DOUBLE TAXATION AVOIDANCE AGREEMENT: EXAMINATION OF EXECUTIVE ACTION AND JUDICIAL PROTECTION BETWEEN INDIA AND OTHER COUNTRIES

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"Double taxation" for "Double income" but no "Double avoidance" and "Double evasion"

Introduction

In the current era where foreign retail investments and cross border transactions are taking place, our country residents are earning worldwide, tax liability comes into picture since domestic tax policies are different from other countries tax policies , economy of our country is affected. People earning worldwide were lead to pay tax twice, one in the source country and the other in the resident country which leads to double taxation and subsequently tax evasion. When a taxpayer is resident in one country but has a source of income in another country, it gives rise to possible double taxation. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a nonresident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides.[2] Therefore this DTAA scheme was being enacted by our government so that double taxation can be avoided, tax evasion can be prevented, interest of foreign retail investors can be increased, and cross border transactions can take place and

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[2] Sarbapriya Ray , "A Close Look into Double Taxation Avoidance Agreements with India: Some Relevant Issues in International Taxation" , International Affairs and Global Strategy - ISSN 2224-574X , Vol 2, 2011 , www.iiste.org, September 19, 2016 , 02:45PM

most importantly for the growth of international trade and commerce will be there.

DTAA is a bilateral or multilateral treaty as it can be applied for two or more countries entered by India to avoid this issue of double taxation between the resident and the source country. Not only it helps in avoid paying double tax but also provides us lower withholding tax i.e. Tax deduction at source , exemption from tax , underlying tax credits, tax sparing credits and Power given to NRI that whether he wants to be governed under DTAA scheme or by income tax act whichever is more beneficial to him.[3] Double Taxation may also arise in cases where a person is deemed to be resident of two or more States simultaneously or where two or more States find that the source of the income, the asset or economic transaction that takes place to be within the territory of all the concerned States.[4]

These DTAA schemes nature can either be Comprehensive or they can be limited, when they are comprehensive they cover taxes on all types of incomes, they ensure that taxpayers are equally traded in both the states and when the treaty is limited, it provide for taxes on income arising only from shipping and air transport or estate, inheritance or gift and are limited to certain issues of taxability of income only. They can be of two type's bilateral or multilateral treaties, when treaty is only between two states, its bilateral treaty but when it involves more than two states, it's multilateral. There are many mechanisms also

[3] Income Tax Act, 1961 , Section 92 (2)
[4] In contrast, the term „Economic Double Taxation" is used to describe the situation that arises when the same economic transaction or asset is paid for in two or more states during the same period but by different taxpayers. Economic Double Taxation takes place 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 assets to its legal owner while the tax law of the other state attributes it to the person in actual possession or control.

which DTAA can provide for to avoid the double taxation. These mechanisms can be deduction method where deduction of taxes is allowed in our government which is paid in foreign government, exemption method where tax payer is exempted from paying tax in our country for the income which he earned outside.

Legal Provisions covering DTAA Schemes

Any policy made or treaty entered by government is to be in consonance with the constitution therefore to determine the constitutional status of DDAA, Article 265[5] is to be studied. It provides that no taxes shall be levied or collected except by authority of law. Seventh schedule Article 246[6] talks about the three list in which Union of India is authorized to levy taxes on the subject matters of Union list and State Legislative is authorized to levy taxes on the subject matters of State list but Entry (14) of Union List empowers the Union of India to enter into treaties and agreements with foreign countries and implement such treaties, agreements and conventions and entry (11) covers Diplomats, Councils and trade representation and entry (10) is dealing with foreign affairs all matters which bring the Union into relation with any foreign country.

Therefore, the tax treaties Taxation falls in the domain of the Central Government in view of the Constitutional Authority conferred on it. As our constitution only shows that our central government is allowed to enter into treaties and agreements with other countries, Income Tax Act 1961 contains explicit provisions regarding these treaties and agreements with foreign countries which also includes DDAA.

[5] Income Tax Act, 1961
[6] ibid

This agreement of DDAA is signed by India with many countries, 84 countries are being covered which includes all the major countries the US, the United Kingdom, the UAE, Canada, Australia, Saudi Arabia, Singapore and New Zealand and is also planning to cover more countries. But what is a scenario where no DDAA agreement exists with that country. Will that person will have to pay double tax? , Will he not be able to earn in that country? , Will his tax liability will be exempted?

The answer is No to all the questions as no government can allow its people to earn, use the sources of that country and not pay revenue to that country. Therefore when no DDAA agreement exists with the country Section 91 of Income Tax Act 1961 comes into role which provides for unilateral relief in certain cases and circumstances specified – If any person who is resident in India in any previous year proves that in respect of his income accruing or arising in the previous year outside India on which he has paid tax in a country with which there is no Double Taxation Avoidance Agreements, he shall be entitled to the deduction from the Indian Income-tax, a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country whichever is lower[7] ,In India and in another country with which there is no tax treaty, the income should have been taxable,[8]The tax has been paid by the person or company under the statutory laws of the foreign country is in question.[9] Now the scenario comes where DTAA agreement exits between countries, how this bilateral relief is given? , What are the methods of giving this relief? , Does it actually helps in stopping tax evasion?

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[7] Anonymous , "DTAA" , http://www.gktoday.in/dtaa/ , September 19, 2016 , 2:36PM
[8] Anonymous, "Double Taxation Avoidance Agreement in India" , http://carajput.com/DTAA.aspx#.V993n5h97IU , September 19, 2016 , 03:16PM
[9] ibid

Under Section 90 of Income Tax Act, 1961 central government provides the protection against double taxation by entering into DTAA scheme with other countries on the mutual acceptable terms and conditions. There are two methods by which this bilateral relief can be granted – Exemption method where (the resident country exempts income earned in the foreign country) and Tax Credit Method (it grants credits for the tax paid in the other country by doing deductions from the tax payable in India). Complete avoidance of tax overlapping can be done in exemption method only. Despite of these two methods specific comprehensive agreements are to be made for each and every country due to lack of unified international taxation scheme. Not only there is a lack of unified international taxation scheme but also there is no proper definition of income.

Section 90 A was enacted with the same objectives in mind and hence has exactly the same provisions as Section 90. The only difference is that all the provisions in this section are applicable to „Specified Associations". The term „Specified Associations" includes any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory. The only difference observed between the two provisions was that Section 90 A does not talk about „Specified Associations" belonging to a country. The Act restraints itself to define it as belonging only to India or a specified territory.

After studying an overview about the Double Taxation Avoidance provisions, a look on the taxation of business process outsourcing units in India is required. As no specific provisions are mentioned Income Tax Act 1961, further research is required and therefore help of Circular No. 5/2004 dated 28/09/2004 issued by

CBDT[10] can be taken. There are specific provisions which states that a non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961. However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity. The tax treatment of the Permanent Establishment in such a case is under consideration in this circular and is explained in a detailed manner.

Section 90, 90A and 91 work keeping in mind the principle of "Generalia Specialibus Non Derogant", which means that the provisions of a general statute must yield to those of a special one. The provisions in the Income Tax Act of 1961 are general in nature and they will apply to all Indian residents and NRIs who have their source of income in India but in case these residents have entered into transactions with countries that already have an agreement in place with India to avoid double taxation, then the calculation of income for the purposes of tax of these residents would be according to the terms of the said agreement and not under the Income Tax Act of 1961 in India or the corresponding domestic tax

[10] Income Tax Act , "Taxation of IT-enabled Business Process Outsourcing Units in India" , http://incometaxindia.gov.in/Communications/Circular/91011000000000874.htm , September 25,2016 , 10:21AM

law of the other country[11] unless where provisions to the contrary have been made in the agreement.[12]

Recent Developments

When a view in the recent changes is brought, we cannot ignore the fact that India recently has entered an treaty with Mauritius to remove certain loopholes which entails that an Mauritius entity will have to pay taxes on capital gains when they will be selling shares to the company situated in India, earlier this company was able to avoid tax in both the places, in India stating that company is not the resident of India and in Mauritius taking the advantage of provisions where no taxation is there for its residents on capital gains. Therefore these companies were making huge profits, without paying taxes anywhere and therefore had become the favored route of foreign investors. And in this behalf only the LoB with Singapore is planning to be incorporated in Mauritius , as LoB clause of India and Singapore Treaty restricts eligibility for capital gains tax exemption either to companies listed on the stock exchange or to those who expend a minimum of $200,000 on operations in Singapore for at least two years prior to the date of such gain and in Mauritius this tax was exempted, however in the case of Supreme Court in Union of India v. Azadi Bachao Andolan (2003) it's being recommend that LoB should not be incorporated in the treaty with Mauritius but if the Government really wants to go ahead, then it should wait until GAAR

[11] Austria Micro Systems International AG v. ITO [2004] 85 TTJ (Mum.) 767, DCM Ltd. v. ITO [1989] Taxation 92(4)-16 (Delhi - Trib.), CIT v. Davy Ashmore Ltd. [1991] 190 ITR 626 (Chd.), Banque National De Paris v. IAC [1991] 94 CTR (Bom. - Trib.), Agencia Geral (P.) Ltd. v. First ITO [1993] 45 ITD 243 (Pune - Trib.), CIT v. VR.S.R.M. Firm [1994] 208 ITR 400 (Mad.), CIT v. Hindustan Paper Corpn. Ltd. [1994] 77 Taxman 450 (Cal.), CIT v. Hindusthan Paper Corpn. Ltd. [1994] 77 Taxman 450 (Cal.)

[12] Jayati Ghosh , "Double taxation – DTAAs – Treaty Abuse – A Case study of the treaty between Mauritius and India", http://www.ijesls.com/DOUBLE%20TAXATION-%20Jayati%20Ghosh.pdf , September 25, 2016 , 10:54AM

comes into play and see how investors respond to it before introducing the LoB clause in the DTAA with Mauritius.

When DTAA schemes are entered by our country, many issues are there, these schemes entered are either governed by our country or they are governed by other countries law. The question comes before us is that whether the international treaties can invalidate our national laws? Can someone claim the illegality of our national law on behalf of some international treaty? These questions were answered by our courts in the case of Jolly George Varghese vs. The Bank of Cochin[13] where the Supreme Court said that the executive power of the Government of India to enter into international Treaties does not mean that international law, ipso facto, is enforceable upon ratification. In this case a writ petition before Madaras High court was filed challenging the CBDT Press treaty notifying the Cyprus as non-cooperative jurisdiction. Section 94A of Income Tax Act 1961 was also being challenged which gives tax deduction at highest rate of 30% on payments made to any Cyprus resident. Revenue had held the assesse in default u/s 201(1)/ (1A) for not deducting TDS as per the mandate of Sec 94A in respect of contract entered into with a Cyprus company.[14]

Conclusion

"Elimination of double taxation is admittedly the objective of the foreign tax credit. But this objective cannot always be fully achieved."

DTAA has played a very important role in preventing people from paying tax twice and therefore has encouraged cross border transactions, free trade and good

[13] AIR 1980 SC 470
[14]CA Sachin Kumar B.P and CA Omar Abdullah S.M ,"Pacta Sunt Servanda – agreements must be performed in good faith" , http://www.mca.co.in/images/ICAI_-_June_2016_Article_2-REVIEW.pdf , October 09, 2016 , 08:12PM

investment opportunities. These agreements importance will never decrease and will keep on increasing as cross border business activities will take place and development will be there. These agreements seem to be fake as how countries are having agreements with no disputes and fights but its applicability on real life is already be seen when there is a ease in flow of information between the countries where treaty exists. These agreements have already helped in avoiding tax evasion, preventing double taxation and has also caught the base of black money. However it has not been beneficial in all the countries as flaws in treaties still exist, no rule is there with no flaws but with time and experience our country has able to detect these flaws and has rectified.

These flaws main reason can be the complexity of our Legislation on Tax i.e. Income Tax Act, 1961. No definition or no provision is in simple terms and is not understandable in a plain reading and as we already know that more complicated the legislation is, more flaws are being identified. Even the major terms definition that what is income, what is the source and how to source is not defined. There are many Judicial Pronouncements on this Taxation issue which have able to resolve major complicated issues, these DTAA agreements have acted as a boon but as we know that whenever there is a boon , a ban is also there and the loopholes on our law act as a ban to these boons. There is a requirement that these loopholes are being removed , Tax Law regimes are to be stricter, an International Tax Provision should be enacted and an International Body should be governing it so that the complication of these things can be minimized , it can be made applicable uniformly therefore people will stop taking disadvantage of it.