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How to eradicate double taxation

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INTRODUCTION

Double taxation comes into force, when a person is required to pay multiple taxes from the earning of same income, asset, or financial transaction in different countries of the world. It occurs mainly due to overlapping of the tax laws and the prevailing rules and regulations of the countries where a person operates his business. Double taxation Agreement is a systematic imposition of two or more taxes on the same existing income. The double liability is often mitigated by the tax agreements, commonly known as treaties signed by the various countries of the world[1].

So, ifan Indian businessman makes a certain amount of profit or some other type of taxable gains in another nation from a business, he may be in a situation, where he will be required to pay a tax on that particular income in India, as well as in the nation in which that particular income was made. To protect the large number oftax payers from this unfair practice, the government has entered into tax treaties, known as Double Taxation Avoidance Agreement (DTAA) with 88 countries, including U.S.A, Canada, U.K, Japan, Germany, Australia, Singapore, U.A.E, and Switzerland. DTAA ensures that India's trade and services with other member countries, as well the movement of the capital are not adversely affected.

From a long time, Double taxation has been the subject matter engaging the attention of theCourts in India and other countries.[2] The Supreme Court in a leading judgment Laxmipat Singhania v. CIT[3]has made it very clear that –"it is a basic rule of the law of taxation that unless otherwise expressly provided income cannot be taxed twice. Again, it is not open to Income Tax Officer, if income has accrued to assesee and liable to be included in the total income of a particular year, to ignore accrual and thereafter to tax it as the income of another year on the basis of entire receipt."

[1] Vinod K. Singhania, Taxman's Direct Taxes Law & Practice, (37th Edition, 2007-08), at pg. 1183
[2]R Santhanam, Handbook on the Double Taxation Avoidance Agreements & Tax Planning for Collaborations, (5th Edition 2001), at pg. 455
[3] (1969) 72 ITR 291 SC

This principle founded by the Honorable Supreme Court has also been given statutory recognition in the Income Tax Act,1961 through Sections 2 to 5 of the Income Tax Act,1961[4].

CONCEPT OF DOUBLE TAXATION IN INDIA

In any nation, the tax is levied based on the:

1. Source Rule or the

2. Residence Rule

According to Source rule, the income earned is to be taxed in the nation in which it is actually originated, no matter whether that specific income accrues to a resident or a non-resident whereas according to the residence rule, the power to tax should be with the nation in which the taxpayer resides.

If both the above rules are applied side by side, to a specific business organization and it is taxed at both places, the cost of operating on an international place of market would become prohibitive in nature and would be deterring the process of globalization. It is from this point of view that DTAA becomes very crucial and plays a vital role.[5]

In India, the residential status is crucial for determining the income tax. In case of the Resident,their income (i.e domestic Income & Foreign Income) is taxed in India whereas in case of non-residents only domestic Income is taxed. Therefore,within India residence rule is applied for the residents whereas source rule is applied for the Non-residents as and when it becomes applicable. The residential status of a person is determined based uponthe available provisions of Section 6 of the Income Tax Act, 1961.

Mostly, it is seen that in case of residents, the income tax has been paid in other countries on their income earned abroad (i.e Foreign Income) and on the same earned income they are also required to pay tax in India at specific tax rates. In those cases, there are some provisions of providing relief from the double taxation. Generally, there are two sections i.e.Section 90 and Section 91[6] , which provides relief to them from getting taxed twice.

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Section 90 is applied in cases where India has signed a bilateral agreement with other countries and Section 91 is applied in cases where there is no such bilateral agreement.

GETTING RELIEF FROM DOUBLE TAXATION U/S 90[7]

[4]Explanation 2.—For removal of doubts, it is to be declared that income which has been already included in the total income of a person on the basis that it has been accrued or arisen or is deemed to have been accrued or arisen to him shall not again be included on the basis, that it is received or deemed to have been received by him in India.

[5] Prof Kailash Rai, Taxation Laws, at pg. 477

[6]Income tax Act,1961

[7]Income tax Act,1961

Double Taxation Avoidance Agreements (DTAA)

DTAA are the treaties or agreements between the two nations or even among the two countries where both of them or any one of them are "sovereign" nations.These treaties or agreements provide for relief from the double taxation in respect of income by providing specific exemption and also by providing a tax credit for taxes paid in one of the countries.

These treaties or agreement are based upon general principles laid down in the model draft of the Organization for Economic Cooperation and Development (OECD) with certain modification as agreed upon to by the other member countries. In case of countries with which India has double taxation avoidance agreements, the tax rates are determined by such treaties or agreements.

Honorable Justice Jagarmadha Rao, in a leading judgment in case of C.I. T v Vishakhapatnam Port Trust[8]hadreferred to the major redevelopments in the field of tax treaties or agreements. In this particular case, the assesse was itself a Government officialengaging in the trading transaction with a non-resident German economic entity.

It undertook to setup a plantin India and issue related to extent of non-residents' Indian income liable to Indian tax regime and implication of the DTAA as between India and Germany. The judgment, referred to the development of law on DTAA, which have gone through variouschanges on their own. Various Model forms applicable to all countries were first prepared by the fiscal committee of the League ofNations in 1927. Later on,the said committee conducted meetings at Mexico during 1943 and in London in 1946and proposed other several minor important variations in it.[9]

Different other important modes of avoiding the double taxation causing to individual have been developed because of different types of income being generated due to modernization. Certain other incomes, for example-income earned by way of interest may be taxed into hands of both countries or involved countries. While the applicableaccepted general rule is that, the nation of which theassesee is a resident thereof has right to levy tax, source nation would also have the right to levy tax but at the maximum permissible rate as prescribed.

A DTAA may effectively and efficiently act for avoidance of tax or for the relief against double taxation by providing for the grant of tax credit bynation of residence of the tax paid in source nation. DTAAs may be confined to a particular type of income earned. For example, Income from aviationmay be in general and cover several/all other types of incomes earned by individual.[10]

Our Constitution has conferred upon the sovereign power to levy taxes and to enforce collection and recovery thereof on the Nation under Article 265 of it by mandatorily providing that no tax shall be levied or collected except by authority of law concerned. Accordingly, the Union of India is empowered to enter

[8](1983) 144 ITR AP
[9]Ostime v AMPS (1960) 39 ITR 210 HL
[10]https://www.itatonline.org/interpretation/interpretation17.php

into treaties or agreements with foreign countries and herein falls within the scope of the power of UOI look into the DTAAs between India and different other foreign countries.[11]

In the context of the tax liability of the other foreign member nations, it is essential to ascertain their residential status in order to that of the scope of income chargeable to tax could be properly determined thereon. Foreign member nations are generally companies incorporated outside India and, therefore, they could be regarded as non-resident within the meaning of Section 6(3) since, in the case of foreign companies, the whole of the control and management of the affairs of such a company should not be situated in India, the place of carrying on the business and having transactions and operations being immaterial for the purpose.[12]

HISTORY OF DTAA

As far as the history of DTAA is concerned, the first such treaty or agreement was executed in 1899 between the nation of Prussia and Austro Hungarian Empire. The problem of double taxation first occurred in the 13th century among the nations of France and Italy – where the property concerned with tax was situated in one nation but owned by a resident of the other nation. In case of India, the first step against double taxation was taken in 1939 when the Income-tax (Double Taxation Relief) (for Indian Nations) Rules were framed.Being the Agreements between two member nations, it was found that it would be beneficial to have a Model Agreement which would be the basis for discussion between two member nations contemplating to conclude a Double Tax Avoidance Agreement (DTAA).

First draft Double Taxation Convention on income and capital was framed in 1963. This ultimately gave way to the OECD Model Convention and Commentaries in 1977. On the basis of the recommendation of the Committee on matters of Fiscal Affairs, OECD publishedthe 1992 Model Convention in a loose-leaf format to provide for updating it. The present Model Convention and Commentaries are updated as on January 2003.[13]

OECD Model Convention is generally taken into consideration for interpreting the Agreements between the countries which are not the members of OECD, though it is actually meant for OECD member countries. In addition to OECD Model, UN Model Convention originated in a resolution passed by ECOSOC (Economic and Social Council) in August,1967 and published in 1980 in the form of the Model Double Taxation Convention(MDTC) between developed and the developing countries; which is generally considered to be more favorable for the other developing countries as it places greater impact on the right of the source nation to tax a transaction having international aspects.[14]

INDIAN POLICY ON DOUBLE TAXATION AVOIDANCE AGREEMENT

DTAAs, depending on their scope, can be termed as comprehensiveand limited. Comprehensive DTAAs provide for taxes on income, capital gains andcapital, while Limited DTAAs refer only to income from shipping and air transport, orenations, inheritance and gifts. Comprehensive agreements make sure that

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[11]R. Santhanam, H&book on Double Taxation Avoidance Agreements & Tax Planning for Collaborations, (5th Edition 2001), at pg 457

[12]*Id* at pg 14

[13]http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2036494

[14]Journal Of Legal Studies & Research [Vol. 1, Issue 1], at pg. 46

the taxpayers in both the nations wouldbe treated equally and on equitable basis, in respect of the difficulties relating to the purpose of double taxation.

The primary object of a DTAA is to provide for the tax claims of two governments both are legitimately interested in taxing a specific source of income earned either by assigning to one of the two, the full claim or else by prescribed basis on which tax claims can be shared between them.

The importance and purpose of tax treaties or agreements has been summarized by the OECD in the 'Model Tax Conventionon Income and on Capital'(MTCIC) in the following words:

"*It is desirable to clarify, standardize, and to confirm the fiscal situation of taxpayers who are engaged, industrial, financial, or any other kind of activities in other countries through the application by all countries of common solutions to identical cases of the double taxation.*"[15]

OBJECTIVES OF DTAAs

- They help in avoiding burden of international double taxation from an individual or a nation, by laying down provisions for division of revenues between the two nations; exempting incomes from tax in either of the nation; reducing the applied rate of tax on certain incomes taxable in either countries.
- Tax treaties or agreements helps an individual taxpayer of one nation to know with much greater certainty the actual limits ofhis tax liabilities in the other nation.
- To aconsiderable extent, a tax treaty or agreement provides against non-discrimination of foreign tax payers/permanentestablishments in source nation as well as domestic tax payers or individuals.

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DTAAs allocate specific jurisdiction with respect to the right to tax a specific kind of income. The various relative principles involving tax treaties is sharing the collectedrevenues between two countries. If eachnation gets a specific share of tax revenues, the bilateral and multilateral trade prospers and the overalltax collection also rises as a result both countries gets benefit from it.

Such agreements deal by and large with business income, income from movable and immovableproperty.[16]There are established patterns of taxation of various types on income. It also provides allocation of taxing jurisdictions to different member nations in respect of different heads of income.

Ingeneral sense, the rules are to the following effect:

- The Income earned from business is taxed only in the resident nation, if that economic entity has no activityin the source nation; only on the source nation, if there is a particular fixed place of business activity, i.e. Permanent Establishment and upto the extent it is relatable to that place.

[15] *Id* at pg 47
[16] Ostime v AMPS (1960) 39 ITR 210 HL

- The Income earned from immoveable property arising to a non-resident is being taxed primarily in the nation of its location, i.e.source nation.
- The Income earned from moveable property such as dividend, interest and royalty are primarily taxed in resident nation, but source nation may impose a reduced rate of tax.[17]

Various methods of granting relief under double taxation avoidance agreement[18]

1) The Exemption method – Under this method, a specific income is taxed in one of the countries and exempted in another nation. (For example, for theIncome from Dividend, Interest, royalty &fees for technical services, the source rule is applicable in treaty with Greece, Libyan & UAE. Therefore, for a citizen of these above countries, if the dividend, interest, royalty or fees for the technical services is arising out in India, then it is solely taxable in India only and if for a resident if such income is arising in any of the above mentioned countries then the income will be taxed in above countries and it will not be further taxable in India).

2) The Tax credit method- Under this method, the income is taxed in both the member countries as per the treaty or the agreement and the nation of residence will allow the tax credit or reduction for the tax charged in that nation of source. For example- Mr. X (an Indian resident) has received salary from a USAbased company for job done in USA. Since Mr. X is a resident so his global Income will be taxable. In this case source nation is USA (since the service has been rendered in USA only) and resident nation is India. So at the time of computation of net tax liability of Mr. X, the tax paid in USA will be allowed as set off against his total tax liability but limited to tax payable on such foreign income at the specific Indian tax rates.

In such cases where bilateral agreement has been entered under Section90 of Income Tax Act,1961 with a foreign nation then the assesee has an option as either to be taxed as per the DTAA or as per provisions of Income Tax Act 1961, whichever is more favorable to the assesee.[19]

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GETTING RELIEF FROM DOUBLE TAXATION UNDER SECTION 91[20]

As applicable in India, Section91 is relatedto unilateral relief. It states that, "*if any person or company which is resident of India in any previous year proves that, in respect of its income which accrued during that previous year outside India*", he has paid in any nation with where there is no agreement (under Section90) for reliefof double taxation by deduction or otherwise, under the law applicable in the nation, it will be allowed for deduction from the income tax payable by him of a sum calculated on such double

[17]Journal Of Legal Studies & Research [Vol. 1, Issue 1], at pg 49
[18] Dr Girish Ahuja, Direct Taxes, (29th Edition), at pg 1451
[19] CIT vITC Ltd.2003 85 ITD 162 Cal
[20]Income Tax Act,1961

taxed income at the average Indian tax rate or average rate of tax of said nation, whichever is lower,or at the Indian rate of tax if both tax rates are of equal value.[21]

Similarly, unilateral relief will be available for thetax-payer, if the following conditions are satisfied: -

- The person or company in question must have been the resident in India in the previous financial year;
- Same income must have accrued or arisen to him outside India[22] during the previous financial year and it should also be received outside India. Such income should not be deemed to accrue or to arise in India;
- In respect of that earned income, the assesee(must have paid by deduction or otherwise, tax under the law in force in the foreign nation in question in which the income outside India has arisen.
- That income must be taxed both in India and in a foreign nation and there can be no reciprocal arrangement for relief from double taxation with the nation where the income has accrued.[23]
- It is mandatory that the foreign tax should be levied in a nation with which India has no agreement for relief of double taxation, but it is not material that tax paid in such a foreign nation is in respect of income arose in another foreign nation with which Indian has such an agreement for taxation purpose.

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And if all the above conditions are satisfactory, such person or company shall be entitled to deduction from the Indian Income Tax payable by him of a sum calculated on such double taxed income:

a) the average Indian tax rate or the average tax rate of the said nation, (whichever is lower as applicable)

b) the Indian tax rates,(if both tax rates are equal.)[24]

The one way relief under this Section is available only in respect of the 'double taxed income', i.e. the part of the income which is included in assessor's total income: the amount deducted under Chapter VI-A is not double taxed and therefore, no relief is allowed in respect of such amount charged.[25] Furthermore, the

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[21] Dr Girish Ahuja, Direct Taxes, (29th Edition), at pg 1451
[22]Jeevanlal v CIT 79 ITR 147
[23]Ramanathan V. CIT 88 ITR 169
[24] Dr. Girish Ahuja, Direct Taxes, (29thEdn.), at p. 1460
[25]CIT V. Bhatt 185 ITR 592

Section provides granting of relief calculated on income as nation wise, and not on the basis of aggregate of income from all other nations.[26]

In the leading case of Gamman India v CIT[27], the Honorable Bombay High Court held that a relief provided under Section 91of the Act, could not be claimed in rectification proceedings under Section154, but the Honorable Calcutta High Court took a contrasting view in the leading case of CIT v UCB.[28]

CONCLUSION

Concept of International taxation, nowadays exists through bilateral tax treaties or agreements, based upon the model treaties, formed by the OECD and the United Nations, between the nations. India has entered into a vast network of tax treaties with many countries all over the world to enable free flow of trade and commerce. However, international tax provisions has to be restructured and redeveloped over time,so as to respond to the present challenges anddrawbacks of the existing complexities.

All tax related treaties or agreements provide for a mechanism to eradicate double taxation which is still present. This process requires that each nation grant a tax credit for taxes of the other nation to lower the taxes of a resident of thatnation. The treaty might provide mechanisms for limiting this credit, and might not limit the application of the local law processes to do the same.

The actual issue that has seen in the interpretation of DTAA is that of theposition, where there is a conflict between the provisions of the Income Tax Act,1961 and applicable DoubleTaxation Avoidance Agreement.

Provisions of Section 90(2) of the Act makes it abundantly clear, that where an agreementfor granting relief of tax or avoidance of the double taxation has been entered into, in relation to assesee to whom such agreement applies or being applied to, provisions of Act to the extent that they are more beneficial and relevantas compared to the provisions of DTAA would have to be applied thereon. Itstates that where provisions of the applicable treaty or agreement are more favorable, compared to the provisions of the Act, **the provisions of Agreement will prevail**.

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[26]CIT V. Bombay Burmah259 ITR 423
[27]214 ITR 50
[28]206 ITR 641