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Domestic Tax Laws in Interaction with DTAAs

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-By CA Nikky Jhamtani

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International Tax Law

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Sources of International Tax Law

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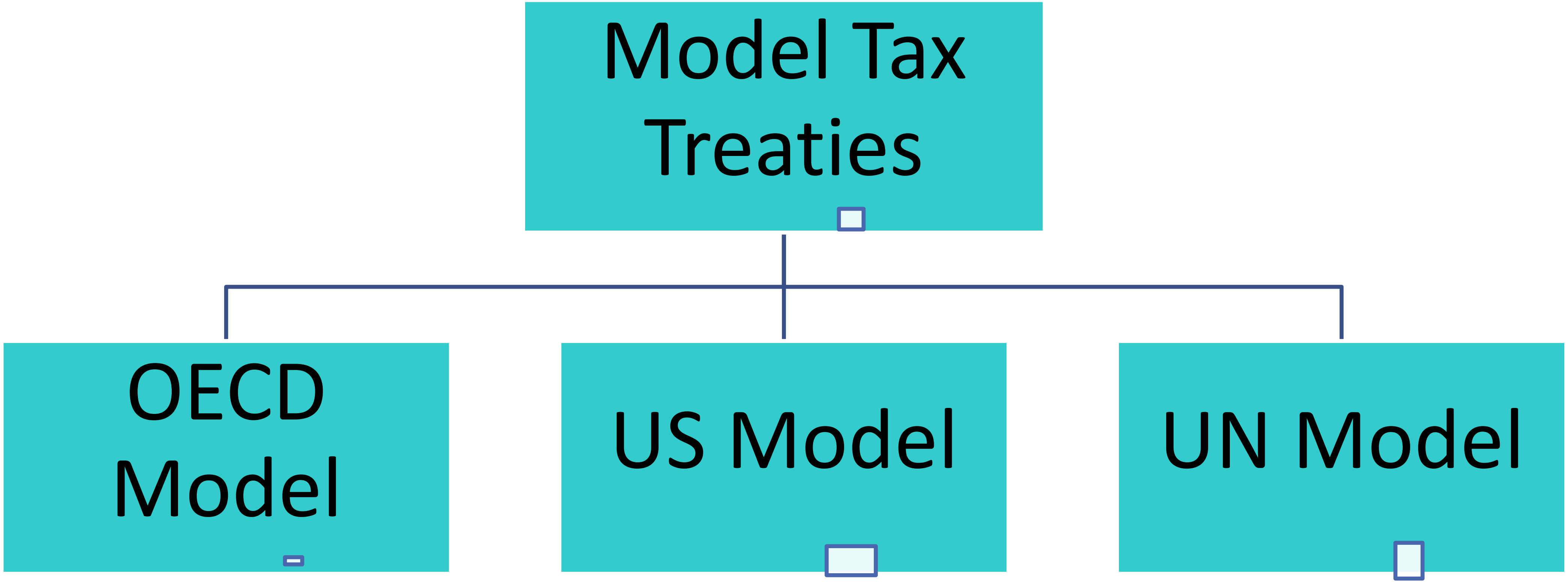
Why Tax Treaties?

For Governments	For Taxpayers
• Rationally and **equitably allocate taxing rights** in multiple jurisdictions • For exchange of information and **prevent tax evasion** • To **prevent double non-taxation**	• To provide relief from double taxation • **Avoid juridical double taxation** by two countries on the same income • Provide **level playing field** to both international and domestic players

Model Tax Treaties



OECD Guidance on Tax Treaties

- The countries are free to use either the OECD Model or the UN Model as a reference for negotiating treaties with other countries.
- OECD Model – A reference point for UN Model. UN Model is generally adopted by developing countries.
- Tax policy considerations:-
  1. Interaction between domestic tax systems of both States;
  2. Significant difference in source rules of two countries should be addressed;
  3. Withholding obligations

Principles of Interpretation of Tax Treaties

- A Tax treaty is an agreement between countries.
- Drafted by diplomats, and not lawyers.
- Need to be given a general meaning (SC in Ram Jethmalani & Ors)
- Treaty cannot levy a tax burden, it can only relieve tax.
- The provisions of Treaty should be interpreted in accordance with the ordinary principle of treaty interpretation as per Article 31(1) of the Vienna Convention on the law of treaties
    - Interpretation in good faith; and
    - Ordinary meaning is to be given to the terms of the treaty in their context and in light of its object and purpose.

Types of Taxing Rights

Residence Based Taxation

- Country gets taxing right by virtue of residency of individuals.
- India taxes global income of Indian residents

Source Based Taxation

- Country gets taxing rights by virtue of the individual earning income in that country
- Non-residents get taxed in India to the extent their income arises or accrues in India.

Types of Double Taxation

- **Juridical**: a taxpayer is taxed by two states on the same income.

- E.g.: Income arising in source state is taxed in that state but taxed in the residence state by virtue of residential status.

- **Economic**: the same income is taxed in the hands of different people.

- E.g.: In case of an Indian company having foreign investors, whenever dividend income was distributed, DDT was levied on that income. That same income was taxed in the state where the foreign investor was a resident of.

Priority of DTAA over Domestic Provisions or vice-versa?

Generally, the first step is to ascertain the tax base in the domestic law and then determine whether the scope has been limited in the DTAA.

Eg: For examining FTS paid by an Indian entity to a UK entity, the definition of FTS will be seen as per Income-Tax Act first to ascertain whether there is an incidence of tax in India. Then the next step is to look at the DTAA.

However, for certain jurisdictions, DTAAs assume more importance because of the laws of contracting state.

Eg: For examining capital gains arising in the hands of an Indian resident in Mauritius, the taxing right between source country (Mauritius) and resident country (India) has to be checked because the domestic laws of Mauritius exempts capital gains and India taxes such income.

Constitutional Background

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Constitutional background

Article 51

- Promote international peace and security
- Maintain just and honourable relations between nations
- Foster respect for international law and treaty obligations

Article 246 r/w Entry 14 of List I

- Parliament is empowered to enact laws with respect to entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries.

Domestic Provisions

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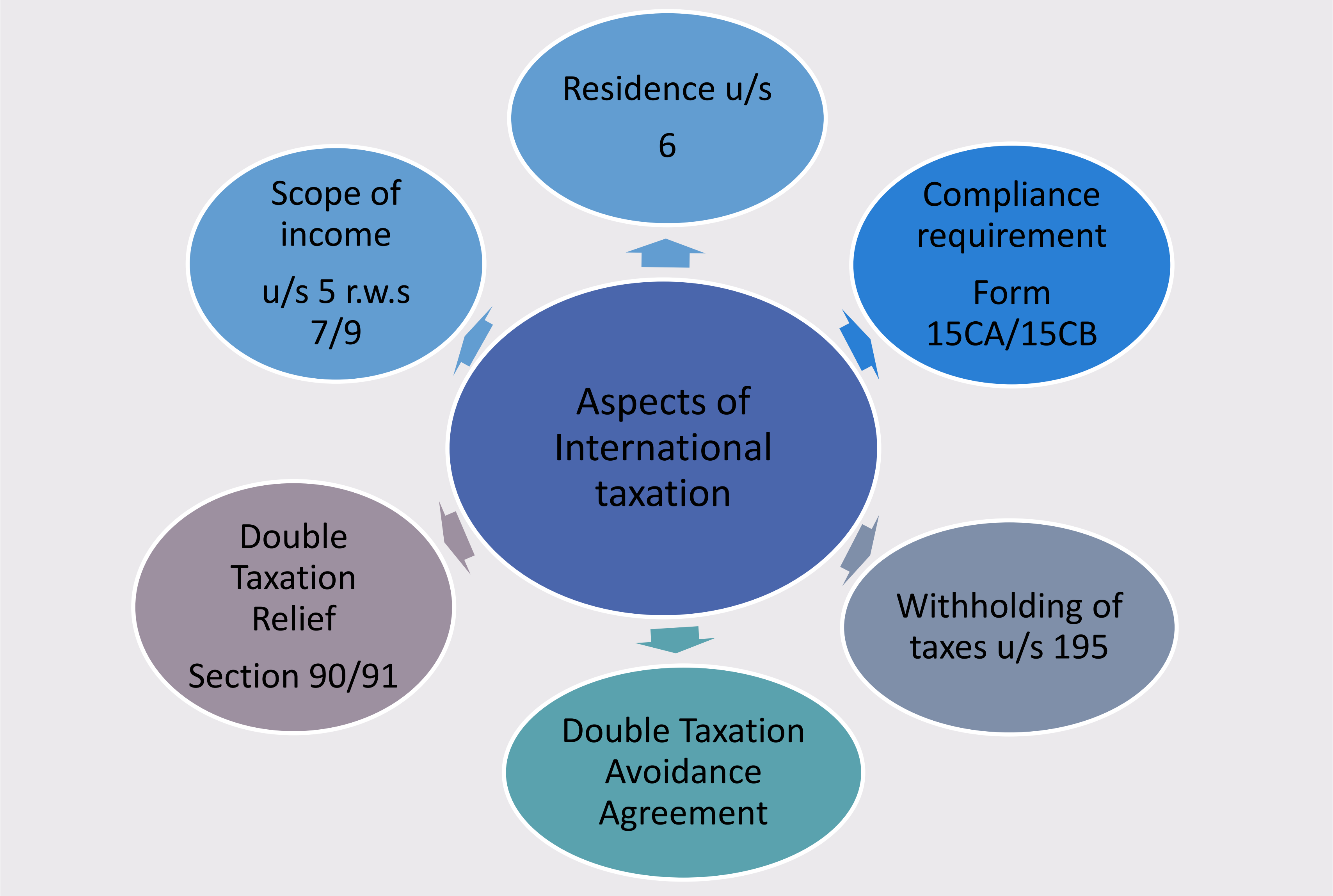
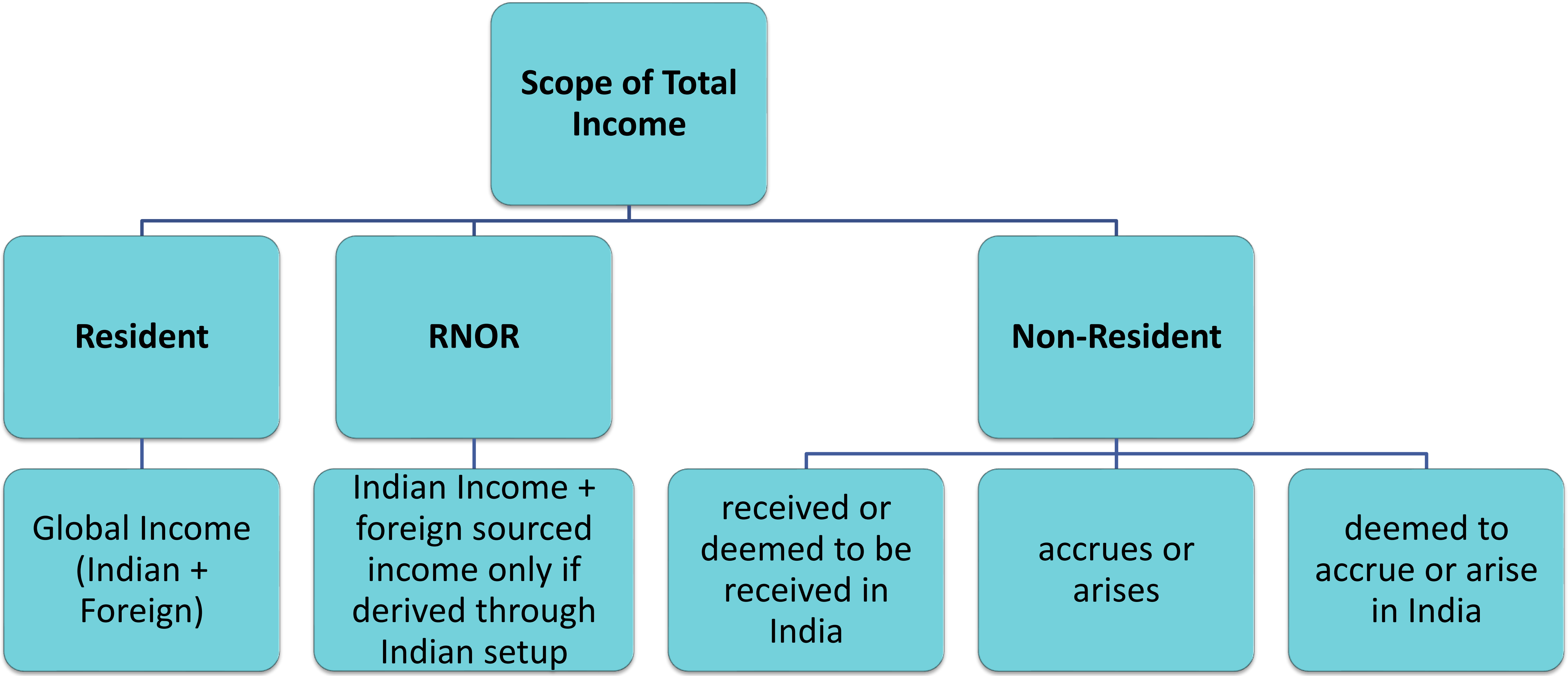
Aspects of International Taxation



Section 5: Scope of Total Income



Section 9: Income deemed to accrue or arise in India

Section 9(1)(i) **Business Connection**	**Section 9(1)(i)** **Capital Gains**	**Section 9(1)(i)** **Income through or from any property in India**	**Section 9(1)(ii)** **Salary**
Section 9(1)(iv) **Dividends**	**Section 9(1)(v)** **Interest**	**Section 9(1)(vi)** **Royalty**	**Section 9(1)(vii)** **Fees for technical services**

Interplay of Domestic provisions with DTAA

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Taxability under Section 9 and DTAA

Nature of Income	IT Act	DTAA
Business/Profession	S. 9(1)(i)	Article 7, 14 r.w. Article 5
Immovable Property	S. 9(1)(i)	Article 6
Capital gains	S. 9(1)(i)	Article 13
Salary	S. 9(1)(ii)	Article 15
Dividend	S. 9(1)(iv)	Article 10
Interest	S. 9(1)(v)	Article 11
Royalties	S. 9(1)(vi)	Article 12
Fees for Technical Services	S. 9(1)(vii)	Article 12

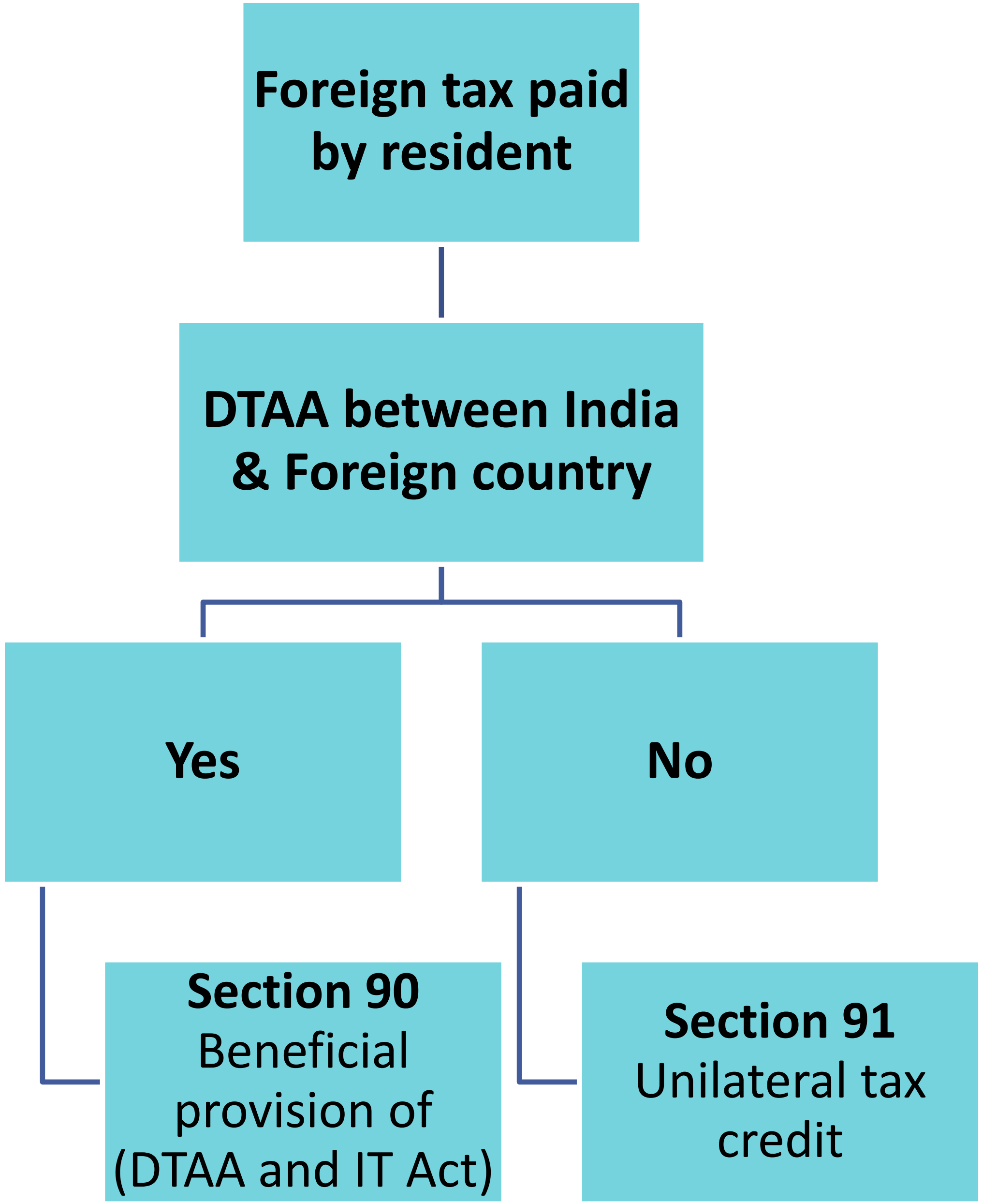
Double Taxation relief provisions in Income-Tax Act

Section 90

- Regulates a case where India has a tax treaty
- Provisions of the tax treaty or domestic laws, whichever is more beneficial shall apply
- GAAR provisions will override Treaty provisions
- To avail benefits under DTAA, a certificate of residence is necessary.

Section 91

- Relief from double taxation if India has no tax treaties
- Person resident in India is allowed credit of foreign taxes paid against amount of Indian taxes.



Foreign Tax Credit (Rule 128)

- Indian resident can claim the amount of tax that he has paid as tax outside India against the income corresponding to such tax has been offered to tax or assessed to tax in India
- The credit will be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- Particulars to be furnished:
  - Statement of income and tax paid outside India in Form No. 67
  - certificate or statement specifying the nature of income and the amount of tax paid accompanied by bank receipts

Illustrations

Illustration 1

India

Mr A pays rent to Mr X (US resident) for an Immovable property situated in India

USA

1. Indian citizen residing in USA (NRI)
2. Earns rental Income from India

1. What will be the taxability of such income in the hands of Mr. X under the Indian Income-tax Act, 1961 **(IT Act)?**
2. Whether these receipts also be taxable in USA?
3. How will we determine which state will get the right to tax?

Taxation of Income from Immovable property per IT Act

9. (1) The following incomes shall be deemed to accrue or arise in India :—

(*i*) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, **or through or from any property in India**, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Taxation of Income from Immovable property as per India-US DTAA

Article 6

- Article 6(1) : Income derived by a resident of a Contracting State from **immovable property** (real property), including income from agriculture or forestry, situated **in the other Contracting State may be taxed in that other State**.
- Article 6(2): Defines immovable property
- Article 6(3): Scope of income arising from immovable property

Illustration 1

1. **What will be the taxability of such income in the hands of Mr. X under the IT Act?**

- The income of Mr. X falls within the ambit of Section 9 of the IT Act

2. **Whether these receipts also be taxable in USA?**

- The receipts received by Mr. X will be taxable in USA by virtue of his residence in US.

3. **How will we determine which state will get the right to tax?**

- The relevant article of DTAA will determine which state has the taxing right. Article 6 gives the taxing right to the source state but the term used is ‘may be’.

Illustration 2

Interest on Loan

Loan Taken

Indian NBFC

Singapore Loan Provider

1. What will be the taxability of such income in the hands of Singapore Loan Provider under the Indian Income-tax Act, 1961 **(IT Act)?**
2. Whether these receipts also be taxable in Singapore?
3. How will we determine which state will get the right to tax?

Interest Income as per IT Act

Interest income shall be deemed to accrue or arise in India if the payer:

- **Government**
- **Resident**
  Interest paid is in respect of a debt which is utilized for the purpose of business or profession carried on by such person in India
- **Non-Resident**
  Interest paid is in respect of a debt which is utilized for the purpose of business or profession carried on by person in India

Interest Income as per India-Singapore DTAA

Article 11

- Article 11(1): Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State

- Article 11(2): The Article provides for taxing rights to the country of source but if the beneficial owner of interest is a resident of the other country, then tax rate shall not exceed certain specified percentage (10/15%)

Illustration 2

(1) What will be the taxability of such income in the hands of the Singapore Loan Provider under the IT Act

- The income will be taxable u/s 9 of IT Act in the hands of Singapore loan provider.

(2) Whether these receipts also be taxable in Singapore as per the Singapore tax laws?

- The receipts received by a Singapore' resident will be taxable in Singapore by virtue of it's residence there.

(3) How will we determine which state will get the right to tax?

- The relevant article of DTAA will determine which state has the taxing right. Para 1 of Article 11 gives the taxing right to the resident state while Para 2 gives the right to the source state. Since there is taxing right to India as per both IT Act and DTAA, the interest income would be taxable in India but at a specified rate.

Withholding tax provisions under Indian Law

Section 195

Other sums

*“**195.**(1) **Any person responsible for paying to a non-resident**, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other **sum chargeable under the provisions of this Act** (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the **rates in force**”…..*

TDS Provision under the Act for payment to Non-Residents

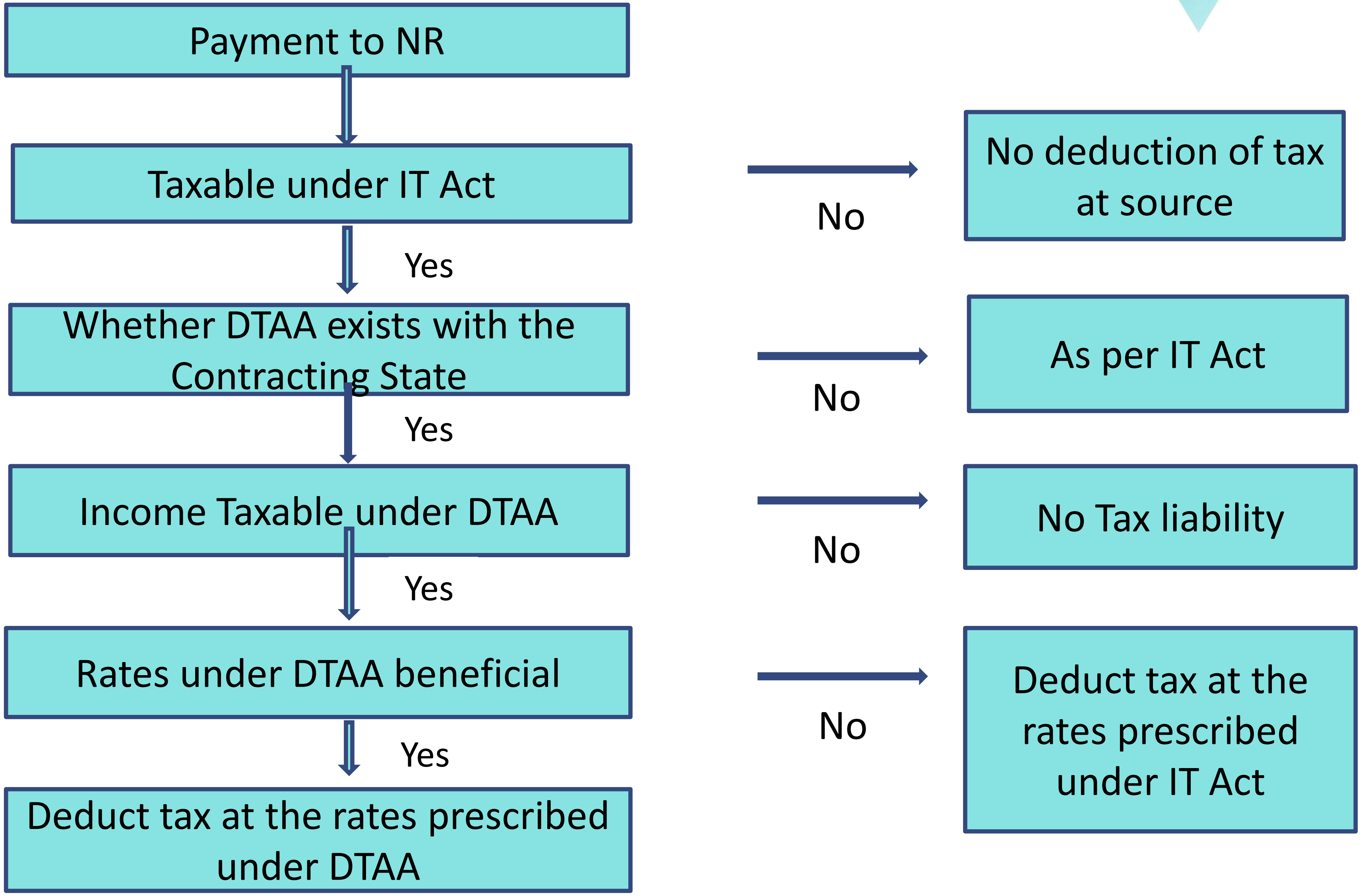


Illustration on withholding obligation

INDIA

Mr.
Roy

UK

Ms.
Karen

An Indian resident is
making payment to a UK
resident for availing
marketing services

1. What will be the taxability of such income under ITA and India-UK DTAA?
2. What are the withholding obligations thereon?

Taxability under IT Act

"fees for technical services" <u>means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services </u>(including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries“

Taxability under India-UK DTAA

The term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provisions of services of technical or other personnel) which:

..

(c) **make available** technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design.

The income is not chargeable to tax in India as per India-UK DTAA, hence the question of withholding does not arise

Reference of Domestic Law in Treaties

Reference of Domestic Law in Treaty (OECD Model)

Article Reference	The Term Specified	Particulars
Article 3	Residuary terms not defined in the DTAA	Any term not defined in the Convention shall have the meaning that it has under the tax laws of that State to which the Convention applies.
Article 4	Residence	the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein
Article 6	Immovable Property	The term “immovable property” shall have the meaning which it has under the law of the Contracting State in which the property in question is situated.

Case Laws

CIT v. PVAL Kulandagan Chettiar *2004 267 ITR 654 (SC)*

Facts

- Assessee-respondent is a firm resident in India and owns properties in Malaysia
- In relevant AY, **assessee earned income from rubber estates in Malaysia and earned short term capital gains through sale of property in Malaysia**
- AO brought both incomes to tax in India
- On appeal, **CIT(A) under Article 7(1) of the India-Malaysia DTAA held that unless assessee had a PE in India, such income not to be included in total income of assessee**
- On appeal, Tribunal upheld the CIT(A) and the AP HC upheld that Tribunal order
- Appeal to the SC

CIT v. PVAL Kulandagan Chettiar *2004 267 ITR 654 (SC)*

Findings

- SC held that in case of conflict between the Act and the DTAA, provisions of the DTAA will supersede the provisions of the Act.
- **Section 90(2) makes it clear that the Act gets modified in regard to the assessee in so far as the agreement is concerned if it falls within the category stated therein.**
- The provisions of a DTAA cannot fasten a tax liability where the liability is not imposed by a local Act. Where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability.
- In relation to business income from rubber plantation in Malaysia, the SC held that:-

  Proceeding on that basis, we hold that business income out of rubber plantations cannot be taxed in India because of closer economic relations between the assessee and Malaysia in which the property is located and where the permanent establishment has been set up will determine the fiscal domicile. On the first issue, the view taken by the High Court is correct.

Engineering Analysis Centre of Excellence Private Limited v. CIT [2021] 281 Taxman 19 (SC)

The Court grouped the appeals before it under four categories, these being:

(i) First Category- computer software purchased by an end user who is a resident in India from a foreign, non-resident supplier or manufacturer.

(ii) Second Category- resident Indian companies acting as distributors or resellers by purchasing computer software from foreign, non-resident suppliers or manufacturers and then reselling the same to resident Indian end-users.

(iii) Third Category- foreign, non-resident distributor or reseller purchasing software from foreign, non-resident seller, resells the same to resident Indian distributors or end-users.

(iv) Fourth Category- computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.

The Court analysed the definition of royalties contained in Article 12 of the DTAAs based on the OECD Model Tax Convention on Income and on Capital. The DTAAs in the appeal are substantially similar, if not identical, in respect of the provisions concerning “business profits” and “royalties”.

Engineering Analysis Centre of Excellence Private Limited v. CIT [2021] 281 Taxman 19 (SC)

The definition of "royalties" as used in the case means *"the payments of any kind received as a consideration for the use of, or the right to use:*

a) any copyright of a literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information;

b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8"

The Court affirmed Supreme Court decision in the case of G.E Technology.

The Court observed the following for all the four categories of transactions mentioned above:
"our answer to the question posed before us, is that the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in section 195 of the Income Tax Act were not liable to deduct any TDS under section 195 of the Income Tax Act."

Nestle SA [2023] 155 taxmann.com 384 (SC)

Facts

- India and the Netherlands entered into a DTAA in 1989 and signed a protocol featuring an MFN clause in 2012.
- Later India signed a DTAA with Lithuania in 2013. Lithuania became OECD member in 2018.
- Issue arose on the favourable tax treatment that India offers to residents of Lithuania, as per the terms of the Lithuania DTAA, can be extended to residents of the Netherlands and whether it is necessary to issue a notification to incorporate the new provisions.
- Furthermore, there is a question regarding the effective date for granting this favourable treatment?
- The Appeal of the Revenue was allowed.

Findings:

- A notification under section 90(1) is necessary and a mandatory condition for a court, authority, or Tribunal to give effect to a DTAA, or any protocol changing its terms or conditions, which has the effect of altering the existing provisions of law.
- The Court emphasized the there is no automatic application of benefits to the nation that requires same treatment in a specific matter, subsequent to its initial signing when another nation receives preferential treatment.
- The relevant date to claim the benefit of the MFN clause is the date when the treaty was entered into with India, not a later date when that country becomes an OECD member.

Thank you!

Nikky Jhamtani– nikky.jhamtani@gmail.com

Contact No. 94140 82748