DTAA

There are different models developed in the span of time which treaties are drafted and negotiated between two Nations. These modes assist in maintaining uniformity in the format of tax treaties.

<sup>8</sup>OECD Model is essentially a model treaty which existed two developed countries and advocates residence principle that is to say it emphasis on the right of state of residence to tax.

<sup>9</sup>UN Model- The UN Model emphasises on the source principle as against the Residence principle of the OECD Model. As correlative to the principle of Taxation at source the articles of the Model Convention are cannotted on the premise of the recognition by the source country that Model is essentially a model treaty existed between two developed

- 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 taxable on the net basis.
- b) Taxation should not be so high
- c) It would take into account the appropriation of the sharing of revenue with the country providing the capital.

United Nation Model Convention embodies the idea that it would be appropriate for the Resident Country to widen a measure of relief from double Taxation through either foreign tax credit or exemption as in the OECD Model Convention.

<sup>10</sup>US Model Convention

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 and UN Models.

## Benefits of DTAA

Every Country seeks to impose tax on the income generated within its territory on the basis of connecting factors such as location of sources, residence of taxable entity, maintenance of permanent Establishment and so on. The interaction between two tax systems belonging to different Countries can result in many advantages of Double Taxation Avoidance Agreement.

- DTAA avoid double Taxation by considering the specific tax Laws of the two Countries.
- DTAA as International tax treaties often provide tax information exchange which lowers the administrative costs of Taxation.
- DTAA as it embodies the principle of legal certainty which encourages foreign investment to developing Countries.
- DTAA incorporates anti- abusive provisions to ensure that the benefits are availed by the genuine residents of the two Countries.

With DTAA Investors need not depend on conflicting national tax rules rather the Taxation of International falls under the rules of DTAA.

## Applicability of Clauses of DTAA on various aspects of Taxation

Article 1 talks about the applicability of this treaty to the person resident of either or both the contracting States. But it is not applicable to the persons who are non-residents of the contracting States There is some ambiguity on the applicability of India- UK DTAA. In India Partnership firms are treated as taxable entities whereas according to domestic laws of United Kingdom Partnership Firms are not taxable.

<sup>8</sup> Organisation of Economic Co-Operation and Development Model Double Taxation Convention on income and on capital, issued in 1977,1992

<sup>9</sup> United Nations Model Double Taxation Convention between the Developed and Developing Countries, 1980

<sup>10</sup> United States Model Income Tax Convention of September, 1996.

<sup>11</sup>In the case of P&O Nedlloyd Ltd & others Calcutta High Court held Indian- UK Partnership firms are eligible for benefit under DTAA and in the case of <sup>12</sup>Harshad Shanthi Lal Mehta v. Custodian held that under <sup>13</sup>DTAA only direct taxes are covered like taxes imposed on Capital and Income. Tax does not include interest or penalty.

As per Article 3 prescribes the general definitions that DTAA is applicable to the persons which includes individual, an estate, a trust, partnership, a Company, or other taxable entity. It also covers the general definitions like definitions of fiscal year, enterprise of a contracting State, tax. Here tax means tax of either country.

Article 4 defines the Residents as a person would be a resident who is assessed to pay tax with regard to domicile, place of Management, place of residence or any other criteria that has been mentioned in related Laws. In the case of Dual Resident, the resident for the purpose of treaty is being determined by his economic and personal ties like permanent residence, citizenship while in case of others it is decided by Place Of Effective Management (POEM).

<sup>14</sup>Joint Director of Income tax (international Taxation) vs. cma egm sa France,

In this case the assessee was engaged in business transportation by ships operated by other enterprises under the slot chartering arrangement.

Mumbai Income Tax Appellate Tribunal held the income earned by assessee through these activities only taxable in the country of residence and therefore such income will be exempted from Taxation.

There are many controversies surrounding residents of Contracting States like residents of UAE are not liable to pay tax under domestic Law so whether they will be resident for claiming benefit under tax treaty.

Art 6 – Under this Article includes income from livestock, agriculture and forestry. In this case primary right is with the State where primary right is included.

As per Art 10 Dividend may also be taxed where the company paying the dividend resides as per the law of that country. According to Sec 9(1)(iv) states that dividend paid by an Indian Company to a non- resident shall be deemed to accrue in India. Generally dividends are received by company out of profit of Company which have already taxed, therefore if dividend gain is taxed, then it will be double Taxation. As per Article 11 interest also can be paid by the person where he resides. However, interest can be taxed by the contracting States where it arises as per the laws of that country.

### **Royalty and Fees for technical services**

Royalties for technical services would include payment of any kind received in relation with use or right to use any Copy Right of Literary, Scientific or Artistic work and also includes cinematographic film or tapes. Royalties arising from shall be taxed where the recipient of such royalty or fee resides. Such royalties and fee can be taxed by the country where it arises on the law of that State.

DTAA differs from country to country. <sup>15</sup>Some DTAA have provisions dealing with 'Fees for Technical Services'. <sup>16</sup>Some have terms like managerial, technical and consultancy. <sup>17</sup>Some DTAA don't have FTS Provisions.

In the case of National organic chemicals Industries Ltd v. Dy. CIT<sup>18</sup> It was held that even if FTS has accrued but not paid there is no question of taxability will arise. The reason for the same under Indo- French DTAA both the conditions of accrual and payment are to be satisfied in order to tax Fee for Technical Services.

<sup>11</sup> W.P. no.457&458 of 2005

<sup>12</sup> (231 ITR 871 (SC))

<sup>13</sup> Article 2

<sup>14</sup> 2009 27 SOT 367

<sup>15</sup> FTS – eg: Cyprus

<sup>16</sup> Norway, Italy Japan

<sup>17</sup> Mauritius, UAE

<sup>18</sup> (2005) 96 TTJ 765(Bom)

The same has been stated in the case of CSC Technology Singapore Pte. Ltd v. ADIT<sup>19</sup> it was held that Fee for Technical Services are taxable on the basis of payment not on the basis of accrual. Thus, income accrued to a foreign company cannot be taxed in the source country when the amount is not received in the foreign Country. Another controversy in this regard is how fees for technical services should be taxed in the absence of specific provision in Tax Treaty.

In the case of <sup>20</sup>Lanka Hydraulic Institution Ltd it was held that in the absence of specific provision for Taxation under DTAA , the payment would be taxable under Art 22 ie other income. It is proved that Indo-Lanka Treaty do not have specific provision for technical services and therefore provision Article 22 will apply where it is clearly mentioned that the item of income expressly specified in any of the Articles then he will be taxed only in that State where he is subjected to be taxed.

Article -13 – Capital Gain with respect to immovable property will be taxed by the Country of Source. Ie where the property is situated. In case of immovable property business property of a permanent establishment shall be taxed in the country of Permanent Establishment. Tax shall be levied by the Resident Country in the case of movable property excluding shares and in the case of shares tax shall be levied by the country where the situs of the company located. Under India- Mauritius<sup>21</sup> capital gains on transfer of shares are taxable only in Mauritius but there is no imposition of tax on capital gains in Mauritius as per their domestic Law.

<sup>22</sup>Vodafone International holdings v. Union of India Where Supreme Court quashed the order of High Court demanding Rs 12,000 crore as capital gain tax. Court held that revenue authorities cannot impose tax on an offshore transaction that took place between two non-resident companies but controlling interests in an Indian Resident Company.

<sup>23</sup>Income from rendering Professional services or any other activities of an individual shall be taxed by country of residence where these services are performed by the individual. <sup>24</sup>Income from dependent professional services shall be taxed by the contracting State where they were exercised. <sup>25</sup>Income derived by Artists or Sports person shall be taxed by the country where they exercised such activities and<sup>26</sup> income which are not covered under other Articles and such incomes shall be taxed by the country where it arises. However, there is one exception method for elimination of double Taxation even though there is allocation of exclusive right to tax but tax credit method which provides provision enables credit to tax be paid in the originating State by the Resident State. <sup>27</sup>The national of the contracting State shall not be subjected to any other taxation in other contracting States.

## Conclusion

Double Taxation Avoidance Agreement is intended to make country an interesting destination for investors by providing relief on dual Taxation. For us to prosper, the economy has to grow. And for growth in today's globalised world, foreign investments are inevitable. DTAAs basically provide clarity on how certain cross-border transactions will be taxed and this encourages foreign investors to take the plunge. Double Tax Avoidance Agreement is a treaty which helps in removing ambiguity of paying tax twice and at same time ensures that there is no tax evasion by exchange of information among both the countries. However the comprehensive network of tax agreement has also led to treaty abuse and so-called "treaty-shopping arrangements there by depriving jurisdictions of tax Revenues.

---

<sup>19</sup> 2012-LL-0217-40)

<sup>20</sup>

<sup>21</sup> DTAA

<sup>22</sup> (2012) 6 SCC 613

<sup>23</sup> Art 14

<sup>24</sup> Art 15

<sup>25</sup> Art 17

<sup>26</sup> Art 23

<sup>27</sup> Art 24

**REFERENCES**

1. Dr. Vinod Singhania & Monica Singhania, Taxmann's Students' Guide to Income Tax Including GST, 64th Edition ,2020-21.
2. Dr. Girish Ahuja & Dr. Ravi Gupta, Direct Taxes Ready Reckoner, 20<sup>th</sup> Edition, 2019.
3. T.N. Manoharan & G.R. Hari, Direct Tax Laws & International Taxation Assessment Year 2020-21, 2020.
4. Taxmann, Taxmann's Income Tax Act with Supplement-As Amended by The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act 2020, 2020.
5. Atal Kumar, Taxation Laws, Central Law Publications, 2016.
6. Dr S.R Myneni, Principles Of Taxation & tax Law Part.1, 4<sup>th</sup> Edition, 2018.

