UNRAVELLING THE MYSTERIES OF DOUBLE TAXATION

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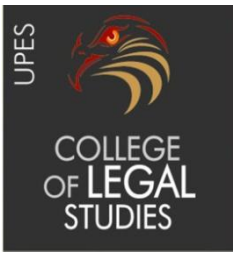
This dissertation is submitted in partial fulfillment of the degree of B.B.A., LL.B. (Hons)



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CERTIFICATE

This is to certify that the research work entitled **"UNRAVELLING THE MYSTERIES OF DOUBLE TAXATION"** is the work done by **PUJA KUMARI** under my guidance and supervision for the partial fulfillment of the requirement of B.B.A. LL.B.(Hons) with Specialization in Corporate Laws, degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled **"UNRAVELLING THE MYSTERIES OF DOUBLE TAXATION"** is the outcome of my own work conducted under the supervision of **Mr. Sujith Surendran**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

PUJA KUMARI

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ABBREVIATIONS

1. &- And
2. AIR- All India Reporter
3. CBDT- Central Board of Direct Taxes
4. CFC- Controlled Foreign Corporation
5. CG- Central Government
6. CIT (A)- Commissioner of Income Tax Appeal
7. CIT- Commissioner of Income Tax
8. Del- Delhi
9. DTTA- Double Taxation Avoidance Agreements
10. ECOSOC- Economic and Social Council Council
11. Ed- Edition
12. FDI- Foreign Direct Investment
13. GAAR- General Anti- Avoidance Rules
14. HSN - Harmonized Commodity Description and Coding System.
15. HUF- Hindu Undivided Family
16. IT Act- Income Tax Act
17. ITO- Income Tax Officer
18. ITR- Income Tax Return
19. LLP- Limited Liability Partnership
20. Ltd. – Limited
21. MAP- Mutual Agreement Procedure
22. OECD- Organisation for Economic Co-operation and Development
23. Ors- Others
24. RNOR- Resident and Not Ordinary Resident
25. ROR-Resident and Ordinary Resident
26. SC- Supreme Court
27. SCC- Supreme Court Cases
28. SG- State Government
29. u/s- Under Section
30. UNCTAD- United Nations Conference on Trade and Development
31. UOI- Union of India

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- CIT v. Kulandagan Chettiar (2004) 267 ITR 654 (SC)
- CIT v. R.M. Muthaiiah [1993] 202 ITR 508
- CIT v. TISCO Ltd 60 ITR 405
- CIT v. Visakhapatnam Port Trust (1983) 44 ITR 146 (AP)
- CIT v. R.D. Aggarwal & Co (1965) 56 ITR 20
- CIT versus Laxmi Textile Exporters Ltd (Mad) 245 ITR 521
- CIT vs PVAL Kulandagan Chettiar (267 ITR 654) (SC)
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- Sakalchand Babulal v ITO 47 ITR 673 (Mad)
- State of Jharkhand v. Tata Cummins Ltd (2006) 4 SCC 57
- State of Rajasthan vs. Basant Nahata, (2005) 12 SCC 77
- Timken India Ltd. v. CIT [1954] 26 ITR 27
- Union Of India v Azadi Bachao Andolan (263 ITR 706) (SC)
- Union of India v. Azadi Bachao Andolan (2004) 10 SCC 1
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CHAPTER 1

TAXATION REGIME IN INDIA

1.1 Overview

The human life is woven in a web of rights, duties and obligation. A country cannot function without laws. These rights and duties and obligations find their origin in some or the other statutes or the supreme law of land and in the case of India, it is the Constitution of India. With the ever increasing industrialization and globalization, cross-border transactions have increased manifold. The Indian economy is growing and with the benefits accruing to the citizen as well as the non-citizen, burden being imposed on them in the form of tax is apparent which can not be avoided.

Taxation is a statutory field. No tax can be levied or collected except according to the authority of law. Taxation is a vast subject. It is not limited to few provisions or rules. Indian taxing statutes are complex due to variety of reasons which will be dealt in brief in the report.

The taxation is an ever expanding area. It has to incorporate not only the domestic taxation but even the international aspect involved in it. The exports and imports are enormously increasing in our country. It is one the major sources of income to our country. The corporations are keen to establish their offices and branches in India and exploit the resources easily available in our country and take the gains to their country.

Taxes in India are collected by the Central Government and the State Governments. Some minor taxes are additionally imposed by the municipal body or the local authority.[1] No other body or institution is entitled to collect tax in India.

The power to tax income is derived from the Constitution of India which designates the ability to impose different charges between the Union and the State. An imperative confinement on this power is Article 265 of the Constitution which expressly states that:

"No tax can be extracted or gathered by any person or institution other than the body of law". Therefore every tax imposed or gathered must be supported by the law passed by the State Legislature or the Parliament.[2]

[1] Tax Structure in India, available at http://business.mapsofindia.com/india-tax/structure/, last accessed on 10th March, 2015.

Further, taxation system has undergone extensive changes over the past years in the line of liberalisation.[3] The assessment rates have been continuously rationalized and tax laws have been modified and simplified according to the economic state of the country.

It has brought better agreeability, simplicity in the payment by providing electronic facilities with regard to income tax computation and the payment of the same. The methodology of legitimization of tax administration is continuous in India.

1.2 Historical shift

India was an agriculture oriented country during British times. The major chunk of income India earned was by exporting jute and tea in which India enjoyed monopoly status in the world. Most of the major imports were from Britain which charged heavy import duties. Many enactments like, the Sea Customs Act, 1878; and the Tariff Act, 1934 were repealed and the Customs Act, 1962 and Customs Tariff Act, 1934 came into being.[4]

Further, taxes in different form were imposed on several commodities even in ancient times. Reference with regard to taxation has also been made in Manu Smriti and Arthshashtras. Various saints have mentioned about the tax being charged by the king for the effective functioning of the administration.[5]

The tax played the major source of revenue which was utilized for the effectiveness of the military and for general administration like maintenance of roads, public sanitation or temples. The system of taxation was not homogenous during those days.

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[2] Taxation System in India, available at http://indiainbusiness.nic.in/newdesign/index.php?param=investment_landing/293/6, last accessed on 10th March, 2015.

[3] Taxation, available at http://www.archive.india.gov.in/business/taxation/index.php, last accessed on 10th March, 2015.

[4] Dr. K.N. Chaturvedi, Interpretation of Taxing Statutes 2-4 (Taxmann 2008).

[5] History of Taxation Pre-1922, available at http://www.incometaxindia.gov.in/Pages/about-us/history-of-direct-taxation.aspx, last accessed on 13th March, 2015.

It was highly uncertain. There was no specific mechanism which governed the taxation. Further, it was collected both in the form of cash or in kind.[6]

The Central Excise Tariff Act, 1985 is based on internationally accepted harmonized commodity description and coding system. The first Income-Tax Act was introduced in the year 1886. In a welfare state, the prima object of the Taxation Act is not just the generation of revenue but it also aims at meeting the socio-economic objectives of the country.

The levy of income tax in India is governed by the Income Tax Act, 1961 and Income Tax Rules, 1962. The Income Tax Department is governed by CBDT and it is a part of the Department of Revenue under the Ministry of Finance, Government of India.

1.3 Income Tax

Income tax is the form of direct tax imposed by the Government on income, commodity or activity. It serves as a source of income for the government. The responsibility for collection of income tax vests in the Central Government which is collected under the purview of Income Tax Act, 1961.

"Income Tax is levied on the total income of the previous year of every person." For the purpose of Income Tax Act, 1961, any individual, Hindu Undivided Family, Association of Persons, Body of Individuals, a firm, a company a local authority and every artificial, juridical person, not falling within any of the above categories falls under the scope of income tax.

1.4 International Taxation

The theory of international tax treaties is covered under the concept of International Taxation. With the increasing cross border transactions, mergers and acquisitions, growth of multinationals, the foreign countries are shifting their focus and approach to India. India is the world's largest democracy and one of the fastest growing economies. In such a growth

[6] History of Taxation, available at http://business.mapsofindia.com/india-tax/concepts/history-taxation.html, last accessed on 13th March, 2015.

accelerated scenario, it is important that the country's tax and regulatory policies are well understood for success opportunities.[7]

The Indian business houses are also interested in making money from the international market and are even making a way for the overseas business houses to enter the India.

The word "International taxation" is an expanded term and subject to various interpretations but in general, the global taxation pattern of any country governing its cross border transaction is referred to as the international transaction. The cross border transactions in India are governed by DTAA and in the absence of such agreements it is governed by the provisions of Income Tax Act, 1961.[8]

"International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions."[9]

It has been defined vide Section 92B of the Income Tax Act. It provides that "International Transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided to any one or more of such enterprises.[10]

[7] Available at http://www.cbec.gov.in/aar/definitions.htm, last accessed on 12th March, 2015.

[8] Available at http://www.rashminsanghvi.com/articles/taxation/international-taxation/fundamentals-of-international-taxation.html, last accessed on 14th March, 2015.

[9] Available at http://www.moneycontrol.com/glossary/taxes/international-taxation_2977.html, last accessed on 14th March, 2015.

[10] TAX LAWS AND PRACTICE 643 (2014 ed. The Inst. of Secretaries of India).

CHAPTER 2

BASIC CONCEPTS IN INTERNATIONAL TAXATION ARENA

2.1 Income deemed to accrue in India

The income of non- residents and foreign companies is liable to be taxed in India, but only to the extent to which it accrues in India. The accrual of income is different from receipt of income. Income is said to accrue when it comes into existence for the first time or at the point of time when the right to receive the income arises although the right may be exercised or exercisable at a future date. Income accrues from the place where the source of income lies but not particularly the place where business is carried on.

Section 5(2) of the Income Tax Act, 1961 (hereinafter referred as "Act") provides that the total income of a non-resident would comprise of:

"Income received or deemed to be received in India in the accounting year by or on behalf of such person and the income which accrues or arises or is deemed to accrue or arise to him in India during the previous year."

Further Section 9 of the Act provides specific instances when a particular income can be considered as "deemed to accrue or arise in India". Those instances are mentioned as follows:

- Income which arises by virtue of business connection-

The SC has held in the case of *Barendra Prasad Ray & Ors. v. ITR*[11], that the business does not necessarily mean trade or manufacture only, it even includes within its scope professions, vocations and callings.

However, where a substantial part of non- residents output is sold in the Indian market through brokers to various customers in India, or mere rendering of services outside India to a person carrying on business in India does not amount to a business connection in India.[12]

[11] Barendra Prasad Ray & Ors. v. ITR (1981) ITR.

[12] TAX LAWS AND PRACTICE 35 (2014 ed. The Inst. of Secretaries of India).

- Income arising from any asset or property in India-

In this context, term property not only includes house property but even includes tangible and intangible property.[13]

- Capital asset-

Such capital asset must be situated in India and it can be movable, immovable, tangible or intangible asset.[14]

- Income from salaries-

Income chargeable under the head salary is deemed to accrue or arise in India in all cases when earned in India. In such a situation, income is said to be earned in India if the services are rendered in India.

- Taxability of interest, royalty and fees for technical service-

In such cases, any interest, royalty or fees for technical services payable by Government or resident of India, except where it is payable in respect of business or profession carried outside India or earning any income from any source outside India or a non-resident in India provided the amount is payable in respect of business or profession carried on in India or earning any income from any source in India.

- Taxability of dividend-

The residential status of the shareholder as well as his status of the assessee, whether he is an individual, company or local authority is irrelevant.

It has been settled in the cases of *CIT v. R.D. Aggarwal & Co.*[15]; *Sakalchand Babulal v ITO*[16]; *Annamalais Timber Trust & Co. v CIT*[17] that the principle applied in Section 9 of the Act does not apply on the income arising or accruing to the assessees in India.

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[13] Mehul S. Shah, Income deemed to accrue or arise in India: A study, available at http://www.lexsite.com/services/network/caa/ar23-e.shtml, last accessed on 23rd March, 2015.

[14] Income Tax Handbook for Salaried Employees, available at http://www.taxspanner.com/ts/income-deemed-to-accrue-in-india, last accessed on 22nd March, 2015.

[15] CIT v. R.D. Aggarwal & Co (1965) 56 ITR 20.

[16] Sakalchand Babulal v ITO 47 ITR 673 (Mad).

[17] Annamalais Timber Trust & Co. v CIT 41 ITR 781 (Mad).

On the other hand, any income which accrues or arises outside India cannot be deemed to be received in India on the ground that the balance sheet is prepared in India. So, such conflicting scenarios have to be looked in detail.[18]

2.2 Residence of person

Under Section 6 of the Act, a person can be considered as a resident in India in any previous year if either of the following condition satisfies:

"Has been in India for at least 182 days during the previous year; or has been in India for at least 365 days during the four years preceding the previous year and has been in India for at least 60 days during the previous year where if any of the condition is satisfied then an individual is resident otherwise he will be a non-resident."

Such conditions do not apply for:

"Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India, or the citizen of India or any person of Indian origin engaged outside India whether for rendering services outside India or not and who comes on a visit to India in any previous year."

Further, an individual may become a resident and ordinarily resident in India if he has satisfied the following conditions besides satisfying any of the above mentioned conditions:

- He has been resident in at least any 2 out of the 10 previous years immediately preceding the relevant previous year, and
- He has been in India for 730 days or more during the seven previous year immediately preceding the relevant previous year.[19]

Residence as defined in Double Taxation treaties is different from residence for domestic tax purposes. Tax treaties generally follow the OECD Model Convention which provides:

"For the purposes of this Convention, term 'Resident of a Contracting State' means any person who, under the laws of that State, is liable to the tax therein by reason of his domicile,

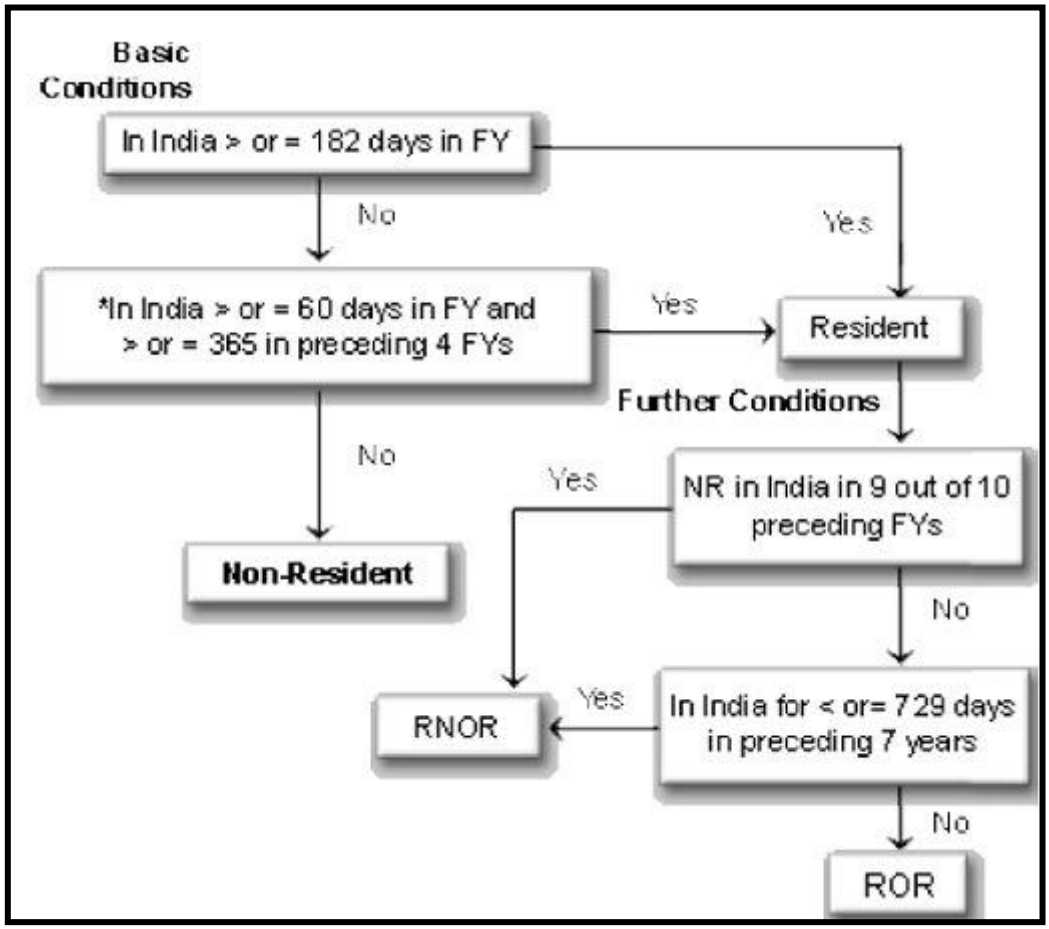
[18] Available at http://www.lexsite.com/services/network/caa/ar23-e.shtml, last visited on 15th March, 2015.

[19] Available at http://allbankingsolutions.com/Top-Topics/Who-is-NRI-Define-Non-Resident-Indians.shtml, last visited on 16th March, 2015.

residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that state and any political sub-division or local authority thereof."

This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or Capital situated therein.[20]

The flow chart below depicts the condition for determining the residential status of any person who is liable to be taxed on his income earned in the previous year.[21]



[20] Available at http://allbankingsolutions.com/Top-Topics/Who-is-NRI-Define-Non-Resident-Indians.shtml, last visited on 16th March, 2015.

[21] Available at http://taxguru.in/income-tax/residential-status-income-tax-act-fema-bank-accounts-nris.html, last accessed on 17th March, 2015.

Where by reason of the provisions an individual is a resident of both Contracting States, than his status shall be determined as follows:

- He shall be deemed to be a resident only of the State in which he has a permanent establishment available;
- If he has a permanent establishment available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economical relations are closer. It will be considered as his centre of vital interests;
- If the state in which he has his centre of vital interests cannot be determined, or if he is not having a permanent establishment available to him in either State, he shall be deemed to be a resident only of the state in which he has an habitual abode;
- If he has an habitual abode in both States, he shall be deemed to be a resident only of the State of which he is a national;
- If he is a national of both States or neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Where by reason of the provisions, a person other than an individual is a resident of both the Contracting States, than it shall be deemed to be a resident only of the state in which his place of effective management is situated.[22]

2.3 Permanent Establishment

One of the most imperative terms that comes up in most of the Double Taxation Avoidance Agreements is 'Permanent Establishment' which has not been mentioned and defined in the Income Tax Act.

However as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state. Tax is computed by treating the PE as a separate and autonomous enterprise. It should be an independent enterprise.[23]

Some prominent aspects concerning a PE could be discussed as under

[22] Available at http://blog.reachaccountant.com/residential-status-and-tax-incidence-under-the-income-tax-act-fema-and-companies-act/, last visited on 17th March, 2015

[23] Available at http://www.taxmann.com/taxmannflashes/flashart5-1-10_7.htm, last visited on 17th March, 2015

- PE is defined with indication to place and persons;
- PE could be a permanent place, a manufacturing or construction site, service PE, agency PE branch etc.
- PE denotes non-resident's business preserves.
- The degree of vital interest which could constitute PE has been illustrated by 'inclusions and exclusions'.[24]

Secluded or periodic exchanges through a few persons or agency do not create liability is basis of PE. There must be progression of activities adding to the procuring of salary something. It should be more than mere transaction of purchase or sale or transactions of preparatory or auxiliary nature. Such activities must be value creating activities requiring capital and several other inputs.

"Permanent" in PE does not mean perpetual or everlasting.[25]

"*In order to avoid Double Taxation it is provided that if the resident of India becomes liable to pay tax either directly or by deduction in other country in respect of income from any source, he shall be allowed credit against the Indian tax payable in respect of such income in an amount not exceeding the tax borne by him in the other country on that portion of the income which is taxed in the said other country. The same benefit is available to the resident of the other country, on income taxed in India.*"[26]

[24] Available at http://www.mondaq.com/india/x/254984/Income+Tax/Permanent+Establishments+Attribution+of+Business+Profits, last visited on 16th March, 2015.

[25] Available at http://taxbymanish.blogspot.in/2013/06/india-dtaa-and-agreements.html. last visited on 17th March, 2015.

[26] TAX LAWS AND PRACTICE 636 (2014 ed. The Inst. of Secretaries of India).

CHAPTER 3

DOUBLE TAXATION AVOIDANCE AGREEMENTS

3.1 Definition

DTTA as the name suggests is a mechanism to avoid double taxation of the income. For example, any country A will enter into a bilateral agreement with country B to avoid its income being taxed twice; once in the country of residence and again in the source country. To mitigate the problem of double taxation of income, the provisions for double taxation relief has been made.[27]

Herein, the residence country refers to where the assessee resides and the source country is the country from where the income is generated. If a country does not enter into DTTA with the country from where income has generated, the assessee will be liable to pay tax on the income in both the countries.

The Indian Government derives its power to enter into treaties with one or other countries by Article 253 of the Constitution of India.[28] The double taxation relief is available in two ways: bilateral relief or unilateral relief.

The theory of double taxation has always been the area under discussion and has gained the attention of the courts in India and abroad from time to time. In *Laxmipat Singhnia v. CIT*[29], the S.C has held that the basic rule of the law of taxation is that unless otherwise expressly provided income cannot be taxed twice.

The Income Tax Officer, even if the income has accrued to the assessee and is liable to be included in the total income of a particular year, cannot overlook the accrual and tax it as the income of another year on the basis of receipt. This principle enunciated by the Supreme Court has also been given statutory recognition to certain provisions of the Income Tax Act related to international taxation.

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[27] TAX LAWS AND PRACTICE 631 (2014 ed. The Inst. of Secretaries of India).

[28] Annapurna Chakraborty, Double Taxation Avoidance Agreements in India, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2404797, last accessed on 12th March, 2015.

[29] Laxmipat Singhnia v. CIT (1969) 72 ITR 291 (SC).

A specific branch in the law of taxation has been developed in India after a number of DTAAs has been entered into by India with several foreign countries. The reason for such agreements was due to the income generated in India by person who is not the resident of India.

The desire of a country to tax an income can never be satisfied. In such circumstances, both the residence country and the country of origin would like to tax the income.[30]

Then the real need for DTAA comes into play. It may vest right to tax a particular type of income in one of the contesting States. A right to tax a particular income under the DTAA may depend on certain circumstances.

For example, business income is generally taxable in the source state if the enterprise has a permanent establishment therein. By source state, it is meant the state where the income arises or the state the residents of which make payment to the residents of the other contracting state.[31]

3.2 History

The history of DTAA can be traced back to 1899 when it was entered for the first time between Prussia and the Austro Hungarian Empire. The need for DTAA was felt in the 13th century when there was a dispute between Italy and France with regard to a property situated in France which belonged to the Italian resident.

A committee was setup to formulate a Model Convention by the OECD which was previously known as the Council for European Economic Co-operation. In 1963, the draft Double Taxation Convention on Income and Capital was framed which gave birth to the OECD Model Convention and Commentaries.

The 1992 Model Convention was published by OECD just as a trial measure. The Model Conventions are now updated at a regular interval. Many countries who are not even part of

[30] Available at http://www.goodreturns.in/classroom/2013/07/what-is-double-taxation-avoidance-agreementdtaa-193501.html, last visited on 18th March, 2015.

[31] Available at http://www.itatonline.org/interpretation/interpretation17.php, last visited on 17th March, 2015.

OECD employs its principles for interpretation of the agreements though it is basically meant and formulated for the countries who are signatory to OECD.[32]

Further UN Model Convention originated in August, 1967 by a resolution passed by ECOSOC and published a Model Double Taxation Convention in the year 1980 for the developed as well as developing nations. It serves as a good source of revenue for the Government and will provide ample growth by encouraging investments and retaining the government's taxation rights.[33]

It even provides framework for corporate tax evasion and provides a set of rules to be abided to while investing in a developing country.[34] This was a favourable step for developing countries as their income could be taxed in the source country.

In the year 1939, Income Tax (Double Taxation Relief) Rules were formulated by the Central Government invoking Section 59 of the Income Tax, Act which reads as "Power to make rules".[35] It was the first move taken by India in respect of Double Taxation. The need for the same was felt when many states started entering into Double Taxation Avoidance Agreement.

Further, relief against double taxation has been provided in the Section 90 and Section 91 of the IT Act. Presently, India has entered into Double Taxation Avoidance Agreement which is either bilateral or multilateral with more than 110 countries.[36]

Thus, the term "heart yearns for more" is not applicable in the case of taxation. No one would appreciate an income to be taxed twice. Thus, in the present scenario the need for DTAA has

[32] Available at http://www.slideshare.net/nishidh41/double-taxation-avoidance-agreement-dtaa-16507859, last accessed on 20th March, 2015.

[33] Available at http://unctad.org/en/Pages/AboutUs.aspx, last visited on 20th March, 2015

[34] Available at United Nations Model Double Taxation Convention between Developed and Developing Countries available at http://www.un.org/en/development/desa/publications/double-taxation-convention.html, last visited on 20th March, 2015

[35] Available at http://www.incometaxindia.gov.in/Acts/Indian%20Income-Tax%20Act,%201922/102120000002045736.htm, last visited on 29th March, 2015

[36] Available at http://businesstoday.intoday.in/story/how-treaties-with-foreign-countries-can-help-nris-save-tax/1/194401.html, last visited on 15th March, 2015

been felt across the globe and the countries in order to avoid any conflict at a later stage with regard to taxation of an income is making proper utilization of DTAA.[37]

The bilateral or multilateral treaties entered between India and the other country is based on the general principles provided in the OECD Model. Those principles are incorporated as whole or with certain modifications while formulating the treaty. The tax rates are specifically determined in those treaties.

Such treaties do not have universal applicability. There can be a situation when a particular income has been taxed twice in both the states. For example, income by way of interest can be taxed twice. Thus, the Tax Avoidance Agreement can be only applicable for particular type of income, for example, aviation income or may be general and cover several types of income.[38]

As both the countries form part of the commercial transaction, the income tax laws of the both the country will be taken into consideration with respect to generation of income, profit or gains. The DTAA does not put the revenue of either of the country at stake. It is basically a collaboration agreement.

Such scheme of DTAA is very much applicable in the case of mergers and acquisitions. It should be formulated in such a manner by utilizing proper tax planning and avoiding the burden of same income to be taxed twice putting the tax payer in a disadvantageous position. Further, DTAA should not be affected by the economic and political changes in a country. The tax regime of a country undergoes substantial changes at a regular interval and the same must be incorporated in the DTAA. The same has to be incorporated in the collaboration agreement to remain in par with the taxation laws of a country. [39]

The modifications and amendments should not be so typical as to modify the DTAA as a whole.[40]

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[37] Available at http://www.moneycontrol.com/news/nris/how-can-nris-avoid-double-taxation_1174191.html, last visited on 18th March, 2015

[38]Available at http://economictimes.indiatimes.com/news/economy/foreign-trade/india-mauritius-to-work-to-avoid-abuse-of-dtat-pm-narendra-modi/articleshow/46537298.cms, last visited on 17th March, 2015.

[39] Available at http://www.slideshare.net/nishidh41/double-taxation-avoidance-agreement-dtaa-16507859, last visited on 17th March, 2015.

[40]Available at http://economictimes.indiatimes.com/wealth/tax-savers/tax-news/claiming-tax-benefits-under-dtaa-things-you-should-know/articleshow/45921752.cms, last visited on 17th March, 2015.

The Constitution of India is the law of land in India. The word "tax" in its widest sense includes money raised by taxation. It therefore includes tax levied by the Central and State Legislatures, and also those known as "rates" or other charges, levied by local authorities under statutory powers. Taxation has been defined in clause (28) of Article 366 of the Constitution of India to include "the imposition of any tax or impost whether general or local or special" and it has been directed that tax shall be construed accordingly."[41]

The Constitution of India under Article 265 has conferred the sovereign power to levy taxes and to enforce collection and recovery thereof on the State by explicitly providing that:

"No tax will be levied or collected other than by authority of law."[42] But a contrast situation has also been observed in India, post independent. The involvement of judiciary in law making is increasing which has led to the dissolving of power of the legislature. Moreover, liberal interpretation of taxation laws in also required.

3.3 Necessity & Application

The taxation scheme is different for every country. Many a times a particular income is generated in a country which is not the place of residence of the assessee. In such a situation, we need to mitigate the instances of double taxation. It is a relief mechanism to prevent the burden of income being taxed twice of a particular person. Thus, double taxation is the levy of tax on the income in both the countries. In order to avoid such instances, the countries enter into tax treaties. The definition of source of income is different in taxation statutes all over the world. The real problem arises due to different notions on the source of income.[43]

The problem becomes extensive where the taxation rate on a particular source of income in both the countries is more than 50%. In such a situation, the tax payer will regret earning any income. In such a complicated situation, the assessee will be left with a negative income because all the income earned will be dumped as tax along with entitling the assessee to pay from his pocket. This will have a negative impact on the economic growth of the country.

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[41] D.G. Gouse & Co. v. State of Kerala AIR 1980 SC 271

[42] Available at http://lex-warrier.in/2013/08/article-265-and-the-authority-to-impose-tax/, last visited on 17th March, 2015.

[43] Available at http://businesstoday.intoday.in/story/how-treaties-with-foreign-countries-can-help-nris-save-tax/1/194401.html, last visited on 17th March, 2015.

To promote free flow of trade and investment, DTAA is required. Without DTAA, the investors will become de-motivated and will prefer not investing in a foreign country which will adversely affect the cross-border transactions and foreign investments. Such treaties even contain provisions with regard to mutual exchange of information which promotes technological upliftment.[44]

The object of DTAA is to provide a scheme where either of the country will tax the income or a scheme where the tax benefits will be shared by both the countries in a prescribed format. The need and purpose of tax treaties has been explained in a summarized way by the OECD in the "Model Tax Convention on Income and on Capital" in the following words:

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

The objectives of DTAA can be summarized as follows:

- Mitigating the instances of double taxation;
- Exempting the taxation of certain incomes in either country;
- Reduction in the tax rates;
- Prescribing guidelines and rules for division of revenue between the countries;
- Harnessing the potential limits of his tax liabilities in the other country
- Foster economic trade between countries
- Settlement of taxation claims between the two government[45]
- Legal and fiscal certainty
- Mutual exchange of information[46]
- Non-discrimination of foreign tax payers in the source country
- Allocation of taxes between treaty nations
- Mitigating tax avoidance
- Equal and fair treatment of tax payers having different residential status

[44]Available at http://www.nritaxservices.com/tax_dbl.htm, last visited on 18th March, 2015.

[45] Available at http://www.archive.india.gov.in/business/doing_business/double_taxation.php, last visited on 22nd March, 2015.

[46] Available at http://communities.nasscom.in/file_cabinet/download/0x0000951c2, last visited on 22nd March, 2015.

The need for DTTA arises due to the rules on chargeability of income in two different countries based on accrual and receipt or residential status, etc.[47]

The DTAA eliminated incidence of double taxation of the income by sharing revenues arising out of the international transactions by the two contracting states to the agreement. DTTA is required to avoid the possibilities of income being taxed in:[48]

- One of the countries
- Neither of the countries
- Taxed in both the countries[49]

Thus, the main purpose of DTAA is to benefit the assessee. The tax payer should not be brought in a state where he is liable to pay tax in both the countries. Generally, in the absence of express DTAA between two countries, the domestic law of the countries apply.

There are two modes of granting relief under DTAA:

- Exemption method
- Tax credit method

Under the exemption method, a particular income is taxed in one of the two countries whereas under the tax credit method, income is taxable in both the both the countries in accordance to the respective tax laws read with the DTAA. However, the country of the residence of the tax payer allows him credit for the tax charged thereon in the country of source against tax charged on such income in the country of residence.[50]

While framing DTAA, utmost importance is given to the definition. There should not be clash of definitions. A particular term should not have different meaning in both the countries in accordance to their taxing statutes. Most of the treaties also provide a Mutual Agreement Procedure or MAP which comes into practice on the vent of dispute in interpretation of treaty provisions.

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[47] Available at http://www.taxmann.com/taxmannflashes/flashart9-2-10_11.htm last visited on 22nd March, 2015.

[48] Available at http://www.legalserviceindia.com/article/l304-Double-Taxation-Avoidnce-Agreements.html last visited on 22nd March, 2015.

[49] Available at https://www.gov.uk/tax-foreign-income/taxed-twice, last accessed on 20th March, 2015.

[50] Dr. Vinod K. Singhania, Corporate Tax Planning & Business Tax Procedures with Case Studies 213 (2013 ed. Taxmann).

Another way of resolving disputes relating to taxes involving international transactions is through MAP in regard to those categories of disputes where there are no DTAA through OECD Models and UN Models regarding double taxation avoidance agreements.

In order to reduce the tax havens, some countries have started the concept of CFC or Controlled Foreign Corporations to deal with the problem of tax evasions. There are low as well as nil tax haven jurisdictions.[51]

Further, a treaty should also have GAAR which specifically provides that a transaction should not be carried in order to avoid payment of tax. It prescribes rules and restrictions for the same.[52]

Specific provision to deal with tax evasion is also provided. Further, rule with regard to collection of tax is also present in the treaty that follows OECD Model Convention.[53]

Example depicting the need of DTAA

P is a Resident of country XYZ. He earns Rs. 100 as income from country ABC.[54]

Tax rate of Country ABC – 40%

Tax rate of Country XYZ – 40%

Taxability of Assessee P (when DTAA does not exist between country XYZ and country ABC) is explained hereunder:

[51] TAX LAWS AND PRACTICE 626 (2014 ed. The Inst. of Secretaries of India).

[52] Available at https://www.pwc.in/assets/pdfs/publications-2012/pwc-white-paper-on-gaar.pdf, last visited on 24th March, 2015.

[53] Available at http://www.ey.com/IN/en/Services/Tax/EY-interaction-between-gaar-and-tax-treaties-jayesh-sanghvi, last visited on 23rd March, 2015.

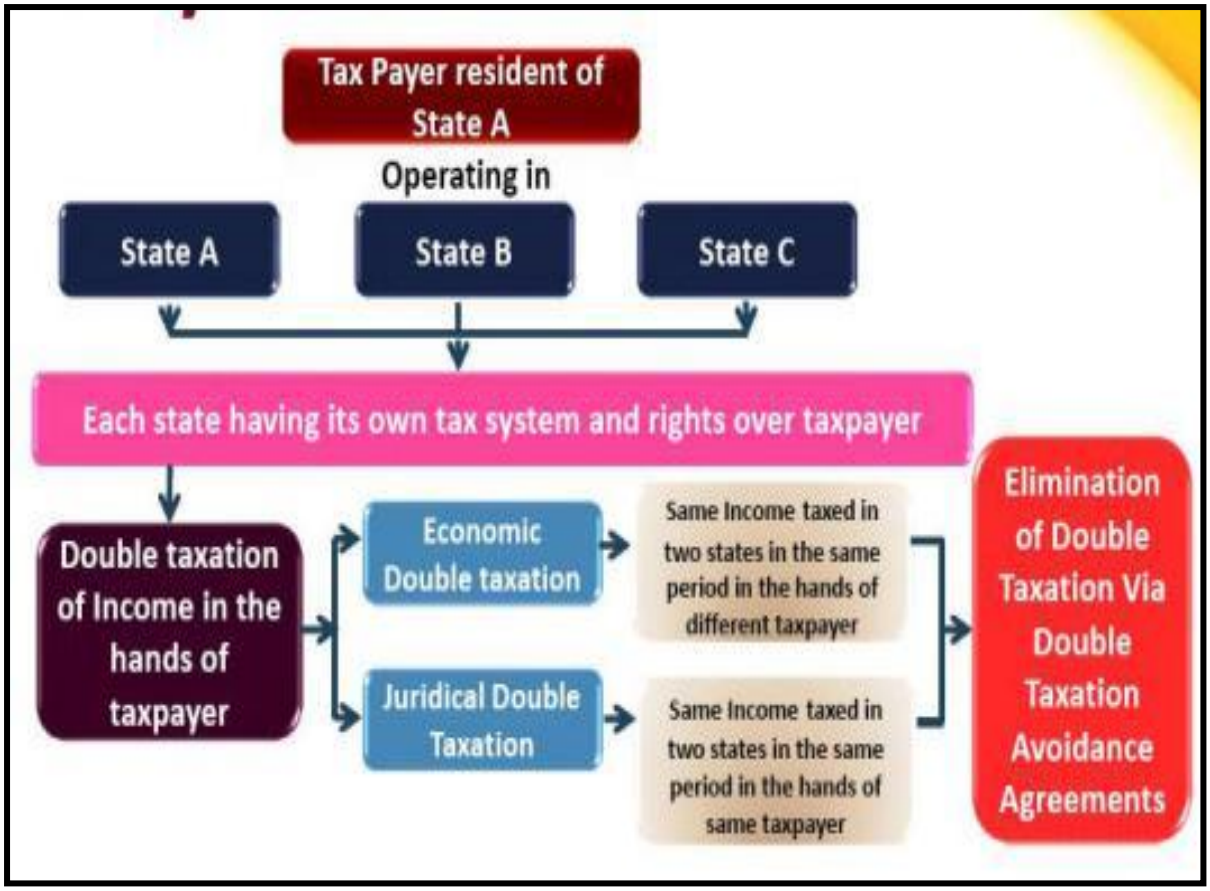
[54] Available at http://www.legalserviceindia.com/article/l304-Double-Taxation-Avoidance-Agreements.html, last visited on 23rd March, 2015.

Particulars	***Amount***
Income earned from Foreign Source	100
Foreign Tax (40%) – Source Based	40
Domestic Tax – Global Income Taxable (40%)	40
Total Taxes Paid	80
Balance Income after Tax (100-80)	20
Effective Tax Rate	80%

It can be concluded that without a DTAA between countries huge amount of income will flow as tax from the person earning money to the Governments of the source country as well as the Government of the residence country.

This will hamper the trade and commerce between countries as no one would invest in a foreign country to suffer loss. The income being taxed twice, both in the country of residence and the source country is not appreciated by the tax payers.

In the above example the taxpayer ended up paying 40% of his income as tax in the country of residence and 40% of the remaining as tax in the source country. The effective tax rate amounted to 80% and he is left with only 20% of the income earned.



The diagram above explains the situation when the income can be taxed twice. If any person who is the resident of country A and has business operation in country A, country B and country C cannot be taxed in all the three countries on the income generated. To avoid such conflict of jurisdiction, the countries enter into Double Taxation Avoidance Agreement.

3.4 Nature of DTAA

DTAA can be bilateral which means there are two parties to an agreement or it can be multilateral which means there can be more than two parties to an agreement.[55]

Further a DTAA, can be either comprehensive or limited.[56]

- Comprehensive

[55] Available at http://www.ird.gov.hk/eng/pol/dta.htm, last accessed on 26th March, 2015.

[56] Available at http://businesstoday.intoday.in/story/how-treaties-with-foreign-countries-can-help-nris-save-tax/1/194401.html, last accessed on 26th March, 2015.

Such agreements cover almost all types of income as provided under any Model Convention. It is not an agreement for a specific source of income. It is more of general in nature. It covers taxes on income, capital gains and capital. The treaty at times even covers wealth tax and gift tax.

India has entered into comprehensive agreements with more than 70 countries.[57][58] The name of few of the countries with whom India has entered into comprehensive DTAA is mentioned below:

- ❖ USA[59]
- ❖ UK
- ❖ Japan
- ❖ Italy
- ❖ Korea
- ❖ Kenya
- ❖ Turkey
- ❖ Thailand
- ❖ Tanzania
- ❖ Australia
- ❖ Austria
- ❖ Brazil
- ❖ Belgium and many more
- Limited

They are not general in nature and covers taxation of income generated from specific sources. It provides for taxation on income from shipping and air transport or estate, inheritance or gift.

As the name provides, limited DTAA are confined to certain issues of taxability of income. For example in case of Aircraft operations, any income generated by the airlines will be

[57] Available at http://www.taxguideforstudents.org.uk/types-of-student/international-students/residence-and-domicile/what-is-a-double-taxation-agreement, last accessed on 26th March, 2015.

[58] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2018859, last accessed on 26th March, 2015.

[59] Available at http://www.advocatekhoj.com/library/agreements/doubletaxation/75.php, last accessed on 26th March, 2015.

exempted from taxation under reciprocal exemption clause between India and Afghanistan in their limited agreement.[60]

DTAA between India and Pakistan is limited to shipping and aircraft profits only. The countries with which India has entered into limited agreement are as follows:

- Afghanistan
- Bulgaria
- Iran
- Kuwait
- UAE
- Uganada
- Oman
- Pakistan
- Saudi Arabia and many more..

India has even entered into agreements with countries like Argentine, Bahrain and Bahamas with respect to exchange of information and assistance in collection of taxes with foreign countries.[61]

3.5 Relief Mechanism

The situation of double taxation may occur when:

- Income is generated in a different country where the assessee is a non-resident
- Source based taxation v. Residence based taxation[62]
- Residency in Two States[63]

[60]Available at http://www.incometaxindia.gov.in/_layouts/15/dit/Pages/viewer.aspx?path=http://www.incometaxindia.gov.in/dtaa/limited%20agreements/108690000000000002.htm&k=&IsDlg=0, last visited on 25th March, 2015.

[61]Available at http://www.incometaxindia.gov.in/_layouts/15/dit/Pages/viewer.aspx?path=http://www.incometaxindia.gov.in/dtaa/tax%20information%20exchange%20agreement%20(tiea)/108690000000000278.htm&k=&IsDlg=0, last visited on 25th March, 2015.

[62]Available at http://articles.economictimes.indiatimes.com/2011-05-30/news/29598842_1_dtaa-tax-resident-double-taxation-avoidance-agreements, last accessed on 23rd March, 2015.

There are two mechanism employed for computation of tax:

I. Deduction Method

The concept is similar to deduction of expenses while computing taxable income. The taxpayer can apply in its resident country a claim as deduction for taxes which will comprise of income taxes paid to a foreign government in respect of foreign source income. Thus, even if the tax has been deducted in the foreign company, the resident country will provide benefit in terms of deductions.[64]

II. Exemption Method

It prevents complete overlapping of taxation of the same income. Thus, the income generated in the foreign company will be exempted from being taxed in the source country.

III. Credit Method

A. Ordinary Credit

Partial or full credit of taxed paid in foreign country will be provided to the aseessee. This means that the tax payer will be taxed on the same source income. The tax will be specified accordingly but lower amount of taxes will be paid by the tax payer to the extent of available credit.

B. Underlying Credit:

In addition to the tax paid on dividends credit for corporate tax will be available when the dividends are paid by resident of one state to another.[65]

The example will explain the different methods in a better way:

P is the resident of country ABC and earns Rs 100 of Income from country XYZ.

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[63] Available at http://www.moneycontrol.com/news/nris/how-can-nris-avoid-double-taxation_1174191.html23rd March, 2015.

[64] Available at http://www.nehasinghi.com/foreign-tax-credit-%E2%80%93-a-discussion-from-indian-context/23rd March, 2015.

[65] Available at http://www.india-briefing.com/news/withholding-taxes-india-6785.html/, 23rd March, 2015.

Tax rate of Country ABC – 40%

Tax rate of Country XYZ – 50%

Particulars	***Deduction Method***	***Exemption Method***	***Credit Method***
Income from Foreign Source	100	100	100
Foreign Tax (40%)	40	40	40
Deduction of foreign tax	40	Nil	Nil
Net Domestic Income	60	Nil	100
Domestic Tax Before credit	30	Nil	50
Less: Tax Credit	0	0	40
Final Domestic Tax	30	Nil	10
Total Domestic and Foreign Taxes	70	40	50

Thus, it could be deduced that double taxation cannot be fully avoided in the Deduction method. It saves tax by the amount of –**Foreign Tax Paid x Domestic Tax rate**.

If the tax rate in domestic country is higher than that of in the source country, exemption method is a better one

Credit Method is preferable when the assessee gets taxed at domestic tax rate without any double tax and the country also receives its eligible amount of tax.

3.6 How to Apply for DTAA

The steps for how to apply DTAA are as follows:

- Firstly, determine the nature of income arising to the non-resident according to the clauses in DTAA. The income is from business or they are capital gains or from profession must be determined.
- Then, determine the nature of income arising to the NR under the IT Act.
- Now, determine the tax liability to the NR under the IT Act.
- Income is taxed in accordance to any specific articles for taxation if it is applicable.
- In the case of NR having a PE in India, general articles for taxation would be applicable.
- Now, determine the tax liability under the DTAA.
- Then we have to determine whether IT Act or DTAA is more beneficial by applying Section 90(2) of the Act.
- Final tax liability of the NR as per provision is determined.[66]

3.7 Procedure for claiming relief from double taxation

The procedures which are required to follow for claiming relief under double taxation are stated below:

- The country of residence of the assessee is determined. The tax payer must be a resident of either of the contracting country and cannot be the resident of both the nations.
- Further, the presence of specific provisions with regard to particular income is determined in the DTAA between the two countries.
- There should be a DTAA signed between the countries.
- Then it is has to evaluated whether the person who claims "tax exemption" and tax credit" has paid tax in the "the source country". [67]

[66] Available at http://business.mapsofindia.com/india-tax/double-taxation-india.html, last accessed on 18th March, 2015.

[67] Available at http://www.business-standard.com/article/markets/how-to-avoid-double-taxation-114122000669_1.html, last accessed on 18th March, 2015.

Following documents has to be submitted to the tax-authorities as evidence for claiming benefits. The documents include-

1. Tax Residency Certificate which will declare that a person A is the resident of Country X.

2. Self-attested Xerox of Pan Card.

After submission of these documents, the tax authorities will look into the claim of the tax payer with regard to prevention double taxation and to get other tax benefits.

CHAPTER- 4

SALIENT FEATURES OF DOUBLE TAXATION AVOIDANCE AGREEMENTS AGREEMENTS BETWEEN INDIA & OTHER COUNTRIES

4.1 General

As per the World Investment Report (UNCTAD, 2009)[68], up-till 2010 there were 2805 exhaustive or restricted respective bargains or bilateral treaties between nations from a conceivable most extreme of around 50,000 arrangements. These settlements are mostly between nations with significant exchange or other monetary relations. Most of these settlements are entered into between the developed nations while the rest are entered between developed and developing nations.[69]

Most of the DTAAs have significant characteristics:

(a) They give equal concessions to relieve twofold levy or double taxation,

(b) They prescribe assessment rights or taxation rights generally as per that "current accord" depicted beneath and

(c) They follow to a great extent the OECD Model Tax Convention or, for developing nations, the UN Tax Convention.[70] Lately settlements contain new provisions taking after the OECD Model Tax Conventions of 2005 to 2010 which stretches out regions of collaboration to regulatory and data issues[71].

While current arrangements focus on the taxation of income and to some extent taxation of capitals, the recent development in the OECD Model could enhance the scope by even including VAT.[72]

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[68] Available at https://www.imf.org/external/pubs/ft/bop/2009/09-13.pdf, last accessed on 20th March, 2015.

[69] Available at http://unctad.org/en/Docs/iteiit16_en.pdf, last accessed on 20th March, 2015.

[70] Available at http://www.india-briefing.com/news/double-taxation-agreements-india-investment-strategy-6619.html/, last accessed on 20th March, 2015.

[71] Available at http://www.taxtreatiesanalysis.com/tag/india/, last accessed on 20th March, 2015.

[72] Available at http://fas.org/sgp/crs/misc/R40623.pdfhttp://www.mondaq.com/x/215794/tax+treaties/The+Role+Of+Double+Taxation+Treaties+Within+The+Maltese+Tax+System, last accessed on 20th March, 2015.

Since such arrangements are intended to be advantageous and not prescribed to put citizens of a contracting state to an impediment. It has been explicitly mentioned in Sec. 90 that a gainful provision under the Indian Income Tax Act won't be precluded to occupants from securing contracting state just on the grounds that the comparing provision in the tax treaty is less useful.

The DTA Agreement between India and any another nation covers residents of India and the other contracting nation who has gone into the concurrence with India. An individual who is not the inhabitant of India or of the other contracting nation can't benefit any profit under the said DTA Agreement.

Such understanding by and large gives that the laws of the two contracting states will represent the assessment of salary in particular state except when the contrary intention has been expressed in the agreement. A circumstance may emerge when initially the rate of tax in the other contracting state offered concessional treatment contrasted with India but the Indian laws at a later stage undergoes modification or amendment and prescribes a tax rate lower than the contracting state.

Some Double Taxation Avoidance Agreements prescribes that income generated by means of interest, royalty or fee for technical service is charged to tax on net basis.

This may bring about assessment deducted at source from sums paid to Non-Residents which may be more than the complete tax liability.[73][74]

The Assessing Officer has subsequently been permitted u/s 195[75] to determine the suitable extent of the sum from which duty is to be deducted at source. There are occurrences where according to the Income Tax Act, tax is to be deducted at a rate endorsed in DTAA.

But in such scenario, the foreign companies may even apply for refund. To avert such troubles, Sec. 2(37A) of the IT Act prescribes that the tax may be deducted at source at the

[73] Available at http://www.taxindiaonline.com/RC2/inside2.php3?filename=bnews_detail.php3&newsd=17270, last accessed on 20th March, 2015.

[74] Available at http://www.puneicai.org/(X(1)S(xmongz45piqcyvfgmbpwal55))/material/certification-and-practical-issues-195-N-C-Hegade.pdf, last accessed on 20th March, 2015.

[75] Available at http://taxguru.in/income-tax/faq-tds-residents-us195-income-tax-act.html, last accessed on 20th March, 2015.

rate mentioned in a specific case in accordance to Section 195 on the amount payable to non-residents or as per the rates determined in DTTA.[76]

4.2 Current Scenario of Double Taxation Avoidance Agreements in India

The Indian Income Tax Act, 1961 provides a framework for taxation of income in India. The Income tax is chargeable on the total income. There are Income Tax Rules, 1962 to assist in the functioning of the Act.

In accordance to Section 5 of the Income Tax Act, 1961 the non residents are liable to be taxed on their income which has its source in India and the persons who are resident of India are liable to be taxed on their global income.[77]

The DTAAs which is approximately more than 100 in number of which India is a signatory is reviewed on a continuous basis. The Finance Minister has made it mandatory to review all the taxation agreements to incorporate the fiscal changes that take place in a nation.[78]

The survey is being carried out to follow the rules of Organization for Economic Co-operation and Development (OECD) on imparting data on streaming and stopping of dark cash in different nations and to satisfy India's dedication at the G-20 Nations summit.[79]

More than 25 countries have been blacklisted by OECD due to the tax concessions offered for parking funds.[80] These incorporate Mauritius, Cyprus, Switzerland and the Netherlands. Such instances are referred to as tax haven. It is referred to as a place where there is low tax rate or no tax rate at all. Such tax haven policies are made available to the multinational companies.

[76] Available at http://indiainbusiness.nic.in/newdesign/index.php?param=investment_landing/293/6, last accessed on 17th March, 2015.

[77] Available at http://www.tjaindia.com/articles/dtaa.pdf, last accessed on 18th March, 2015.

[78] Available at http://www.allindiantaxes.com/income-tax-dtaa.php, last accessed on 17th March, 2015.

[79] Available at http://www.kwm.com/en/uk/knowledge/insights/international-tax-in-focus-at-the-2014-g20-summit-and-finance-ministers-meeting-20141014, last accessed on 19th March, 2015.

[80] Available at http://www.taxpayer.com.au/KnowledgeBase/10202/Small-Business-Tax-Super/Tax_havens, last accessed on 17th March, 2015.

Companies and individuals move from places which charge high tax rate to places where the tax rate is lower. This has created competition among various governments of the world to lure more investments from abroad.

But in last 10 years, the tax haven countries have adjusted their domestic laws partially to check tax avoidance tax evasion practices due to the pressure created by OECD. Though, it is not always profitable to do business through tax haven countries. Some tax havens like Beirut, Liberia, etc have been great failures.[81]

Global income of the Indian Resident is taxable in India through Section 91 of the Act which provides relief by way of credit in respect of the tax paid on their foreign income if, the source in the country with which there is no DTAA. Non- residents are subject to source based taxation.[82]

India has more than 100 DTAAs existing with different nations on the globe. The oldest of the treaty is the one which had been signed with Greece in the year 1965. Further, India is in the state of negotiation with regard to formulation of tax treaties with many countries. India is also the signatory to the Multilateral SAARC Avoidance of Double Tax Convention framed in the year 2005.[83] [84]

It has not always been India's initiative to sign a treaty. India has been regarded as an industrial hub since time immemorial. The exports and imports statistics prevalent in the past days suffice the statement. Further, the dates of marking distinctive settlements recommend that the activity for the DTAAs may not generally have originated from India in the early years.

[81] Available at http://www.ibtimes.com/tax-havens-map-former-current-emerging-tax-shelter-countries-interactive-map-1403162, last accessed on 23rd March, 2015.

[82] Available at http://www.nishithdesai.com/fileadmin/user_upload/pdfs/The_changing_face_of_NRI_taxation_in_India.pdf, last accessed on 24th March, 2015.

[83] Available at http://saarc-sec.org/areaofcooperation/detail.php?activity_id=45, last accessed on 23rd March, 2015.

[84] Available at http://articles.economictimes.indiatimes.com/2011-02-05/news/28427145_1_saarc-dtaa-black-money, last accessed on 25th March, 2015.

Greece being a real dispatching country would profit from a bargain that gave the privilege to tax shipping income to the resident nation – which the India-Greece arrangement does provide.

The following five settlements, with Egypt, Tanzania, Libya, Zambia and Sri Lanka, marked by a protectionist, high duty India, appear to offer no specific preference to it, given restricted cross-fringe factor flows. The treaty with Mauritius in the year 1982, has ended up being a real wellspring of income misfortune for India.

Treaties for the exchange of information and technology along with labour and capital from International Affairs and Global Strategy were also signed by India in the early 1900s.

In the year 2000, India again started signing treaties with countries with which it had restricted economic relations.[85]

A key arrangement issue arises when we have to interpret whether India truly needs all these tax arrangements. The past studies proposes that the monetary basis for tax treaties other than the information sharing is constrained. Such constrains does not arise when the productivity factor is elastic to tax treaty rights allocation and the tax rate.[86]

The source nation has residual rights in the wake of withholding taxes to tax active income. On the passive income, the residence nation has residual rights. Specifically, for business income, the source nations have the privilege to assess the PE characterized to a great extent as in the UN Model Convention. Other than this designation of bases, all Indian settlements accommodate twofold tax help or the double relief by means of foreign tax credits.

Most arrangements accommodate citizens or the tax payers to choose whether they want to be governed under the tax treaty or not. If the rates prescribed under the withholding non-treaty rates are lower and favourable, the tax payers can chose to be governed under that. The agreement distributes the jurisdiction between the source and home nation with regard to taxation.

Wherever such purview is given to both the nations, the understandings recommend most extreme rate of levy in the source nation which is by and large lower than the rate of tax

[85] Available at http://www.oecd.org/tax/exchange-of-tax-information/automaticexchange.htm, last accessed on 26th March, 2015.

[86] Available at http://www.business-standard.com/article/current-affairs/how-india-s-failure-to-sign-an-agreement-affects-tax-treaties-with-other-nations-114110100343_1.html, last accessed on 27th March, 2015.

under the laws of resident nation. Thus, in gest 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 India by NRI's and foreigners which generally are taxable in India under certain conditions, In the former case, income are taxed as per 'worldwide income' principle, whereas in the latter case it is done through 'source principle'.

4.3 Taxation of Income from Air and Shipping Transport under DTAA

The DTAA is based on four models of DTAA and they are-OCED Model Tax Convention (emphasis is on the residence principle), US Model (combination of residence and source principle but the emphasis is on source principle), US Model (Model to be followed for entering into DTAAs with the U.S. and it is peculiar to the US) and the Andean Model (model adopted by member States namely Bolivia, Chile, Ecuador, Columbia, Peru and Venezuela).[87]

Income derived from the operation of Air transport in international traffic by an enterprise of one contracting state will not be taxed in the other contracting state in respect of an enterprise of one contracting state, income earned in the other contracting state from the operation of ships international traffic, will be taxed in that contracting state wherein the place of effective management of enterprise is situated. However some DTA agreements contain provisions to tax the income in the other contracting state also, although at reduced rate.[88]

These agreements follow a near uniform pattern in as much as India has guided itself by the UN model of double taxation avoidance agreements. The agreement allocated 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 generally lower than the rate of tax under the domestic law of that country.[89]

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[87] Available at http://www.caclubindia.com/share_files/shipping-air-transport-dtaa-article-8--39061.asp, last accessed on 2nd April, 2015.

[88] Available at http://taxguru.in/income-tax-case-laws/shipping-profits-dtaa-taxation-income-slot-charter.html, last accessed on 1st April, 2015.

[89] Available at http://www.slideshare.net/ppshaandassociates/bcas-dtaa-study-course-presentation-on-article-8-on-international-shipping-01122012, last accessed on 1st April, 2015.

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 payable in the residence country by the amount of tax paid in the source country.

These agreement give the right of taxation in respect of the income of the nature of interest, dividend, royalty and fees for the 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. The rate of taxation is on gross receipts without deduction of expenses.[90]

[90] http://www.legalserviceindia.com/article/l304-Double-Taxation-Avoidance-Agreements.html

CHAPTER 5

PROVISIONS IN INCOME TAX ACT, 1961

5.1 Section 90- Agreement with foreign countries or specified territories

India has entered into bilateral agreements with many countries regarding avoidance of double taxation including tax avoidance and tax evasion issues. Section 90 of the Act deals with relief granted to assessee involved in paying taxes twice that is paying tax in India as well as in Foreign Countries or specified territory outside India.[91]

As per Section 90[92], the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,-

- With respect to providing relief in circumstances
  - ❖ when tax has been paid in accordance to Income Tax Act, 1961 in India as well as in accordance to the Income Tax Act prevailing in the foreign country;
  - ❖ when tax has to be levied in accordance to Income Tax Act, 1961 along with the prevailing law in the foreign country in order to enhance the trade, investment and economic relations.
- To avoid the income being taxed twice and attracting the instances of double taxation, thus mitigating double taxation of income
- For the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory by exchange of information
- For the income-tax recovery under this Act and under the prevailing law in the other country or territory[93]

Where the Central Government has gone into a concurrence with the Government of any nation outside India or determined region outside India for allowing alleviation of assessment, or as the case may be, evasion of double taxation, then, in connection to the assessee to whom such understanding applies, the provisions of this Act should apply to the

[91] TAX LAWS AND PRACTICE 631-632 (2014 ed. The Inst. of Secretaries of India)

[92] Available at http://www.vakilno1.com/bareacts/incometaxact/incometaxact.html, last accessed on 23rd March, 2015.

[93] Available at http://www.taxpointindia.com/dtaasec9091.html, last accessed on 24th March, 2015.

degree they are more gainful to that assessee. The assessee should have an endorsement of his being an occupant in the form of a residential certificate.[94]

The accompanying sub-section (2A) was embedded after sub-section (2) of Section 90 by the Finance Act, 2013, w.e.f. 1-4-2016:

The Income Tax Act should apply to the assessee regardless of the fact that such provisions as prescribed in the Act are not valuable to him.

Any term mentioned yet not characterized as a part of this Act or in the agreement and which is not conflicting with the provisions of this Act or with the understanding, will be accorded the same meaning as per the the notice or the notification issued by the Central Government in the Official Gazette for this purpose.[95]

An assessee, not being an Indian resident, to whom the tax treaty referred to in this Section applies, should not be qualified for any claim under such understanding unless a testament of his being the resident in any foreign nation outside India or indicated domain outside India, as the case may be, is obtained by him from the Government of that nation or the determined region.[96]

The assessee mentioned in this particular section should likewise give such different information and documents as may be recommended.

Clarification 1-

Tax should not be charged at higher rates from any foreign company as compared to domestic company.

[94] Available at http://www.icaiknowledgegateway.org/littledms/folder1/chapter-15-double-taxation-relief.pdf, last accessed on 19th March, 2015.

[95] Available at http://taxguru.in/income-tax/how-to-get-relief-from-double-taxation.html, last accessed on 19th March, 2015.

[96] Available at http://www.hdfcbank.com/nri_banking/proposed-amendment-in-IT.html, last accessed on 19th March, 2015.

Clarification 2-

For the purpose of this section, specified territory means any indicated domain which implies any zone outside India which may be informed in that capacity by the Central Government in the form of notification.

Clarification 3-

If a particular word which has been mentioned in the Agreement but is neither defined in the Act as well as the agreement will be given meaning in accordance to the notification issued by the Central Government for clarification and the said word with the meaning attached to it will be deemed to have effect from the date on which the said agreement came into force.

5.2 Section 90A- Adoption by Central Government of agreement between specified associations for double taxation relief

The Central Government is entitled under Section 90A to go into a concurrence with any specified association in the predefined domain outside India and the Central Government is approved to make such provisions by notice in the Official Gazette as may be essential for embracing and executing such understanding.[97]

- When tax has been paid in accordance to Income Tax Act, 1961 in India as well as in accordance to the Income Tax Act prevailing in the foreign country or a specified territory outside India;
- When tax has to be levied in accordance to Income Tax Act, 1961 along with the prevailing law in the foreign country in order to enhance the trade, investment and economic relations.
- To avoid the income being taxed twice and attracting the instances of double taxation, thus mitigating double taxation of income[98]
- For the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory by exchange of information or investigation of such cases of evasions and avoidance

[97] Available at http://www.caclubindia.com/experts/sec-90-91-of-income-tax-act-212328.asp, last accessed on 14th March, 2015.

[98] Available at http://www.lawzonline.com/bareacts/income-tax-act/section90A-income-tax-act.html, last accessed on 14th March, 2015.

- For the income-tax recovery under this Act and under the prevailing law in the other country or territory[99]

Where the Central Government has gone into a concurrence with the Government of any nation outside India or determined region outside India for allowing alleviation of assessment, or as the case may be, evasion of double taxation, then, in connection to the assessee to whom such understanding applies, the procurements of this Act should apply to the degree they are more gainful to that assessee.

Here, "specified associations" implies any organization, affiliation or body, whether consolidated/ incorporated or not, working under any law which in force in India or the laws of the predetermined domain outside India and which may be notified in that capacity by the Central Government.

Further, "specified territory" implies any zone outside India which may be notified by the Central Government in accordance to this particular provision.

In order to remove any doubts, it is specifically declared that in cases when a particular word which has been mentioned in the Agreement is neither defined in the Act nor in the agreement will be given meaning in accordance to the notification issued by the Central Government for clarification and the said word with the meaning attached to it will be deemed to have effect from the date on which the said agreement came into force.[100]

5.3 Section 91- Countries with which no agreement exists

In the event that any individual who is occupant in India in any previous year demonstrates that, he has paid tax in any nation with which there is no understanding under Section 90 for the relief of double taxation for the income which accrued or arose during the previous year by deduction or in some other way, he will be mitigated from the instance of double taxation by way of deduction from the Indian Income Tax payable by him calculated on such doubly

[99] Available at http://www.caclubindia.com/notice_circulars/section-90-a-of-the-income-tax-act-1961-893.asp, last accessed on 14th March, 2015.

[100] Available at http://www.taxmann.com/taxmannflashes/flashst26-5-10_1.htm, last accessed on 1st March, 2015.

taxed income at the Indian rate of tax or the rate of tax of the said nation, whichever is the lower, or at the Indian rate of tax if both the rates are equal and identical.[101]

If there should be an occurrence of any individual occupant in India, who is earning income from agricultural operation in Pakistan and has paid duty thereof can look for alleviation at rate being lower of the accompanying choices essentially:

(a) of the measure of the tax actually paid in Pakistan

(b) sum processed under Indian Indian Tax Rates;

In the event that any non-resident individual is surveyed on his income of a registered enrolled firm evaluated as inhabitant or resident in India in any previous year and such share incorporates any income accruing or arising outside India amid that previous year (and which is not considered to gather or emerge in India) in a nation with which there is no agrrement under Section 90 for the mitigation of double taxation[102] and he demonstrates that he has paid pay tax by way of deduction under the law in power in that nation in admiration of the income so included he might be entitled:[103] [104]

----to a conclusion from the Indian salary charge payable by him of an aggregate ascertained on such doubly saddled wage so included

- at the Average Indian Tax Rate or
- at the Average Foreign Tax Rate,

whichever is lower or at the Indian rate of tax if both the rates are alike.

For clarification,

- Indian income tax refers to the income tax charged in accordance to the sections in the Income Tax Act, 1961;
- Indian rate of tax means the rate controlled by partitioning the amount of Indian income-tax after deductions under Income Tax Act, 1961

[101] Available at http://www.thehindu.com/business/Economy/concerns-over-tax-residency-certificate-allayed/article4465507.ece, last accessed on 1st March, 2015.

[102] Available at http://taxguru.in/income-tax/relief-case-double-taxation.html. Last

[103] Available at http://www.lawzonline.com/bareacts/income-tax-act/section91-income-tax-act.htm

[104] Available at http://www.archive.india.gov.in/business/doing_business/unilateral_relief.php

- ❖ Rate of tax of the said country implies tax and super tax really paid in the said nation as per the relating laws in power in the said nation after all the required deductions of relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of income as assessed in the said country;
- ❖ Income tax in relation to any country refers to tax charged on the profits including business profits of the government.[105] .

Indian Tax on doubly taxed income:

$$\frac{\text{Tax on Total Income in India} * \text{Doubly Taxed Income}}{\text{Total Income in India}}$$

Foreign Tax on doubly taxed income:

$$\frac{\text{Tax Paid in Foreign Country} * \text{Doubly Taxed Income}}{\text{Total Income in Foreign Country}}$$

Section 91 provides for the grant of unilateral relief in the case of resident taxpayers on income on which tax has been charged in India as well as in the country with which there is no ADT.[106]

The following requirements have to be satisfied in order than an assessee is entitled to claim deduction on the doubly taxed income:

a. the assessee must have been resident in India in the relevant previous year;

b. income must have accrued or arisen to him during the previous year outside India;

c. in respect of that income which accrued or arose outside India, he must have paid by deduction or otherwise tax under the law in force in the country in question.

[105] Available at http://www.incometaxindia.gov.in/Pages/acts/income-tax-act.aspx, last accessed on 18th March, 2015.

[106] Available at http://nkumarandaggarwal.com/news-detail.php?idt=66, last accessed on 18th March, 2015.

The relief is worked out as under:

First, ascertain the amount of doubly taxed income. It consists of such income as has accrued or arisen to the taxpayers in a foreign country and has been subjected to income-tax in that country as well as in India. It, however , does not include income which is deemed to income, whichever is lower.

Indian Rate: the indian rate of tax means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provision of the Act, but before deduction of any relief due under section 90 and 91, by the total income.

Foreign Rate: The rate of tax of the foreign country means income-tax and supertax actually paid in that country in accordance with the corresponding laws in force thereafter deduction of all relief due, divided by the whole amount of the income as assessed in the country.

CHAPTER 6

DTAA VS INCOME TAX

The most vital issue in the elucidation of a DTAA emerges when there is a conflict with the provisions of the Income-Tax Act, 1961. The real problem emerges as to which of the two clashing procurements ought to beat the other. Section 90(2) of the IT Act, which was embedded by the Finance (No. 2) Act, 1991 to be applicable retrospectively from 1-4-1972, makes it explicit that in the event of DTAA signed by India with another nation; those provisions of the Income Tax Act will apply on the assessee which is more useful to him. Nonetheless, if the procurements of the DTAA are more positive to the assessee then the Income Tax Act won't make a difference. The guideline under Section 90(2) was initially perceived by the Andhra Pradesh High Court in *CIT v. Visakhapatnam Port Trust*[107], which was later on acknowledged by the Supreme Court in *Union of India v. Azadi Bachao Andolan.*[108]

The CBDT itself had acknowledged this standard at an earlier stage and further, Section 2(37A) was also introduced by the Finance (No. 2) Act, 1991.

Likewise the said provision prescribes that where the tax is deductible at source from the income of the non-resident, the payer could apply the rate as recommended in the Income Tax Act or the rate appropriate under the DTAA whichever was lower.[109] A few other related issues came up while keeping in view the above general rule:

- It is settled that the DTAA would beat the Act. The inquiry emerges regarding whether an assessee can choose being represented by the DTA Agreement in one year and the ITA in the other year? Nonetheless, it might be contended that such alternative is accessible and assessee can utilize the same.
- The other inquiry that emerges is whether an assessee can choose being represented by the Income Tax Act for the appraisal of a specific sort of income, say, gains from

[107] CIT v. Visakhapatnam Port Trust (1983) 44 ITR 146 (AP)

[108] Union of India v. Azadi Bachao Andolan (2004) 10 SCC 1

[109] Available at http://www.livemint.com/Money/9JSuTNpcXjFSdMBNodg8NL/Taxes-deducted-at-source-for-NRIs-are-subject-to-DTAA.html, last accessed on 18th March, 2015.

capital, and by Agreement for another kind of salary, say, business income. This must be permitted on the grounds that the dialect of Section 90(2) applies the Income Tax Act to the degree helpful to the assessee.

- Another issue emerges when there is an an occurrence of same sort of income generated by the assessee from two separate states. The inquiry is whether he can decide on being administered by the Income Tax Act for the income generated from state A and the clauses of the Agreement for the income from state B.

For instance, an Indian organization may have extensions (permanent establishments) in Bangladesh and Pakistan. The branch in Bangladesh creates benefit and the Indian organization chooses to be administered by the Agreement and takes the stand that the benefit is assessable just in nation where there is a PE, in accordance with the perspective taken by the High Courts and the Supreme Court as alluded to hereinafter.

The PE in Pakistan incurs a loss. Then the Indian co. desires to set off such business losses against its Indian business income as allowed under Section 70 of the Act and would not like to be represented by the provisions of the Tax Agreement where under the loss is assessable.

Despite the fact that the matter can't be said to be free from all uncertainty, it would be passable to pick the more helpful proviso, that is the Treaty.

- A further refinement, which the blunter would call hair part by a bald individual, is whether an assessee can guarantee that the processing of his income ought to be under, say, the Income Tax Act yet the tax rate ought to be according to the DTAA. It might be contended that this is not acceptable on the grounds that when a lower rate is regularly recommended then expenditures is not deducted in computing particular type of income as per the treaty.

Thus, one cannot take the benefit of both the Act for deduction and then switch to the Agreement for a lower rate of return. Section 90(2) is placed at a higher level and in the presence of a tax treaty, the assessee can choose to be governed by the tax treaty keeping it above the Income Tax Act.

The SC in Chettiar's case observed that agreements executed as per the Section 90 of the Act are stipulations or exemptions to the charge of assessment imposed by Section 4 and Section 5 of the Act which deals with the charge of income tax and scope of total income respectively.

Such agreements can be considered to be a part of the Act.

- Another issue that emerges is whether Parliament can sanction enactment after tge countries have entered into a DTAA and whether the resulting enactment will override and have negative impact on the provisions of the agreement. In the event when the answer is yes, then what will be the framework of such enactments and how will it be implemented?

Under the French and Dutch Constitutions, a consequent enactment can't override the provisions of an arrangement. While in the United States of America and United Kingdom, the incident altogether is very surprising.

Article 51 of our Constitution[110] gives an ordered guideline in the form of Directive Principles of State Policy that the state shall strive to protect and attempt to foster respect towards worldwide law and settlement commitments commonly referred to as the "international law and treaty obligation" in the dealings of composed people groups with each other. Thus, the Indian Parliament should not administer in a way which may clash or override the provisions of a prior arrangement or agreement with any foreign nation.

To comprehend the connection in which the Explanation was included a couple of realities must be noted. A higher rate of tax is charged on non-domesticated companies as compared to domesticated companies which is not at all ethical and such practices must be avoided. It can be non- beneficial for the foreign company and they would prefer not to make investment in India.[111]

The Explanation to Section 90 reads that ―the burden of duty in appreciation of a foreign organization at a rate higher than the rate at which an Indian organization is chargeable, should not be viewed as less positive charge in admiration of such foreign company.

At the end of the day, the segregation of rate is not to be viewed as a less positive charge of duty clearly for the reasons of Agreements for Avoidance of Double Taxation as the issue of non-favourable rate of tax would arise only for the entities governed under the treaty. In

[110] Available at http://www.lawnotes.in/Article_51A_of_Constitution_of_India, last accessed on 19th March, 2015.

[111] Available at http://articles.economictimes.indiatimes.com/2013-03-01/news/37373194_1_tax-residency-certificate-kpmg-india-kpmg-partner, last accessed on 18th March, 2015.

actual practice, it has not yet been tested in India whether a subsequent enactment by the Parliament can override the provision of the Tax Agreement. It is again not clear regarding who will test the matter in cases of conflict as the Agreement is between two nations. Is it the state which must take up the issue or would it be a good idea for it to be governed under the shared assention strategy or MAP or can the affected individual challenge the alteration regardless of the possibility that the concerned state has not challenged?

In Double Taxation Avoidance Agreements, it is not acceptable that one of the contracting parties modify or amend the terms of the agreement unilaterally without the consent of the other party.

It might be noticed that by the Finance Act, 2003 Sub-sec (3) has been added to Section 90 of the Income Tax Act which entitles the Central Government to issue notification with regard to the meaning of a word which is used in the Agreement but the meaning of the same has not been provided in the Agreement or even in the Act.

Such meaning which has been provided by the CG should not be conflicting with the procurements of the Act or the Agreement. There may be different occurrences where there is a conflict between the meaning of a specific word in DTAA and in Income Tax Act, for instance, the meaning of terms like dividend, royalty, interest, residence and so forth.

The meaning assigned to the term "royalty" under the Agreement or under the Act can all together convey a different logic but it is a undisputed fact that the meaning assigned to a word in accordance to the DTAA will prevail over the meaning provided in the Act. There can two situation in such cases:

1. In the event when the Income Tax Act gives a meaning of a specific term at the time when the Agreement was formulated, however no definition was provided in the Agreement, whether the definition in the Income Tax Act would be accepted?

2. In the event when the Agreement was formulated, there was no meaning of a specific term in either the Income Tax Act or the Agreement, and hence the definition is embedded into the Income Tax Act at a later stage after the agreement had come into force. Whether this definition would apply for determining the real intention and meaning of the word?[112]

[112] Available at http://www.mcciapune.com/pdf/taxaudit44abguidancenote2013.pdf, last accessed on 20th March, 2015.

In the first case, the definition given in the Income Tax Act at the time of entering into the Agreement will be appropriate unless the setting requires something else. However the position is not clear in respect to what will happen if the definition given in the Income Tax Act is corrected consequent to the going into DTAA.[113]

As per Article 3(2) of the OECD Model Convention,[114] unless anything explicitly mentioned, any term not characterized in the arrangement might have the significance as it has under the law of the State to which the settlement applies. It is undisputed that the definition under the state laws will win just when the Convention is quiet about it. An ensuing alteration in the meaning of a term under the local laws won't be material if the term is now characterized in the agreement.

The expressions "at that time" and "at any time" in the Article 3(2) of the OECD Model is well explained. These expressions are excluded from the UN and US Model Conventions.

But the general rule in the interpretation is that, with regard to a particular term or word not defined in the Agreement, the same will hold the meaning as defined under the local laws of a state. It can have a contrasting effect at times when a particular word in the Agreement was construed generally and later on when it was interpreted in accordance to the local laws, the whole meaning became different altogether and the sole purpose and the scope of the Agreement changes.

As per the Model Convention any word in the Agreement must be assigned meaning in accordance to the local tax law and not any law in general. In the US and UN Models, it is explicitly mentioned that any meaning which has to be assigned to any word in the treaty during its interpretation should be none other than the local tax laws.[115]

Another situation may arise, subsequent to the enactment of the tax treaty, both the contracting states modify the meaning of a particular word in their local tax laws which can instigate a conflict between them as both the states has assigned a more favourable meaning to the word in their tax law. In case of such conflict, the definition assigned by the source state would apply.

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[113] Available at http://www.itatonline.org/info/wp-content/files/controversies_in_assessment_income_tax_dept.pdf, last accessed on 20th March, 2015.

[114] Available at http://www.oecd.org/berlin/publikationen/43324465.pdf, last accessed on 20th March, 2015.

[115] Available at http://www.oecd.org/tax/treaties/2014-update-model-tax-concention.pdf, last accessed on 20th March, 2015.

In the case of Siemens *A.G. v. ITO*[116], the Special Bench of Tribunal did not interpret the term royalty in accordance to Section 9 of the Income Tax Act which was the term in conflict in the Indo- German Double Taxation Agreement.[117]

Thus, the principle of interpretation is not a well defined rule and is just a generalization. The state has power to over ride the provision of the Agreement by suitable enactments but whether it has actually over ruled or not depends upon the language and intention of the subsequent legislature.

Taxability of Income

The income can be residence based or source based. But now the question is, who can tax the income; the resident country or the source country? The DTAA is entered into to decide the jurisdiction of the taxation of a particular income. In the absence of DTAA, there will be an instance of conflict in each and every case of income arising or accruing in India by a non-resident and the vive-versa in the case of an Indian National earning income outside India.

In cases when it is mentioned in the DTAA that an immovable property will be taxed in the contracting state where the property is situated. Then the source country will tax the gains from the immovable property accrued to the assessee. Now, the tax payer will claim credit in the resident country with regard to the tax already paid to the source country. Further, there can be a clause in the Agreement which specifies that the business gains will only be taxed in the residence country. But this particular clause won't be applicable in cases when the assessee has its Permanent Establishment in the source country.[118]

When it is specifically mentioned in the agreement that a particular income will be taxed only by a particular country, then it is implicit that the other contracting party cannot tax the income. There should not be any further dispute on this.[119]

In a situation when an Indian Resident has a Permanent Establishment or has owned an immovable property in Malaysia, such income will only be taxed by Malaysia. It has been

[116] Siemens A.G. v. ITO 1996 217 ITR 622 Bom

[117] Available at http://www.igsg.org/seiten_ab-2012-10/Doppelbesteuerung_2013-01-17-en.htm, last accessed on 20th March, 2015.

[118] Available at http://incometaxindiapr.gov.in/incometaxindiacr/contents/DTL2011/casesec90.htm, last accessed on 28h March, 2015.

[119] CIT v. R.M. Muthaiiah [1993] 202 ITR 508

settled in the case of *CIT v. Kulandagan Chettiar*.[120] The Indian Government cannot impose any tax on such incomes.

Claiming benefit under the treaty

The resident has to prove that he is the resident of either of the contracting countries. The provisions of DTAA applies to the resident of the contracting party in accordance to Article 124 of the OECD Model Convention. A person is considered as a resident in accordance to the place of management or the law governing the entity. Such benefits can only be claimed on the ground of such particulars falling within the scope of DTAA.

- A particular type of income may be taxed in one of the contracting and is not taxed in the other contracting state.
- Further DTAA may specifically mention whether it is applicable both to the corporare assessee or the non-corporate assessee likr individuals and firms.
- There is no law for taxation the income in a particular state.
- There is any Government notification with regard to taxation of a particular income if such condition has to be fulfilled in a particular nation before taxing the income.
- Huge problems arise in the case of taxation of Partnership firms and LLP's.

[120] CIT v. Kulandagan Chettiar (2004) 267 ITR 654 (SC)

CHAPTER 7

LIFE OF THE TREATY

Under section 90 of the Income Tax Act 1961 the CG in India is empowered to enter into DTAA as well as it can make provisions for the execution of the same by way of notification issued in the Official Gazette. Such agreements are considered as the part of the Act and it is not treated separate from the Act.

The SC in the case of *CIT vs Kulangadan Chettiar*,[121] held that DTAA formulated under section 90 of the Act is an exception to section 4 and section5 of the IT Act. The power to enter into treaties is exclusively vested in the Union under Entry 14, list 1 of Schedule VII of the Indian Constitution.

In the case of *Meganbhai v. Union of India*[122] and *Union of India v. Azadi Bachao Andolan*,[123] it was held that a tax treaty does not require any further enactment to gain its validity.

DTAA once entered continues to be in force unless the parties to the agreement amends or modifies the terms and conditions or one of the party terminates the Agreement. Any modification or amendment must be mutual between the parties and it should not be an unilateral amendment to the provisions. There is a stipulation in regard to any subsequent modification or amendment, that, it could only be done after the expiry of a minimum time period.

The treaty automatically terminates in a situation when a new treaty on the same subject is negotiated upon and the same is implemented. The parties to DTAA are obliged to inform regarding the compliance with procedures required in accordance to the respective authority in the state in order to implement the new treaty. The Agreement comes into force after the lapse of certain time.[124]

[121] CIT v. Kulandagan Chettiar (2004) 267 ITR 654 (SC)

[122] Meganbhai v. Union of India 1969 SCR (3) 254

[123] Union of India v. Azadi Bachao Andolan (2004) 10 SCC 1

[124] Available at http://uk.practicallaw.com/books/9781847668790/chapter07, last accessed on 20th March, 2015.

The provisions of the Agreement are applicable in respect of fiscal year starting from 1st April in India. The position of the parties can be negatively affected in a situation when the parties enters into a private contract during the existence of the DTAA and an amendment to the treaty dissolves the complete purpose of entering into DTAA and making it applicable on a private contract.

Another issue crops up when the assessee puts up the question whether the previous tax agreement or the amended agreement will govern the private contract between the parties? The general perspective is that it is the provisions of the Convention as on the first day of the applicable appraisal year will be considered and not the procurements of the Convention when the parties went into a contract.

In the case of *CIT v. Isthmian Steamship Lines*[125], it was held that the principle is the same as when deciphering a change to the Income Tax Act- the Income Tax Act (as revised) existing on first April, of the appraisal year will apply. Thus, there should not be any ground for confusion.

Similarly in the case of *Timken India Ltd. v. CIT*[126], the Calcutta High Court took a comparative view that one needs to consider the terms of any taxation agreement for that particular assessment or appraisal year in which the income is subjected to tax.

The Mumbai Bench of the Income-Tax Appellate Tribunal in the case of In *CIT v. TISCO Ltd*[127], held that it is an incorrect view of considering the amended tax treaty to govern the private contract. The issue in this case was, that the Indo-German Treaty of 1959 was amended by a protocol dated 26th August, 1985.

The Tribunal held that for the assessment year 1984-1985, the amended agreement would not govern the computation of taxation on the income of the that period. The treaty existing at the time of entering into the private contract must be considered even after the subsequent amendment. Thus, the amendment to the treaty cannot influence taxability under a prior entered private contract.

But later on in many of the cases, the Tribunal's opinion in the TISCO Case was contended to be vague and improper. But a final decision on the subject has still not been given. There is

[125] CIT v. Isthmian Steamship Lines [1951] 20 ITR 572

[126] Timken India Ltd. v. CIT [1954] 26 ITR 27

[127] CIT v. TISCO Ltd 60 ITR 405

discussion going on in several cases whether a retrospective application to the amended tax agreement can be given and thus made applicable on the private contracts or transactions which has taken place before the last assessment year or not.

CHAPTER 8

SPECIAL INSTANCES INVOLVED WITH DTAA

8.1 Double non-taxation

After so much of arguments, the position is well settled that if a specific income is assessed for tax in the source state, then the state of resident can't charge tax on the same. In the same way, there may emerge a circumstance of double non-tariff where a specific salary is not subjected to tax in the source state, as a result of an incentive or benefit or exception prevailing in that specific state and the same is not charged in the resident state.[128]

For instance, if an occupant of India possesses property in nation A which is an immovable property, the amount generated from the immovable property ―may be subjected to tax under DTAA however the laws of nation A' for reasons unknown don't accommodate taxing of the income from such immovable property, then, such income would go totally untaxed as nation A in which the jurisdiction to assessment of that income has been presented picks not to tax the same.

These days, a perspective is growing globally that a DTAA should not to be deciphered to offer ascent to double non-tariff or taxation on the grounds that its objective is just to avoid or mitigate the instances of double taxation. The fundamental logic in this perspective is that the state of resident keeps an inalienable right to tax the income of the inhabitant.

Henceforth, regardless of the fact that, in the above case, nation A does not impose tax on the income from immovable property, India being the resident country can assess the same.[129] However this perspective may not be satisfactorily effective. A DTTA must be translated or interpreted entirely all alone on its own terms regardless of the possibility that it results in

[128]Available at http://www.oecd.org/ctp/aggressive/fightingunintendeddoublenon-taxation.htm, last accessed on 21st March, 2015.

[129]Available at https://www.kluwerlawonline.com/abstract.php?id=TAXI2005048&PHPSESSID=d1u2p4f05g6nopdi4fecfh48b2 last accessed on 20th March, 2015.

double non-taxation. The Supreme Court has likewise specificially certified the perspective that a probability of double non-taxation is insignificant.[130]

In Azadi Bachao Andolan, the Mauritian speculators had asserted that as per Article 13 of the Indo-Mauritius DTAA, gains from capitals emerging to them were assessable in Mauritius. In spite of the fact that it was noticed that the capital increase was not assessable according to Mauritian law, yet the Supreme Court maintained the case of the Mauritian financial specialists and investors.

In *CIT vs Laxmi Textile Exporters Ltd.*[131] , the assessee, who was an occupant of India, was maintaining a business in Sri Lanka through a PE. Nonetheless, such income was not assessable in Sri Lanka. The Madras High Court held that this does not provide that India is entitled to tax the same. Thus, there has always been contrasting opinion and claims with regard to applicability of DTAA which is giving rise to instances of non-taxation.

8.2 Treaty Shopping

At the point when the law is decently settled that the treaty will be given overriding impact on the provisions of the Income Tax Act, so far it is beneficial to the assessee but it has even given way to another issue is known as treaty shopping. The assessee prefers to be guided and taxed under the treaty on its income in situation when India has favourable or beneficial treaty with any other nation when contrasted with the general provisions of the Income Tax Act, 1961. Indo-Mauritius settlement, convention with Cyprus and the Netherlands are some great instances in this respect.[132]

Assume that the provisions in the Indo-Mauritius Treaty[133] when contrasted with the Indo-US Convention, an assessee will characteristically be pulled in to structure his exchange in such a way as to get profit through the Indo-Mauritius treaty by consolidating an organization in Mauritius, however the individual connected with the organization may be settled in some other place. And such scenario is referred to as treaty shopping.

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[130] Available at http://businessfinancemag.com/blog/15-steps-deal-double-non-taxation, last accessed on 20th March, 2015.

[131] CIT versus Laxmi Textile Exporters Ltd (Mad) 245 ITR 521

[132] Available at http://ec.europa.eu/taxation_customs/taxation/individuals/treaties_en.htm, last accessed on 20th March, 2015.

[133] Available at http://www.moneycontrol.com/news-topic/india-mauritius-tax-treaty/ , last accessed on 20th March, 2015.

This treaty shopping is regularly abused by the foreign elements with the end goal of dodging taxes. For instance, more than 40% of the aggregate FDI (Foreign Direct Investment) in India gets through the course of Mauritius in light of the fact that under the Indo-Mauritius DTAA capital gains are evaluated according to the law of the residency of the party.[134]

There is no taxation of capital gains in Mauritius. Thus all the capital gains coming to India through the Mauritius route goes completely untaxed. Another instance of treaty shopping can likewise be carried out in situations where the rate of assessment in one state is lower when contrasted with the rate of taxation in another state.

The Supreme Court discussed the issue of treaty shopping in the case of Union of India v. Azadi Bachao Andolan, where it held that if the aim of the DTAA was to prevent a national of third nation from taking the profit out of the favourable terms, then a particular provisions to that impact ought to have been added to it.

It is the obligation of the Parliament to make necessary arrangement in this respect, and if the restriction is not there in the DTAA then nobody can be prevented from utilizing the beneficial tax provision in the conviction that treaty shopping is prohibited.[135]

In the Indo-US DTAA,[136] Article 24 has allowed a non-distinct individual to claim benefits under Agreement only in the situation when more than half of the beneficial interest is bestowed in the individual inhabitant of a contracting state.[137]

Lately in a judgment given by the AAR it was held that the applicant, who is the resident or inhabitant of Mauritius, is not subjected to payment of tariff in India, under India-Mauritius Tax Treaty, on the gain on capitals emerging from the dealings in shares of an Indian organization. This decision additionally certifies the standards set out by the Supreme Court in the leading case of Azadi Bachao Andolan which has been discussed earlier.

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[134] Available at http://articles.economictimes.indiatimes.com/2015-03-13/news/60086172_1_indian-ocean-region-mauritius-national-day-prime-minister-narendra-modi, last accessed on 20th March, 2015.

[135] Available at http://www.interfis.com/articles/treaty-shopping , last accessed on 20th March, 2015.

[136] Available at http://www.iaccindia.com/userfiles/files/India%20US%20Double%20Taxation%20Avoidance%20Treaty.pdf, last accessed on 20th March, 2015.

[137] Available at http://www.sircoficai.org/downloads/cpe-materials/Overview-of-India-US-DTAA.pdf, last accessed on 20th March, 2015.

CHAPTER 9

PRACTICAL APPLICABILITY- CASE STUDIES

9.1 Triangular Cases

In order to have an in-depth understanding of DTAA, the triangular cases is being dealt with. This is an hypothetical example explicitly for the purpose of understanding the mechanism of DTAA

Let's take a situation, when there are 3 companies:

- A, India
- B, UK
- C, Mauritius

A has taken loan from C and C charges interest from A for the same. The real issue is regarding the applicability of treaty. Which treaty will be applicable on the said transaction? We are provided with 3 options:

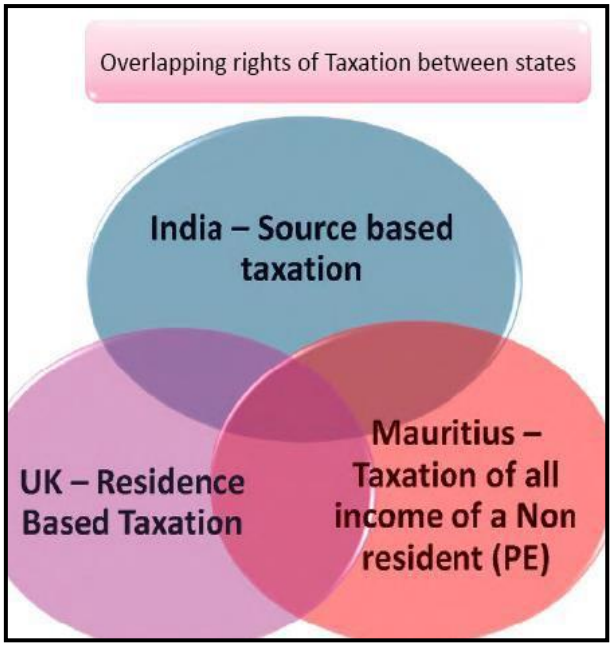
1. Indo-Mauritius Treaty

2. UK-Mauritius Treaty

3. Indo-UK Treaty

A treaty is only applicable on the entities of the contracting state. A third party who is not the resident of either of the contracting nation should not be taking benefit out of the treaty. The person should be a resident of one or the other state.

Person other than individual is a resident of state where its place of effective management is situated.



Indo-Mauritius Treaty

Since, C is not the resident of Mauritius or the resident of India, the Indo- Mauritius treaty cannot be made applicable on him. As we already know, that a person or entity should be the resident of either of the contracting nation to be governed under the treaty.

UK-Mauritius Treaty

As already discussed, C is a non-resident of Mauritius. It has its Permanent Establishment in UK and the principal business or effective management in UK. Thus, he is a resident of UK.

However, A does not have access to UK-Mauritius Treaty being the resident of India.

Indo-UK Treaty

C is a resident of UK though situated in Mauritius. C has its place of "effective management" in UK. Thus, there is no relevance of Mauritius over here. C is not a resident of Mauritius or India.

Tax of C will be deducted by A who is a resident of India under Indo-UK treaty.

Credit of taxes to B or C

The tax is not deducted under the Indo-Mauritius Treaty and thus, no tax credit will be made available to C. The tax credit will not be available to C since the tax is not deducted under Indo – Mauritius Treaty whereas relief to taxes in the form of tax credit will be made available to B while filing its income return. The income of C will be joined with the income of B as C is the PE of B

Such cases are referred to as the triangular cases in DTAA which creates confusion with regard to applicability of a treaty on the transaction.

9.2 Interpretation of India-UAE Tax Treaty

The Mumbai Tribunal decided that the declaration 'liable to tax' utilized as a part of the India-UAE tax arrangement does not so much suggest that individual ought to really be at risk to assessment on his income in UAE.[138][139]

In the case of *Mahavirchand Mehta*[140] who was the tax payer, it was has held by the Mumbai Bench of the Income-Tax Appellate Tribunal which will be referred to as, the Tribunal that "liable to tax" as mentioned in Article 4(l) of India-UAE Tax Treaty does not imply that the individual ought to really be subjected to the tax in that contracting state due to any existing legal provision to that effect. It will likewise cover situations where the other contracting state has the privilege to tax such individual, whether such a right is invoked or not[141].

Relevant facts

- The citizen is an individual and an occupant of UAE. Amid the previous year, he earned profits on short term capital by selling shares in India. The assessee argued that since he is an UAE resident, the income could only be taxed in UAE and not in India under Article 13(3) of the tax treaty.

[138] Available at http://www.offshoreinvestment.com/media/uploads/UAE%20Tax%20Treaties%20with%20India.pdf, last accessed on 20th March, 2015.

[139] Available at http://www.advocatekhoj.com/library/agreements/doubletaxation/72.php, last accessed on 20th March, 2015.

[140] ITO vs Mahaveer Chand Mehta [2011] 11 taxmann.com 194 (Mum)

[141] Available at http://www.kpmg.com/IN/en/services/Tax/FlashNews/Abu-Dhabi-Commercial-Bank-Ltd.pdf

- The Assessing Officer rejected the case of the assessee on the ground that when he is not even paying tax in UAE, his income will be taxed in India. The AO relied on the case of Abdul Razak Meman[142] and held that the assessee has not been able to release the onus on it to demonstrate that his income falls under the taxable income in UAE and he is liable to pay the same.
- The AO watched that it is not sufficient for an individual to invoke their rights under Article 13(3) and claim the benefits by being the resident of other contracting state, but should have actually paid taxes on the income in appreciation of which the claim under Article 13(3) is asserted.

The CIT(A) held that the tax payer is not liable to be taxed on his income under Article 13(3) of the tax treaty in India in an appeal filed by the tax payer. The CIT studied in detail the various cases before reaching to this conclusion. In doing as such, he took after the choice of the Tribunal on account of Green Emirate Shipping & Travels.

In the instance of *Green Emirate Shipping*[143], the Tribunal while managing a comparative issue had held that the judgments of *Cyril Eugene Pereria*[144] and Abdul Razak A. Meman don't set out the right law. The Tribunal, depending upon the judgment of Supreme Court on account of Azadi Bachao Andolan, had detailed certain points as under:

- Mitigation of double taxation or tariff is not dependant on duty being really paid in one of the Contracting States;
- Recommendation that twofold tariff shirking is not admissible unless the tax is paid, is as opposed to the intendment of Section 90 of the Income-Tax Act, 1961;
- Taxability in one nation is not indispensable and it is not a criterion for non-taxability in the other nation. What is to be actually looked into while deciding taxability in a particular nation has to be determined on the grounds of residence, citizenship, period of stay, domicile, place of management or incorporation or any other such features or characteristics.

[142] 276 ITR 306 (AAR), last accessed on 20th March, 2015.

[143] Assistant Director of Income Tax vs. Green Emirate Shipping 2006 286 ITR 60 Mum

[144] Cyril Eugene Pereria vs Unknown 239 ITR 650

Major issue before the tribunal

- Whether the statement "liable to tax" in contracting state as utilized as a part of Article 4(1) of the tax treaty infers that an individual ought to really be obligated to be taxed in that contracting State?

The Tribunal held relying on various cases one of them being Green Emirate Shipping maintained the oreder of CIT(A). The Tribunal held that "liable to tax" should be interpreted in a proper way. Article 4(1) of Indo-UAE tax treaty does not suggest that the individual ought to really be at risk to assessment in that contracting state. It is sufficient if other contracting state has right to tax such individual, whether such a right is worked out or not.

The same opinion was dissented by the Mumbai Tribunal in the case of Ramesh Kumar Goenka[145] where on comparative certainties the Tribunal held that the representation 'liable to tax' as utilized in Article 4(1) of India-UAE Tax Treaty does not so much infer that individual ought to really be subject to assessment in that contracting state. This judgment strengthens the view that the term obligated to tax does not imply that assessment ought to have really been paid.

In a few arrangements, for example, in USA, the terms 'subject to duty' or 'liable to tax' or 'at risk to tax' have been utilized at the same time. The term 'subject to tax' is connected with income though the term 'liable to tax' is connected with an individual.

In another case of *General Electric Pension Trust*[146], the AAR had held that the citizen was unquestionably an individual obligated to assessment in the USA however it can't be said that its income is subjected to tax as its whole salary is excluded from levy in the USA. Thus, the individual was held not to be obligated to tax as he was not the USA resident.

It is appropriate to note that India marked a convention on 26 March 2007 with UAE where the meaning of "Resident" was altered and it included the instance when any individual gets to be the resident in the event when he stays in UAE for no less than 183 days in the previous year. Further, an organization also becomes the inhabitant or resident in the event that it is fused or incorporated in UAE and which is overseen and controlled completely in UAE.

[145] Ramesh Kumar Goenka vs Department of Income Tax I.T.A.No. 3562/Mum/2009

[146] General Electric Pension Trust vs A. RULINGS INCOME TAX A.A.R. No. 659 of 2005

Consequently, "tax laws give a helpful arrangement of cases for investigating the interpretative methodologies of the judicial mechanism in India. It is observed that the "Interpretation of statute implies that the court needs to discover the realities and afterward translate the law to apply to such truths. Understanding can't be in vacuum or in connection to speculative certainties. It is in the capacity of the legislature to say what might be the law and it is for the court to say what the law is.

Further, that the financial statutes ought to be understood truly does not preclude the utilization of the sensible development. This was expressed while deciphering Sec 40A(7) of the IT Act, 1961.

Words are blemished images to convey plan or intent. Also, words are uncertain and frequently their implications get changed over the long haul. It is likewise a remarkable actuality that the English dialect is not an instrument of scientific exactness. It cannot guarantee mathematical accuracy.

Subsequently, no arrangement can explicitly resolve all issues that may emerge sometime during its application. Along these lines, in the same way as whatever other legitimate content, tax treaties oblige and leave space for elucidation or interpretation. Treaties are more to be settled by looking into the intent of the parties and by the conduct of the parties, which can't be portrayed in words.

Likewise, it is not within the jurisdiction of human forces to anticipate the complex arrangement of certainties which may emerge later on, and regardless of the fact that it were along these lines, it is impractical to accommodate every one of them with total exactness. All these viewpoints give different view point with regard to the application and interpretation of treaties. There is no exact rule of interpretation. The one which harmoniously interpret the provision must be looked into.

9.3 Latest rulings with regard to DTAA

- **Motorola Inc v. Deputy Commissioner of Income Tax**[147]

It was held that, DTAA is not an absolution administration however it is essentially an optional tax administration. The liability is first on the revenue department to demonstrate that the assessee has an assessable pay under the DTAA and afterward the weight is on the

[147] Motorola Inc v. Deputy Commissioner of Income Tax, [2005] 95 ITD 269 (Del) (SB)

assessee to demonstrate that the wage is excluded even under the DTAA. In such a way, the assessee can avoid its income from being taxed.

- **Assistant Director Of Income Tax v. Green Emirate Shipping & Travels**[148]

Any entity is not needed to deliver any proof to demonstrate whether it is obligated to pay charges or paying duties or taxes in UAE. It was observed by ITAT that the absolution or exemption which has been decided to is autonomous of whether the contracting state forces any tax burden on the assessee in the circumstance to which exception applies. Both the current as well as the potential chances of double taxation is taken care of in the Taxation Treaty. Thus, the tax payer should not be put in a situation of twofold taxation or levy even in the future.

- **Re: Rajiv Malhotra**[149]

It was held that the commission collected in India as wellspring or source of income was in India, the rendering of the administration outside India and the settlement of remote trade would not change the source being in India. In this manner, the pay was obligated to be subjected to tax and TDS was to be deducted.

- **Commissioner Of Income Tax v. Heg Ltd** [150]

The Appellant argued that any data or information related to the business venture can't be viewed as data as seen in the connection of the procurement or that of the arrangement to win the status of royalty. There should be extraordinary highlights or characteristics or features to acclaim the status of royalty. All data, in the event that it concerns the commercial ventures or business endeavor would not be considered or treated as royalty.

- **Wipro Ltd. v. ITO**[151]

The issue was whether assessee was subject to TDS deductions for the payments made to a company outside India for giving access to its database on membership premise? It was held

[148] Assistant Director Of Income Tax v. Green Emirate Shipping & Travels 100 ITD 203

[149] Re: Rajiv Malhotra (AAR no. 671 of 2005) 284 ITR 56

[150] Commissioner Of Income Tax v. Heg Ltd [263 ITR 230] [MP][2003]

[151] Wipro Ltd. v. ITO (2005) 278 ITR (AT) 57

that the company outside India earned cash by giving copyrighted data and information on membership premise. This was in the way of deductions in India. Therefore such receipts couldn't be dealt as salary collected in India. Subsequently, no TDS was obliged to be deducted.

- **CIT vs. Vishakapatnam Port Trust**[152]

When there is a conflict between the Income-tax Act and provisions of DTAA, provisions of DTAA would have an upper hand over the Income Tax Act provisions. The same principle has been previously explained in detail. Thus, entering into a DTAA with a foreign country in undoubtedly beneficial in order to avoid and mitigate the instances if double taxation.

- **Union Of India v Azadi Bachao Andolan**[153]

It was held that once a DTAA has been signed with a foreign country and it has come into existence, and there is contrasting instance between the DTAA and the provisions of Income tax. Undoubtedly and without any further discussion, the provision of DTAA will prevail over the Act.

- **CIT vs PVAL Kulandagan Chettiar**[154]

It was held that the individual relations which can be personal and monetary relations with one or other, helps in deciding the liability of taxation emerging in appreciation of an individual living in both contracting States. Thus, the country with which the individual maintains a closer relation will be governing the tax liability.

[152] CIT vs. Vishakapatnam Port Trust (144 ITR 146)

[153] Union Of India v Azadi Bachao Andolan (263 ITR 706) (SC)

[154] CIT vs PVAL Kulandagan Chettiar (267 ITR 654) (SC)

CHAPTER 10

REMEDIES TO AVOID CONFLICTS

10.1 Basic principles of statutory interpretation

There are number of additional aids which the courts may take help in interpreting statutes. These are general presumptions; maxims and internal and extrinsic aids to interpretation. The guide to legislative intention can be derived from rules i.e. common law rules or statutory rules which have binding force; principles derived from legal policy which are mainly persuasive and; presumptions based on the nature of legislation and general linguistic canons applicable to any piece of prose.[155]

- Statutes are presumed to be constitutional thus the laws are to be interpreted in such a manner so as to avoid constitutional problems;

"Indisputably, there exists a presumption as regards the constitutionality of a statute. Rule of presumption in favour of constitutionality, however, only shifts the burden of proof and rests it on the shoulders of person who attacks it. It is for the person to show that there has been serious transgression of constitutional principles.

But this rule is subject to the limitation that is operative only till the time it becomes clear and beyond reasonable doubt that the legislature has crossed its limits. This rule in its application as principle of construction means that if two meanings are possible then the court will reject the one which renders it unconstitutional and accept the one upholding the validity of impugned legislation[156]."

- The presumption is that the tax statutes are to be construed strictly, that is, they are to be interpreted narrowly and in the favour of taxpayer;[157]
- Statutes are not to have retrospective effect;[158]

[155] Available at http://fas.org/sgp/crs/misc/97-589.pdf last accessed on 20th March, 2015.

[156] State of Rajasthan vs. Basant Nahata (2005) 12 SCC 77

[157] Available at http://www.hbtlj.org/v04/v04_lowy.pdf last accessed on 20th March, 2015.

[158] Available at http://www.mondaq.com/india/x/19039/Principles+of+Retrospective+Operation+of+Law+and+Ultra+Vires last accessed on 20th March, 2015.

The principle that no-one should be penalised by retrospective law is expressed by the latin maxims which means that no crime can be committed and no punishment can be imposed except under a prior penal law.[159]

The freedom from retrospective operation of criminal law has been recognized as fundamental element of democratic rights and the same has been recognized in Article 15 of ICCPR.[160] Article 15 reads as under;

"*No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence, under national or international law, at the time it was committed*."

As explained by Justice Stone in Welch vs. Henry[161],

"*Taxation is neither a penalty imposed on the tax payer nor a liability which he assumes by contract. It is but a way of apportioning the cost of Government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process*."

- Statutes are not to have extra- territorial effect;[162][163]

Presumptions against implied exceptions- it means exemptions are not to be assumed;

The SC in State of Jharkhand v. Tata Cummins Ltd.[164] observed:

"*…a tax is a payment for raising general revenue. It is a burden. It is based on principle of ability or capacity to pay. It is manifestation of the taxing power of the State. An exemption from payment of tax under an enactment is an exemption from tax liability. Therefore, every such exemption notification has to be read strictly*."

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[159] Available at http://www.legalservicesindia.com/article/article/prospective-vs-retrospective-517-1.html last accessed on 20th March, 2015.

[160] Available at http://www.ohchr.org/en/professionalinterest/pages/ccpr.aspx last accessed on 20th March, 2015.

[161] Welch vs. Henry, 305 U.S., at 146-147

[162] Available at http://jurist.org/forum/2013/05/kenneth-gallant-extraterritorial-application.php last accessed on 20th March, 2015.

[163] Available at http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1170&context=bjil last accessed on 20th March, 2015.

[164] State of Jharkhand v. Tata Cummins Ltd (2006) 4 SCC 57

- Presumptions against implied repeal[165]

In the case of simple repeal there is scarcely any room for expression of contrary opinion.[166] It is now well settled that repeal connotes abrogation or obliteration of one statute by another, from the statute book as completely as if it had never been passed; when an Act is repealed it must be considered as if it never existed as provided under Section 6 of the General Clauses Act, 1897167.

- Presumptions against irrationality and injustice;

Rule against lenity- it means that the law is to be construed strictly if it is intended to punish;[168]

All words in the statute have meaning and those meanings are updated with the change of time. This is also known as Dynamic Interpretation. Approaches to statutory interpretation such as, textualism, intentionalism, puposivism, and there variants- share a common feature. They place emphasis on laws at the time legislature wrote them, requiring judges to

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[165] Available at http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1342&context=californialawreview last accessed on 20th March, 2015.

[166] Available at http://lawaids.blogspot.in/2010/06/presumption-against-implied-repeal.html last accessed on 20th March, 2015.

[167] Section 6 of General Clauses Act, 1897 reads as, "Effect of repeal-Where this Act, or any Central Act or Regulation made after the commencement of this Act, repeals any enactment hitherto made or hereafter to be made, then, unless a different intention appears, the repeal shall not—

(a) revive anything not in force or existing at the time at which the repeal takes effect; or

(b) affect the previous operation of any enactment so repealed or anything duly done or suffered thereunder; or

(c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or

(d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or

(e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, and any such investigation, legal proceeding or remedy may be instituted, continued or enforced, and any such penalty, forfeiture or punishment may be imposed as if the repealing Act or Regulation had not been passed.

[168] http://www.duhaime.org/LegalDictionary/R/RuleofLenity.aspx last accessed on 23rd March, 2015.

undertake archaeological digs to interpret them. As modern literary theory changes from reader to reader and overtime so the meaning of statutory texts changes over time.

Words and phrases are mobile to a variable extent, so that a spectrum of mobility exists, from words and phrases, the meaning of which has changed little over time, to those of which our understanding has changed greatly.

Maxims

Latin maxims denote rules of the language. Ordinarily in a statute all words are to be given meaning, same words are to be given same meaning and different words are to be given different meaning the maxims are as under:

- **Noscitur a sociis**

When two or more words which are susceptible of analogous meaning are coupled together they are understood to be used in a cognate sense. The meaning of more general word take colour from the less general word.

This rule will apply when the when the intention of the legislature in associating wider words with words of narrower significance is doubtful or is otherwise not clear. Thus, a word will be interpreted in the context of surrounding circumstances.[169]

- **Ejusdem generis[170]**

General words receive restricted meaning when used in association with other words by application of the rules of Noscitur a sociis and ejusdem generis. In ejusdem generis a genus or category must be created out of specified words of a class, category or genus.

In Powell v. Kemton Park Race cource[171], the defendant was operating from a place outdoor whereas it was an offence to use a house, office, room or other place for betting". The Court held that "other place" had to refer to other indoor places because the words in the list were indoor places.[172]

[169] Available at http://taxguru.in/income-tax/principle-noscitur-sociis.html last accessed on 23rd March, 2015.

[170]Available at http://thelawdictionary.org/ejusdem-generis/ last accessed on 23rd March, 2015.

[171] Powell v. Kemton Park Race course (1989) AC 143

[172]Available at http://www.legalblog.in/2011/10/doctrine-of-ejusdem-generis-supreme.html last accessed on 23rd March, 2015.

- **Expressio Unius est exclusion alterius**[173]

Express mention of one or more things of a particular class may be regarded as silently excluding all other members of the class

In Tempest v. Kilner,[174] a statute required that contracts for the sale of "goods, ware and merchandise" of 10 pounds or more had to be evidence in writing. The court had to decide whether this applied to stocks or shares. The court held that the statute did not apply because stocks and shares were not mentioned.

- **Generalia Specialibus non derogant**[175]

The general rule to be followed in case of conflict between two statutes is that later abrogates the earlier one. In other words, a prior special law would yield to a later general law, if either of two conditions is satisfied:

the two are inconsistent with each other;[176]

there is some express reference in the later enactment to the earlier enactment.[177]

- **Reddento Singula Singulis**

Where there are general words of description following an enumeration of particular things, such general words are to be constructed distributively.[178]

- **Ut res valeat quam pereat**

This principle implies that no provision should be interpreted superfluous or insensible. However, a word can in some circumstances be omitted if it is absurd or conflicts with another provision.[179]

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[173] Available at http://www.duhaime.org/LegalDictionary/E/ExpressioUniusEstExclusioAlterius.aspx last accessed on 23rd March, 2015.

[174] Tempest v. Kilner (1846) 3 KB 249

[175] Available at http://www.irwinlaw.com/cold/generalia_specialibus_non_derogant last accessed on 23rd March, 2015.

[176] UPSEB v. Hari Shankar Jain AIR 1979 SC 65

[177] J.K Cotton & Spinning Mills v. U.P. AIR 1961 SC 1170

[178] Available at http://hanumant.com/IOS-Unit4-RulesOfInterpretation.html last accessed on 23rd March, 2015.

Popular meaning

Words in the section of a statute are not to be interpreted by having those words in one hand and the dictionary in another. In spelling out the meaning of a word in a section, one must take into consideration the setting in which those terms are used and purpose that they intend to serve.[180]

Ordinary meaning

In Church of Holy Trinity v. United States[181], a Statute made it a crime in any manner whatsoever, to prepay the transportation of an alien to perform labour or service of any kind in the United States. A Church was convicted of violating this Statute, having pre-paid the transportation of its rector from England. The Supreme court of the United States of America reversed the conviction.

Justice Brewer concluded:

"No one reading such a title would suppose that Congress had in its mind any purpose of staying the coming into this country of ministers of gospel, or, indeed, of any class whose task is that of brain."

Technical meaning

Words and expressions in taxing statute, unless defined in the statute itself, have to be construed in the sense in which the person dealing with them understand i.e as per the trade understanding, commercial and technical practice and usage.

Internal Aids

Internal aids to interpretation are contained within the body of the enactment. These are Preamble, headings, marginal notes, punctuations etc. In recent years preambles have been given in the enactment which implements the international Conventions.[182]

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[179] Available at http://www.lawyersclubindia.com/forum/Legal-quiz-Maxim-29100.asp last accessed on 23rd March, 2015.

[180] CGT v. N.S. Getti Chettiar (1971) 82 ITR 599

[181] Holy Trinity v. United States 143 US 457 (1892)

[182] Available at http://e-lawresources.co.uk/Aids-to-statutory-interpretation.php last accessed on 23rd March, 2015.

External Aids

Materials that are considered to be external to the words of the enactment are referred to as the external aids to the statutory interpretation. These include dictionaries; statute in pari material; Interpretation Acts; prior state of the law and legislative history, that is, the account of the events that occurred during the conception, preparation and passing of the enactment.[183]

10.2 Applicability of anti-abuse concept in relation to DTAA

There is a developing practice amongst certain individual or entities who are not the inhabitant or resident of both of the two Contracting States, and in order to get benefits from the beneficial provisions of the DTAA get indulged in the practice of treaty shopping which has been previously discussed in the report.[184]

The profit of the Treaty ought to be concurred just to persons who are inhabitants of either or both of the Contracting States. A stranger to the contract should not be taking benefit out of the contract. This principle is well established principle in the Law of Contracts which is read as "privity to contract" and that a stranger should not be a party to contract and should not be enforcing the same for his benefit.[185]

Even in taxation law, the anti abuse provisions are required. The necessary of the same cannot be ignored seeing the extensive abuse of the DTAA which has to be curtailed. This is additionally supported by the guideline of substance over structure. While there are various choices from the most astounding court in the nation, which offer priority to substance over structure, there is a need to add suitable sections on DTAAs in order to cope up treaty

[183] Available at http://sixthformlaw.info/01_modules/mod2/2_2_3_stat_interp/05_internal_aids_.htm last accessed on 23rd March, 2015.

[184] Available at http://www.bmradvisors.com/upload/documents/Tax%20treaty%20abuse%20and%20anti%20avoidance%20rules_anurag%20jain1281939972.pdf last accessed on 23rd March, 2015.

[185] Available at https://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Documents/IFA-2010-Luxembourg-tax-treaties-and-tax-avoidance.pdf, last accessed on 23rd March, 2015.

shopping, channel organizations and dainty promotion. Such provisions must be construed on the basis of UN or OECD model or any other best worldwide practices.[186]

The increment in outbound ventures has provided the opportunity to companies to generate income in the countries with no or low tax rates which can be termed as "low or no tax jurisdiction" and compromising the taxes in India. It is an unmerited loss of revenue for the government. It additionally de-motivates a country to promote investments.

[186] Available at http://www.taxindiainternational.com/printContent.php?qwer43fcxzt=MTEz&flag=2, last accessed on 23rd March, 2015.

CHAPTER 11

CONCLUSION & SUGGESTIONS

It has been deduced from the discussion carried out above that India has entered into a wide network of tax treaties with various countries all over the world to facilitate free flow of capital into and from India. The regime of international taxation exists through bilateral tax treaties based upon model treaties, developed by the OECD and the UN, between the Contracting States.

India principally goes after the UN model convention and one therefore finds the tax-sparing and credit methods for elimination of double taxation in most Indian treaties as well as more source-based taxation in respect of the articles on 'royalties' and 'other income' than in the OECD model convention.

Double Taxation Avoidance Agreements are evidently an interaction of two tax systems each belonging to different country, which aim to mitigate the effect of double taxation. Double taxation is still one of the major obstacles to the development of inter-country economic relations. Every country seeks to tax the income generated within its territory on the basis of one or more connecting factors.

By means of Double Taxation Avoidance Agreements, each country accommodates the claims of International Affairs and Global Strategy other nations within their fiscal arena to develop international trade and investments with minimal barriers.

However, the international tax regime has to be restructured constantly so as to respond to the current challenges and drawbacks. It is also of great importance for India to take advantage of the current global move to greater transparency and openness by strengthening information sharing and administrative assistance provisions in its DTAAs.

11.1 Lacunas in the current policy governing DTAA along with the suggestions to overcome such loopholes

- The domestic law of a country undergoes substantive change on a regular basis due to shift in economic condition, thus affecting the terms of agreements between the contracting parties.

In order to avoid such a situation, the treaties should be modified and amended on a regular fixed period basis to avoid any confusion. The domestic law of the country should be looked into and incorporated in the treaties. The contracting parties to the treaty should not be in a doubtful state with regard to their jurisdiction on the basis on taxation of a particular income.

- Problem in deducing whether an assessee can opt for being governed by DTAA in a particular year and Income Act Act, 1961 in another year.

Such options are available to the tax payer. They can choose to be governed by DTAA in a particular year and under the provisions of the Income Tax Act in a particular year, whichever seems to be more favourable to the assessee. But on the other hand, it is a confusing scenario for the contracting countries. To avoid such situation, the tax payer must explicitly provide in written before hand to the respective tax authority of a country regarding its choice.

- The problem in interpretation when the assessee prefers to be governed under DTAA for particular source of income and other sources to be taxed under Income Tax Act, 1961.

If the DTAA provides lower rate of tax on a particular source of income in contrast to the provisions of Income Tax Act, the tax payer will undoubtedly prefer to be governed by DTAA. In order to avoid any conflict income which falls within the purview of Double Taxation Avoidance Agreement must be stated.

- Certain words contained in the Income Tax Provisions, which is not present in the Agreements and even if it is mentioned in the Agreement, it conveys a different meaning altogether.

In such a scenario, comes the real application of interpretation of taxation statutes and treaties. The word should be interpreted in a way that does not undermine the basic intention of the statute as well as the treaty. The cardinal principles of interpretation as discussed above must be brought in application.

- Many a times DTAA is giving rise to situation of double non taxation which is contravening the purpose of DTAA.

For instance, if an occupant of India possesses property in nation A which is immovable 'where amount generated from the immovable property ―may be subjected to tax under

DTAA however the laws of nation A' for reasons unknown don't accommodate taxing of the income from such immovable property, then, such income would go totally untaxed as nation A in which the jurisdiction to assessment of that income has been presented picks not to tax the same.

This can be avoided by bringing transparency and accountability in the functioning of tax authorities. Further, the tax challenges of the digital economy must be addressed. The rules for punishing the offenders must be made more stringent.

Moreover, proper use of treaty can avoid double non-taxation. The countries should get some tax benefits. It is the source of revenue which is utilized for the benefit of the citizen of the nation. Thus, before framing the tax treaty, the respective contracting countries must look into the domestic tax provision of the country.

- Instances of treaty shopping is increasing

Treaty shopping is regularly abused by the foreign elements with the end goal of dodging taxes. For instance, more than 40% of the aggregate FDI (Foreign Direct Investment) in India gets through the course of Mauritius in light of the fact that under the Indo-Mauritius DTAA capital gains are evaluated according to the law of the residency of the party.[187]

There is no taxation of capital gains in Mauritius. Thus all the capital gains coming to India through the Mauritius route goes completely untaxed. Another instance of treaty shopping can likewise be carried out in situations where the rate of assessment in one state is lower when contrasted with the rate of taxation in another state.

The Supreme Court discussed the issue of treaty shopping in the case of Union of India v. Azadi Bachao Andolan[188], where it held that if the aim of the DTAA was to prevent a national of third nation from taking the profit out of the favourable terms, then a particular provisions to that impact ought to have been added to it. Such instances has to be avoided.

The corporations and individuals have to avoid getting into the practice of treaty shopping.

The Tax authority must ensure transparency and accountability in the operation of tax treaties.

[187] Available at http://articles.economictimes.indiatimes.com/2015-03-13/news/60086172_1_indian-ocean-region-mauritius-national-day-prime-minister-narendra-modi, last accessed on 23rd March, 2015.

[188] Union of India v. Azadi Bachao Andolan 263 ITR 706

A perusal of the principles laid down by the various decisions while interpreting or giving effect to the different clauses of the DTAA as also the scheme of conferring unilateral relief from these principles, although enunciated in the course of application of a particular agreement or the relevant clauses thereof, would be applicable even to those cases which has similar clauses of DTAAs between India and other countries.

In the end, the ability to arrive at the correct interpretation of a legal provision, which could also mean the interpretation which the Court will ultimately place thereon, is the real art of a lawyer. It depends on his ability to read what is stated, to read between the lines and to read ―through the provision, things which one can do if he has a wide exposure to life as such. The rules of interpretation are elastic enough to enable a judge to interpret the provisions of a treaty in such a way as to further the cause of justice by citing an appropriate rule of interpretation.

- The interpretation and application of tax treaties should not be done in literal sense.It must be scrutinized keeping the domestic law of a country in hand. Any possibilities of conflict must be avoided.
- Tax Treaties should remain stable and any room for ambiguousness or uncertainty must be avoided. Explicit mention of the terms should be there.
- While framing treaties, it should specifically contain the sources of income which will be covered under the DTAA. It should not be left for interpretation.
- No presumptions should be applied in tax treaties. It should be explicit. No room for assumptions must be present.
- Treaties must be framed in good faith, taking into consideration the gains and sacrifices made by both the countries.
- The tax treaties should be reviewed periodically to avoid any clashes with the prevailing economic condition in a country.
- If the contracting countries enter into any subsequent treaties, which may have implication on the prevailing tax treaties, then the situation must be paid detailed attention.
- Treaties should always be framed in an authoritative single language and not in different language as it increases the room for ambiguousness.
- If any term is not defined in a particular treaty, then making reference for the same term in a parallel treaty is not a feasible idea.

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