Concept of Double Taxation Avoidance Agreement in India

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***Abstract*---**In today's modern world of advanced globalization ,business is not restricted to a single geographical territory & crosses all border of the countries. This had emerged a complex world of business along with complex world of Accounting & Taxation. The country has a right to tax on profits earned in its land by anyone and also to tax the global income of its residence. This leads to taxation of same income more than once. Double taxation may arise when the jurisdictional connections, used by different countries, overlap or it may arise when the taxpayer has connections with more than one country. A person earning any income has to pay tax in the country in which the income is earned (as source Country) as well as in the country in which the person is resident. As such, the said income is liable to tax in both the countries. To avoid this hardship of double taxation, Government of India has entered into Double Taxation Avoidance Agreements (DTAAs) with various countries. DTAAs provide for the following reduced rates of tax on dividend, interest, royalties, technical service fees, etc., received by residents of one country from those in the other. The Double Tax Avoidance Agreement (DTAA) is essentially a bilateral agreement entered into between two countries. The basic objective is to promote and foster economic trade and investment between two Countries by avoiding double taxation.

Keywords—Double Taxation Avoidance Agreement, Government of India , Law , Revenue, Treaties.

I. INTRODUCTION

DOUBLE taxation is the imposition of two or more taxes on the same income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). It refers to two distinct situations firstly taxation of dividend income without relief or credit for taxes paid by the company paying the dividend on the income from which the dividend is paid. And secondly taxation by two or more countries of the same income, asset or transaction, for example income paid by an entity of one country to a resident of a different country. The double liability is often mitigated by tax treaties between countries.

The proliferation of Double Taxation Avoidance Agreements entered into by India with several foreign countries has created a new branch of tax law. These Agreements come into play when a resident of one state has income sourced in another state.

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For the purpose of such Agreements income is regarded as sourced in a state if the payer is based there. A country's appetite for taxation being unquenchable, both states would like to tax the income arising from the same transaction. It is here that Double Taxation Avoidance Agreements come into play. The Agreements deal with different types of income. With reference to different types of income different modes of avoiding/restricting double taxation are evolved. The Agreement may vest jurisdiction to tax a particular type of income in one of the contesting states. The vesting of such right may depend on the fulfillment of the prescribed condition/s.

II. WHAT IS DOUBLE TAXATION?

A taxation principle referring to income taxes that are paid twice on the same source of earned income. Situation where a country levies tax on an income that has already been taxed in the same or another country. For example, corporate profits are taxed when they are earned, and then taxed again as personal income when distributed to stockholders (shareholders) as dividend or (in case of an owner-manager) as salary.[1]

In the case ***Cook v. Burlington,*** it was observed 'the taxing of the same item or piece of property twice to the same person, or taxing it as the property of one person and again as the property of another; but this does not include the imposition of different taxes concurrently on the same property (e. g., a city tax and a school tax), nor the taxation of the same piece of property to different persons when they hold different interests in it or when it represents different values in their hands, as when both the mortgagor and mortgagee of property are taxed in respect to their interests in it, or when a tax is laid upon the capital or property of a corporation and also upon the value of its shares of stock in the hands of the separate stockholders.'

Double taxation occurs when the same transaction or income source is subject to two or more taxing authorities. This can occur within a single country, when independent governmental units have the power to tax a single transaction or source of income, or may result when different sovereign states impose separate taxes, in which case it is called international double taxation.[2] The source of the double taxation problem is that the taxing jurisdictions do not follow a common principle of taxation. One taxing jurisdiction might tax income at its source, while others will tax income based on

[1]http://www.businessdictionary.com/definition/double-taxation.html
[2] Detroit Common Council v. Detroit Assessors, 91 Mich. 78,51 N. W. 787, 16 L. R. A. 59.

the residence or nationality of the recipient. Indeed, a jurisdiction might use all three of these basic approaches in imposing taxes.

The problems that double taxation presents have long been recognized, and with the growing Integration of domestic economies into a world economy, countries have undertaken several measures to reduce the problem of double taxation. An individual country can offer tax credits for foreign taxes paid, or outright exemptions from taxation of foreign-source income.

III. What Are Double Tax Avoidance Agreements?

Double Taxation Avoidance Agreements are treaties between two sovereign states. (Such Agreements can also be between two countries which are not "sovereign" states in the full legal sense). Being Agreements between two contracting states it was found that it would be useful to have a Model Agreement which could be the basis for discussion between two states contemplating to conclude a Double Tax Avoidance Agreement. The League of Nations first commenced work in this behalf in 1921 and produced in 1928 the first Model Bilateral Convention. Certain income, for example, interest income may be taxable in both states. In respect of such cases the normal rule is that the state of which the concerned person is a resident has the right to tax his income. However, the source state would also have the right to tax the income. Such taxation by the latter may be subject to a maximum permissible rate. A Double Taxation Avoidance Agreement may effectively provide for avoidance of tax or for relief against double taxation by providing for grant of credit by the state of residence of the tax paid in the source state. Tax Avoidance Agreements may be confined to a particular type of income for example, aviation income or may be general and cover several/all types of income.

It is of interest to note that the first Double Taxation Avoidance Agreement was executed 105 years ago (in 1899 between Prussia and the Austro Hungarian Empire). Seligman in "Double Taxation and International Fiscal Co-operation" notes that the problem of double taxation first surfaced in the 13th century regarding property taxes levied in France and Italy – where the property was situated in one country but owned by a resident of the other country. The first concrete step for relieving against double taxation, in so far as India is concerned, was taken in 1939 with the coming into force of the Income-tax (Double Taxation Relief) (Indian States) Rules. Since then India has travelled a long distance. Presently, India has entered into over 90 Double Taxation Avoidance Agreements — some of them of limited application but most of them being comprehensive agreements.

IV. Purpose For Double Tax Treaties:

"The phenomenon of international juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods."[3] Double taxation is widespread today because the vast majority of states, in addition to levying taxes on domestic assets and domestic economic transactions, levy taxes on assets situated and transactions carried out in other countries to the extent that they benefit resident taxpayers. For example, the foreign income or foreign wealth of a resident natural or juridical person is often subject to taxation based on the principle of residence, which implies the taxation of worldwide income or worldwide wealth. At the same time, since no state unilaterally waives its right to tax transactions or assets of residents and non residents within its own territory based on the principle of source, the tax claims of different states necessarily overlap. Double taxation may also arise when a person is deemed to be a resident simultaneously by two (or more) states, or when source rules overlap because two (or more) states find the same economic transaction or asset to be within their territory. Finally, double taxation may arise because certain states tax the worldwide income of their citizens even when they are residents of another state, as is the case with the United States and Mexico. In contrast, the term "economic double taxation" is used to describe the situation that arises when the same economic transaction or asset is taxed in two or more states during the same period, but to different taxpayers.[4] Economic double taxation takes place if assets are attributed to different persons by the domestic law of the states involved. This dichotomy occurs when the tax law of one state attributes the asset to its legal owner while the tax law of the other state attributes it to the person in possession or control.[5] Further, economic double taxation can result from conflicting rules regarding the inclusion or deduction of positive and negative elements of income and assets such as in cases of transfer pricing. While the concept and effects of "double taxation" remain the subject of much academic controversy, this brief outline of underlying circumstances serves to provide an understanding of the numerous situations which double tax treaties are intended to address. But the conceptual nature of double taxation carries little practical importance for treaty interpretation itself. It is "international tax law" which provides the rules for the avoidance of double taxation of which tax treaties constitute a major part. Traditionally, this term has been used to refer to all international as well as domestic tax provisions relating specifically to situations involving the territory of more than one state, or so-called "cross-border situations".[6]

[3] See organization for economic cooperation and development, report of the OECD committee on fiscal affairs, model double taxation convention on income and on capital (1977).

[4] See 0. BOHLER, supra note 3, at 33; Flick, Das Erfordernis der Subjektidentitat bei Doppelbesteuerungsnormen, 37 STEUER UND WIRTSCHAFT 329 (1960).

[5] For example, see the German Fiscal Code, Abgabenordnung [AO] § 39, 1977 BGBI I 269 (W. Ger.).

[6] 0. BOHLER, supra note 3, at 3; Vogel, Theorie und Praxis im internationalen Steuerrecht, 6 DEUTSCHES STEUERRECHT 427, 428 (1968); Massner, Der Begriff des Internationalen Steuerrechts in der neueren Literatur, 25 OSTERREICHISCHE ZEITSCHRIFT FOR 6FFENTLICHES RECHT 255 (1974).

V. Avoidance of Double Taxation, Particularly Through Treaties

1. Unilateral Measures to Avoid Double Taxation

Double taxation can be avoided unilaterally if one of the states involved withdraws its tax claim. On behalf of the state of residence, this unilateral move often is achieved pursuant to a method developed under Anglo-American law whereby the state of residence, to the extent it is not simultaneously the source state, allows a credit for the tax levied in the source state up to an amount equal to its own tax charge. In other countries double taxation is avoided unilaterally through the allowance of exemptions: Switzerland exempts income from permanent establishments and real property located abroad; the Netherlands and Australia exempt foreign source income generally if the income is taxed in the source country.[7] As a rule, however, unilateral measures are insufficient to avoid double taxation because they generally do not cover all situations giving rise to double taxation, and they may apply to double taxation situations inconsistently depending on which state's measures are applied.

2. The Development of Tax Treaties

Consequently, individual states have entered bilateral agreements for the avoidance of double taxation. At first, only federally related or closely allied states were involved, but following World War I an extensive treaty network developed in Central Europe. Germany entered its first double tax agreement with Italy in 1925. Efforts of the League of Nations contributed substantially to an assimilation of the existing bilateral treaties and to the development of uniform model treaties. In 1921 the Financial Committee of the League of Nations commissioned four experts on public finance, Bruins (Rotterdam), Einaudi (Turin), Seligman (New York), and Stamp (London), to prepare a report on questions regarding double taxation, which was submitted in final form in 1923.[8] Technical experts from seven European countries were called together in 1922 to pursue the same objective. After additional experts were added to the panel, four model treaties were drafted in 1926 and 1927, which were revised and adopted in 1928 by the representatives of 28 states (some of which were not members of the League of Nations) at a conference called by the General Secretary of the League of Nations.[9] To encourage further progress, the Council of the League of Nations appointed a standing committee on taxation in 1928, which in the following year drafted two competing model treaties to replace the 1928 models. A subcommittee, which due to the advent of the Second World War was composed primarily of representatives from Latin American countries, drafted the Model Treaty of Mexico in 1943.[10] By 1946, the subcommittee completed the London Model Treaty.

3. The OECD Model, the U.S. Model, and Other Model Treaties

The efforts of the Organization of European Economic Cooperation (hereinafter the OEEC) and its successor organization, the Organization for Economic Cooperation and Development (hereinafter the OECD), to develop a system for the avoidance of double taxation picked up where the preparatory research of the League of Nations left off. The Committee on Fiscal Affairs submitted a series of model treaty articles in four interim reports between 1956 and 1961 and a summary report in 1963 to which the complete model treaty (hereinafter the OECD Model) and an official commentary (hereinafter the Commentary) were appended. The Commentary interpreted the OECD Model; to the extent OECD member states did not wish to follow particular recommendations of the model, they entered their reservations in the Commentary. The OECD Model and the Commentary were made the subject of a recommendation of the OECD Council to the member states pursuant to Article 5(b) of its charter.The Council recommended that member states continue their efforts to enter bilateral double tax agreements, that they adopt as the basis for their negotiations the model submitted by the Fiscal Committee "as interpreted by the Commentaries in the Report," and that they make allowances for the limitations and reservations contained in the Commentary. In the following years the OECD Model and Commentary were revised by the Fiscal Committee based on practical experience. In 1977 the Committee published a new report with a partially revised model and Commentary, which were once again sanctioned by a recommendation of the Council. The changes did not affect the model as much as the Commentary, which was made more comprehensive and in which the number of reservations was increased. An opposing model, shaped more according to the special interests of developing countries, was concluded in 1971 by the member states of the Andean- Group, an alliance between Bolivia, Chile, Ecuador, Colombia, Peru and - since 1973 - Venezuela. The Andean Model was drafted as an alternative to the OECD Model; it emphasizes the traditional concerns of Latin American countries, especially the source principle. Another model treaty intended to serve the interests of developing countries was published by the United Nations in 1980. This treaty is the result of more than ten years of preparation by a group of experts appointed by the United Nations Economic and Social Council. Its structure corresponds to the OECD Model. Its content, however, diverges in some important respects.[11]

VI. Double Taxation And Indian Scenario:

The India has comprehensive Double Taxation Avoidance Agreements (DTAA) with 88(signed 88 DTAAs out of which 85 have entered into force)[12] countries. This means that there are agreed rates of tax and jurisdiction on specified types of income arising in a country to a tax resident of another

[7] For Switzerland, see H6hn, Funktion, Begriff und Rechtsquellen des internationalen Steuerrechts, in HANDBUCH DES INTERNATIONALEN STEUERRECHTS, supra note 3, at 54, 62 (exemption with progression)

[8] Report on Double Taxation, League of Nations Doc. E.F.S.73.F.19 (1923).

[9] Report Presented by the Comm. of Technical Experts on Double Taxation and Tax Evasion, League of Nations Doc. C.216.M.85 1927 11 (1927).

[10] Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion, Report of the Second Regional Tax Conference, League of Nations Doc. C.2.M.2. 1945 II A (1945).

[11] See Organization for Economic Cooperation and Development (OECD), Model Double Taxation Convention on Income and Capital 1977, reprinted in I TAX TREATIES (CCH) q 151 (1980),

[12] http://pib.nic.in/newsite/erelease.aspx?relid=93330

country. Under the Income Tax Act 1961 of India, there are two provisions, Section 90 and Section 91, which provide specific relief to taxpayers to save them from double taxation. Section 90 is for taxpayers who have paid the tax to a country with which India has signed DTAA, while Section 91 provides relief to tax payers who have paid tax to a country with which India has not signed a DTAA. Thus, India gives relief to both kind of taxpayers.

Section 90(2) of the Act makes it clear that where an agreement for granting relief of tax or for avoidance of double taxation has been entered into, then, in relation to the assessee to whom such agreement applies, the provisions of the Act to the extent that they are more beneficial as compared to the provisions of the Double Taxation Avoidance Agreement would have to be applied. It follows that where the provisions of the applicable Agreement are more favourable, compared to the provisions in the Act, the provisions of the Agreement will prevail. Section 90(2) is a statutory recognition of the rule laid down by the Andhra Pradesh High Court in *CIT v. Visakhapatnam Port Trust*[13], which view has now been accepted by the Supreme Court in *Union of India v. Azadi Bachao Andolan*[14]. Indeed the Central Board of Direct Taxes itself had earlier accepted this position in Circular No. 333[15]. The Finance Act, 1991, which inserted sub-section (2) in section 90 with retrospective effect from 1-4-1972, also inserted clause (iii) in section 2(37A) to provide that where tax is deductible at source from payments made to a non-resident, the payer could apply the rate as prescribed in the Act or the Finance Act or the rate applicable under the relevant Agreement whichever was lower.

VII. CONCLUSION

Through the analysis of the overall article, meaning and understanding of double taxation has become much clearer than before. This article has explained the emergence of various treaties and agreements to avoid double taxation by using various references and examples. More generally, the Article has explained the structure and functioning of the growing network of international tax treaties and its relation to domestic taxation and some of the international law principles. As tax treaty law becomes more widely understood, and as tax treaties demonstrate growing uniformity of text and of interpretation, the international movement of goods, capital, and persons will be facilitated by a uniform and fair system of international taxation. And regarding India, this article has made the understanding of relation between domestic tax law and the treaties more comprehensive.

DTAs represent a complex area in the field of international tax. Therefore this article did not purported to comprehensively cover the topic; it merely provided an understanding of its need, emergence as well as working with an special focus in the Indian context,

[13] 144 ITR 146
[14] 263 ITR 706
[15] Dated April 2, 1982 reproduced in 137 ITR 1

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