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A COMPREHENSIVE ANALYSIS OF THE POTENTIAL BENEFITS AND DRAWBACKS OF DOUBLE TAXATION AVOIDANCE TREATIES IN THE INDIAN LEGAL SYSTEM

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ABSTRACT

International investors always find themselves in an adverse situation of having to face being double taxed – taxed by two different nations on the same income – unless there are Double Tax Avoidance Agreements in place among the two nations.

Double Tax Avoidance Agreements (DTAA) treaties efficiently eradicate double taxation in particular cases by identifying exemptions or reducing the amount of taxes payable. It is, therefore important for foreign investors or expatriates working in India to be aware of any DTAAs that may exist between India and the native countries that apply to them and to understand how these agreements are applied in practice between their native or resident countries and India.

The study critically analyzed the benefits and drawbacks of double taxation avoidance treaties in the Indian legal system. Double Taxation Avoidance Agreements are obviously a communication of two tax frameworks each having a place with an alternate country, which expect to relieve the impact of double taxation.The issue of double taxation continues to pose a significant obstacle to the advancement of international economic relations. Each country looks to tax the income produced inside its region based on at least one interfacing factors. Through Double Taxation Avoidance Agreements, every country obliges the cases of other countries inside their monetary field to foster international exchange and speculations with insignificant obstructions. Notwithstanding, the international tax regime must be rebuilt continually in order to answer the current difficulties and disadvantages. It is likewise vital

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for India to exploit the current worldwide move to more noteworthy straightforwardness and receptiveness by fortifying data sharing and managerial help arrangements in its DTAAs. The eventual acceptance of DTAA’s has only made tax collection more equitable and fair and as the relationships within the countries grow, it will only lead to better taxation arrangements.The study will also discuss jurisdictional issue regarding double taxation avoidance. The study also will make a detail analysis on how double taxation avoidance agreement works in India.

INTRODUCTION

The Double Taxation Avoidance treaty is the tax treaty signed among India and other nation so that taxpayers can avoid paying double taxes on their income earned from the source country as well as the residence nation.

Presently, India has double tax avoidance treaties with more than 80 countries around the world. The need for DTAA arises out of the imbalance in tax collection on global income of individuals. If a person aims to do business in a foreign country, he/she may end up paying income taxes in both cases, i.e. the country where the income is earned and the country where the individual holds his/her citizenship or residence.

A specific branch in the law of taxation has been developed in India after a number of DTAAsentered into by India with several foreign countries. The reason for these Agreements coming into play was in cases where a person having source of income in India was the resident of another country. For the purpose of DTAA, the income is considered as sourced in a country if the tax-payer is based there. Both the countries would like to tax the income of a person arising from the same transaction, because the desire of a country for taxation can never be satisfied. That‘s where the 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 conditions. For example, business income is generally taxable in the source state if the enterprise has a permanent establishment therein. (By source state 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).[2]

[2] Rajaratnam S., Venkataramaiah B.V., Commentary on Double Taxation Avoidance Agreements, (Snow White Publication, 2017)

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India has signed the Double Taxation Avoidance Agreements or DTAA with 88 countries. Foreign companies that are resident in the countries that India has a DTAA with, can claim more beneficial provisions and rates between the IT Act and the DTAA. Recently, the Government of the Republic of India and the Government of the People's Republic of China had signed the Double Taxation Avoidance Agreement (DTAA) on 26/11/2018. This agreement was signed for providing relief on double taxation along with preventing fiscal evasion concerning taxes on income.

Under the DTAA, if an individual or business earns income in one country and is a resident of the other country, the income is taxed only in one of the countries. The taxpayer can choose to pay taxes in either in the country of residence or the country where the income was earned, whichever is more beneficial for them.

DTAA also provides for the exchange of information and assistance in tax collection between the two countries, which helps to prevent tax evasion and tax fraud.

Overall, DTAA plays an important role in promoting trade and investment between India and other countries by removing barriers to cross-border taxation and promoting fairness and transparency in tax treatment.[3]

Objectives and Scope of Double Taxation Avoidance Treaties

The Double Taxation Avoidance Agreement (DTAA) plays a vital role in the international business and taxation landscape, with its primary objectives being:

Avoidance of Double Taxation: This is the cornerstone of any DTAA. It ensures that Income earned in one country by a resident of another is taxed in just one of the two countries, thereby preventing the same Income from being taxed twice. This is particularly important for multinational corporations and individuals who operate across borders.

Prevention of Tax Evasion: DTAA agreements often include provisions that help prevent tax evasion, ensuring taxpayers cannot exploit loopholes in international tax rules to avoid paying taxes.

[3] Anjana Dhand, Double Taxation Avoidance Agreement DTAA in India, https://scripbox.com/tax/double-taxation-avoidance-agreement-dtaa-in-india/

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Information Exchange: These agreements often facilitate the exchange of information between the countries' tax authorities. This exchange is crucial for enforcing tax laws and preventing illegal activities like tax evasion and money laundering.

Specific vs. Comprehensive Agreements: DTAAs can be comprehensive, covering all types of Income and capital or limited to specific sectors or types of Income. Comprehensive agreements provide a broad framework covering various income sources, while sector-specific agreements focus on particular areas like Income from aviation, shipping, etc.[4]

Types of Double Taxation Avoidance Agreements (DTAAs)

Double Taxation Avoidance Agreements (DTAAs) come in different forms, each tailored to the specific needs and relationships between the countries involved. The main types of DTAAs include:

Bilateral Treaties

These agreements between two countries are the most common form of DTAA. For instance, the DTAA between India and the United States is a bilateral treaty involving only these two nations. These treaties are tailored to the two countries' specific economic and taxation contexts.

Multilateral Treaties

These agreements involve multiple countries and are less common than bilateral treaties. Multilateral treaties are usually part of broader regional or international cooperation, such as the APAC (Asia-Pacific) or SAARC (South Asian Association for Regional Cooperation) conventions. These treaties standardize tax rules across several countries, simplifying international trade and investment for countries within the group.

Limited Agreements

Limited DTAAs are narrower in scope, applying only to specific types of Income. For example, a limited DTAA might only cover Income earned from operating ships or aircraft in international traffic. These agreements are typically between countries with significant

[4] Chakraborty, Annapurna, Double Taxation Avoidance Agreements in India, SSRN, (March 5, 2014)

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commercial exchanges in specific sectors but do not require a comprehensive DTAA covering all forms of Income.

Each type of DTAA serves a unique purpose in international tax law, helping to reduce or eliminate the issue of double taxation and promoting cross-border economic activities.[5]

DTAA Rates

DTAA rates vary between countries and depend on the agreements they have with each other. Here are some key points to understand:

Different Rates for Different Countries: The tax rate under DTAA is not the same for all countries. It depends on the agreement between each pair of countries.

No Set Expiry Date: These agreements don't have a specific end date. They continue until any of the countries involved decides to end it.

Changes are Possible: The rules and tax rates under DTAA can change if both countries agree to make amendments.

TDS Rates for Interest: The tax deducted at source (TDS) for interest income usually ranges between 10% and 15%, but this can vary based on the specific agreement.

Tax on Dividend Income: For foreign firms or non-residents receiving dividend income from India, the tax rate is decided based on the relevant DTAA.India has entered Double Taxation Avoidance Agreements (DTAAs) with approximately 85 countries.[6]

Benefits of DTAAs

Sections 90 and 91 under the Income Tax Act 1961 offers specific relief to taxpayers to avoid double taxation. Section 90 deals with those provisions involving taxpayers who have paid tax to another country with which India has a DTAA. Section 91 is for those countries with which India does not have a DTAA. In effect, India provides relief to both types of taxpayers.

Every country seeks to tax the income generated within its territory on the basis of one or more connecting factors such as location of the source, residence of taxable entity,

[5]Divya Singhvi, DTAA - Double Taxation Avoidance Agreement : Definition, Types, and Benefits, QUICKO, 2021

[6] https://www.indiafilings.com/learn/double-taxation-avoidance-agreements-dtaa-types-benefits-and-claim-procedures/

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maintenance of Permanent Establishment and so on. The interaction of two tax systems each belonging to different country, can result in double taxation. Following are the main benefits of DTAAs.[7]

- Avoidance of double taxation: DTAA ensures that individuals or businesses do not pay taxes on the same income in both countries. Multinational companies operating in multiple countries greatly benefit from this practice as it allows them to avoid a substantial tax burde-n.
- Promotion of cross-border investment: DTAA can encourage increased foreign investment in India by reducing the tax burden on foreign investors. This can generate employment opportunities, stimulate- economic growth, and improve the country's infrastructure-.
- Facilitation of trade: DTAA can facilitate international trade by reducing the tax burden on businesses engaged in cross-border transactions. This can facilitate Indian businesses' competitivene-ss in global markets and enhance foreign enterprises' interest in investing in India.
- Avoidance of double taxation on capital gains: DTAA also covers the taxation of capital gains, which is a significant advantage for investors. It prevents the double taxation of capital gains earned in both countries.
- Enhanced transparency: DTAA requires countries to exchange information and cooperate in enforcing tax laws. This enhanced level of transparency has the potential to effectively combat tax evasion while fostering a more equitable and streamlined taxation system.
- DTAAs avoid double taxation by considering the specific tax laws of the two countries (the two countries in the case of a bilateral DTAA).
- DTAAs as international tax treaties often provide tax information exchange. This tax exchange information lowers the administrative costs of taxation.
- Another advantage is that there is legal certainty in DTAAs as there is specific rules for taxing international income. This encourages foreign investment to developing countries as there is tax certainty.
- DTAAs also incorporates anti-abusive provisions to ensure that the benefits of the DTAAs are availed by the genuine residents of the two countries.[8]

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[7] Divya Singhvi, DTAA - Double Taxation Avoidance Agreement : Definition, Types, and Benefits, QUICKO, 2021

[8] Chakraborty, Annapurna, Double Taxation Avoidance Agreements in India, SSRN, (March 5, 2014)

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- With DTAA, investors need not depend on conflicting national tax rules; rather the taxation of international income falls under the rules of DTAAs.

Drawbacks

1. The parties recognize that double taxation agreements are designed to eliminate the possibility of income being taxed twice in two different jurisdictions. However, it is imperative to understand that such agreements may also have inherent disadvantages.

2. Double taxation agreements can lead to complexity in tax planning and compliance for multinational corporations and individuals with income derived from multiple jurisdictions. This complexity may result in increased costs associated with tax compliance and administration.[9]

3. Furthermore, double taxation agreements may create disparities in the treatment of income and assets between different jurisdictions, leading to potential disputes and conflicts between tax authorities. These disputes can result in prolonged legal proceedings and uncertainty for taxpayers.

4. Important note Disadvantages of Double Taxation Agreements may vary based specific terms provisions agreement, well individual circumstances taxpayers involved. Therefore, parties are advised to seek professional legal and tax advice before entering into such agreements.

5. In light of the aforementioned disadvantages, it is crucial for the Parties to carefully consider the implications of double taxation agreements and assess the potential risks and challenges associated with their implementation.

6. This Contract governed laws relevant jurisdictions disputes arising connection Contract subject exclusive jurisdiction courts relevant jurisdictions.

Income Tax Rules governing implementation of DTAAs in India

Rule 128 of Income Tax Rules 1962: This Rule specifies how a resident of another country may claim credit for tax paid on income earned in that country in accordance with a DTAA in India. Some of the important considerations are as follows:

[9] Santhanam, Handbook on Double Taxation Avoidance Agreements & Tax Planning for Collaborations, (5th Edn. 2011)

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The credit of foreign tax shall be available only to the extent of the income tax, surcharge and cess payable under Income Tax Act ,1961. No credit shall be availed for payment of any interest, fee or penalty under the Act.

No credit of foreign tax shall be available if the foreign tax paid is disputed by the said resident unless sufficient evidence is submitted by the resident within six months of the end of the dispute. The said evidence to be submitted should be to the effect that the tax liability is paid by him including an undertaking that no refund is claimed by him in this respect.

The amount of foreign tax credit shall be restricted to the amount of tax payable under Income Tax Act, 1961 and the foreign tax paid on the same income, whichever is lower. If foreign tax paid is in excess of Indian income tax, the difference is to be ignored and is not eligible to be claimed. The rate of conversion to be taken is the telegraphic transfer buying rate on the last day of the month immediately before the month in which such foreign tax was paid or withheld.

In case foreign tax credit is to be availed against tax payable under Section 115JB of the Income Tax Act, 1961 or Section 115JC of the same Act, the foreign tax credit is allowable only to the extent of the tax payable under normal provisions of the Act. Tax as per normal provisions of the Act is the tax payable as per the provisions of the Act other than Section 115JB of the Income Tax Act, 1961 or Section 115JC of the same Act.

Following documents are required for availing the benefit of a DTAA

- Form 67 is required to be filed electronically by the resident providing details like the country of foreign income, amount of income earned outside India, foreign tax paid on the said income, tax payable as per the Act, the foreign exchange conversion rate, the amount of foreign tax credit availed, refunds of foreign tax claimed, etc. The form is to be filed on or before the last day of filing IT returns for the year in which the income is offered to tax in India.
- Certificate or statement, specifying the nature of income and the tax paid or withheld, is to be obtained from the foreign tax authority or the person responsible for withholding of the tax. If such a certificate or statement is not available, then a statement is to be provided by the resident along with the evidence of tax paid or withheld. These documents are required to be uploaded along with Form 67.

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- Form 67 is also used in a case of carry backward losses which may result in the refund of taxes paid by availing foreign tax credit in the earlier year.
- Rule 21AB of the Income Tax Act, 1961: A non-resident is not eligible to claim relief under a DTAA unless he provides the requisite documents and information as referred in Rule 21AB.

The non resident is required to provide the following-

1. Status of the non resident (whether he is an individual, firm, company or any other entity)
2. Nationality of the non resident
3. Tax Identification Number (TIN) of the non resident
4. Period of residential status in the foreign country
5. Address of the non resident in the foreign country
6. Tax Residence Certificate (TRC) issued by the foreign country
7. The non-resident is required to keep adequate documents that substantiate the information provided above.

Further, for availing the benefits of DTAA outside India, Indian residents may also apply for a Tax Residency Certificate (TRC) in the relevant Form 10FA to the concerned officer. The officer, upon receiving the application in Form 10FA, may upon being satisfied, issue the TRC in Form 10FB. [10]

CONCLUSION

In conclusion, NRIs selling property in India can benefit from DTAA agreements by avoiding double taxation and paying taxes only in one country, depending on the tax rates. They can seek the help of a tax professional to ensure that they file their taxes correctly and take advantage of the benefits of the DTAA.

DTAA plays a crucial role in simplifying tax matters for individuals and businesses operating internationally. It helps prevent the issue of being taxed twice, encourages cross-border investments, promote-s trade, and increases transpare-ncy. These agree-ments contribute to creating a faire-r and more efficient global tax syste-m.

[10] Santhanam R., Handbook on Double Taxation Avoidance Agreements & Tax Planning for Collaborations, (Commercial Law Publishers, 2017)

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To benefit from these agreements, individuals need to understand the specific provisions within DTAA agreements between countries and seek guidance from tax experience. Additionally, staying updated on the latest DTAA rates with different countries is necessary for accurate tax planning and compliance.

By requesting this benefit, one can avoid paying two taxes. People should be aware, though, that a nation may deduct tax at source and document tax paid using a foreign tax credit document. The rules for avoiding double taxation thus differ from one country to another. To determine the TDS rate, it is crucial to comprehend what the DTAA acronym stands for and to read the terms between the relevant nations. We genuinely hope that this blog helps you in getting a better understanding of the concept of Double Taxation Avoidance Agreement.

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 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. However, the international tax regime has to be restructured continuously so as to respond to the current challenges and drawbacks.

The biggest concern now is the double taxation levied by both countries. Countries signed the Double Taxation Avoidance Agreement to address this issue. A large number of nations have already signed this pact. Various countries have implemented DTAA tax rates. There are also numerous varieties of DTAA, such as multilateral and bilateral accords. Furthermore, there are other benefits to signing a DTAA, including lower tax rates, tax credits, tax exemption, and many others.

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