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DOMESTIC TAX LAWS IN INTERACTION WITH DTAAS

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Contents

International Perspective

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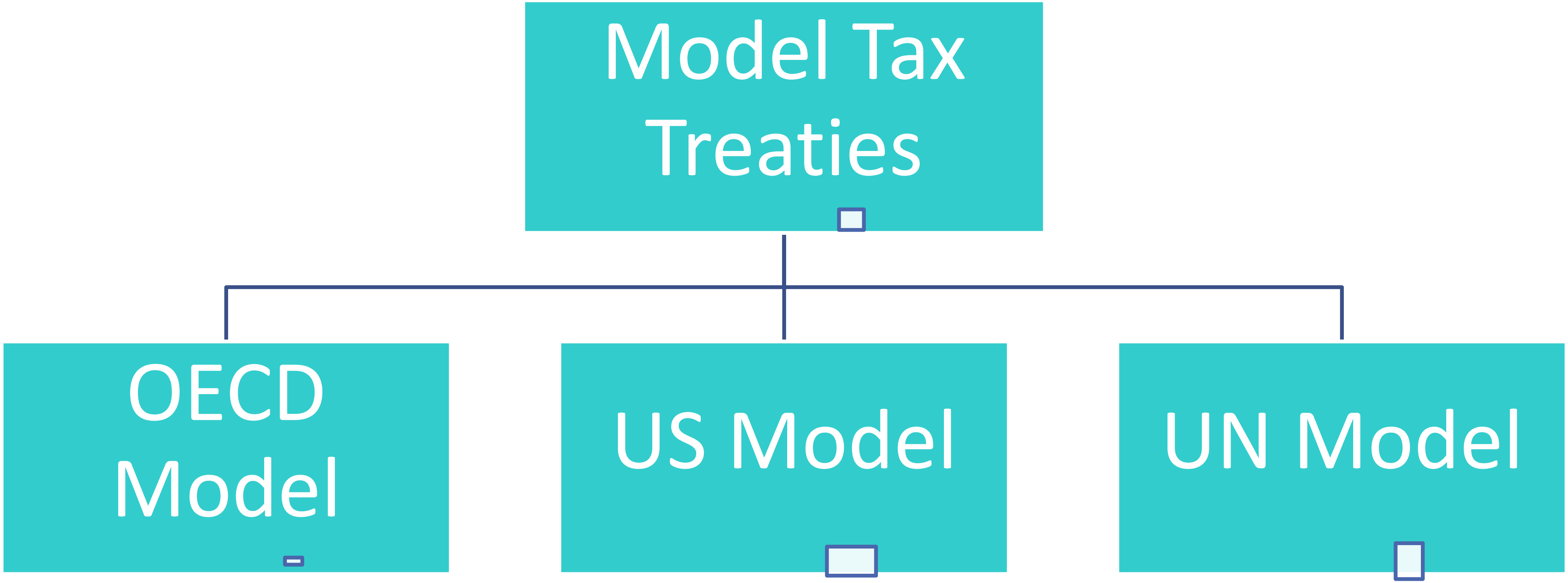
Why Tax Treaties?

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

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.

How to give effect to a Treaty under Domestic Law?

Tax Treaties can have:

- **Direct effect (monistic**)- they automatically become part of the domestic law.

  France, Japan, Luxembourg, Spain, Switzerland

- **Indirect effect (Dualistic)-** they need to be enacted into domestic law and require special legislative steps, in order to be enforceable within that jurisdiction.

  Australia, Canada, UK, India, New Zealand, Sweden

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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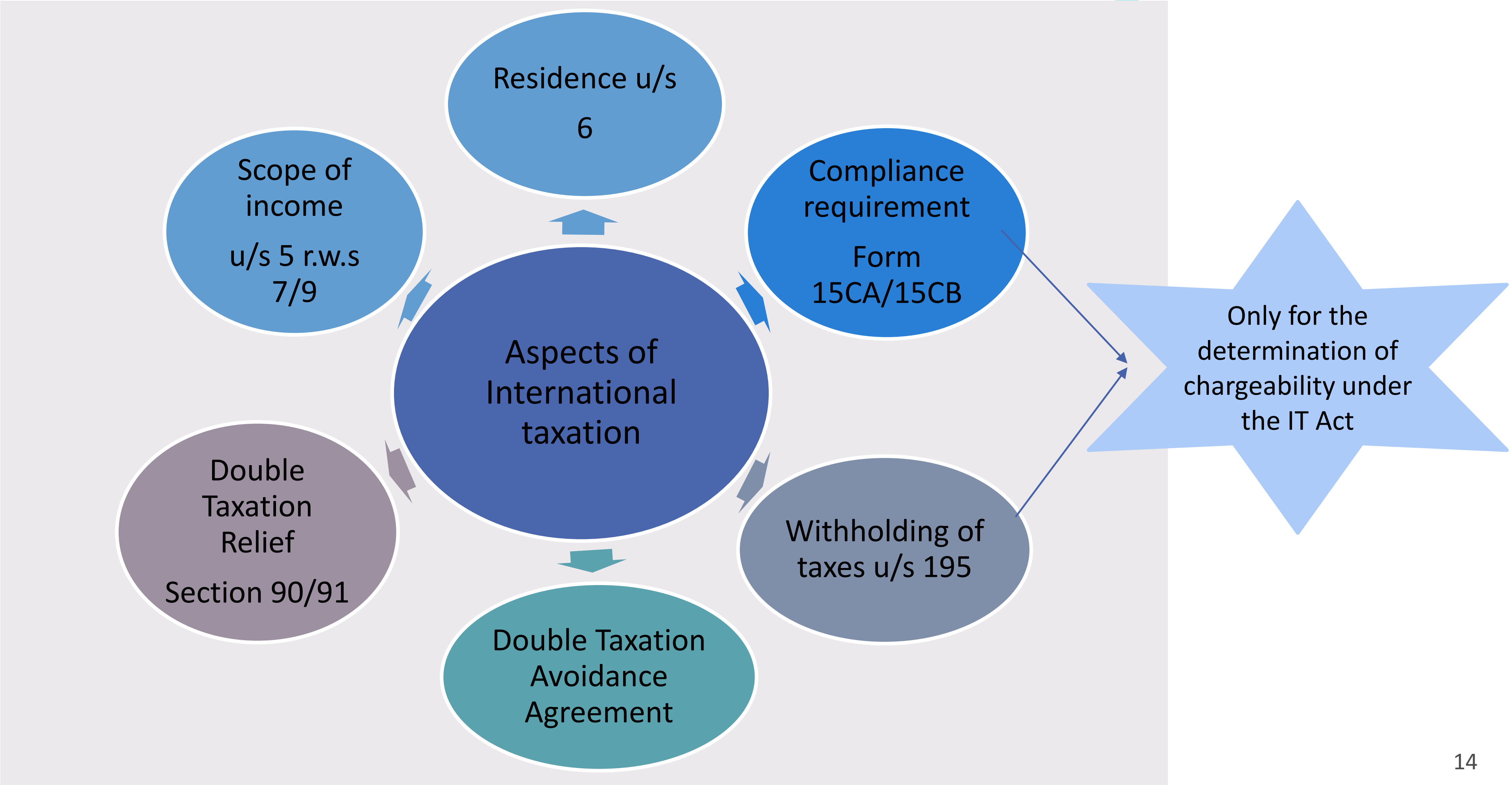
Aspects of International Taxation



Section 5: Scope of Total Income

- **Scope of Total Income**
  - **Resident**
    - Global Income (Indian + Foreign)
  - **RNOR**
    - Indian Income + foreign sourced income only if derived through Indian setup
  - **Non-Resident**
    - received or deemed to be received in India
    - accrues or arises
    - deemed to accrue or arise in India

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

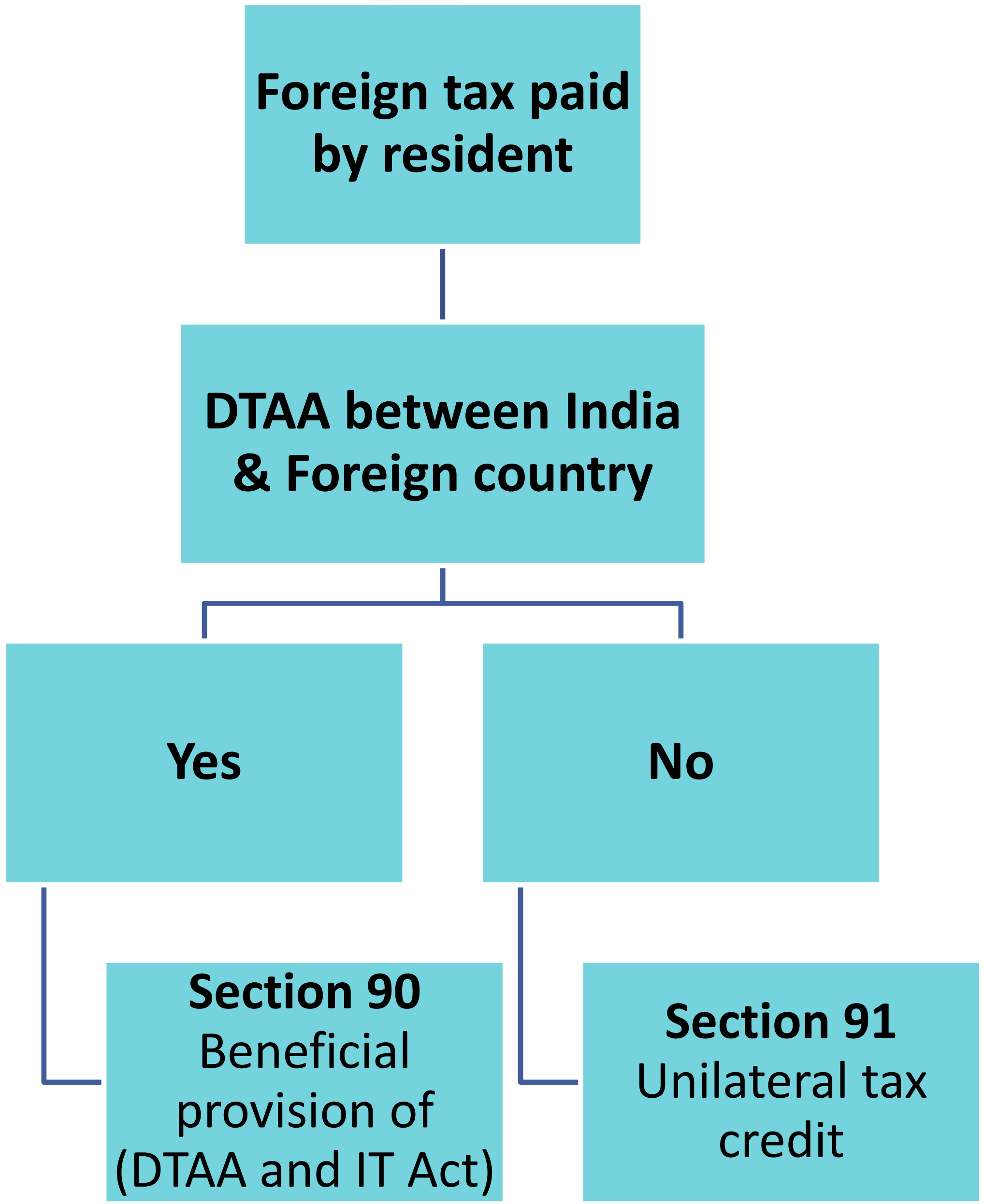
Double Taxation relief provisions in Income-Tax Act

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

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Illustration 1

India

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

USA

Mr. X

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?

- 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

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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

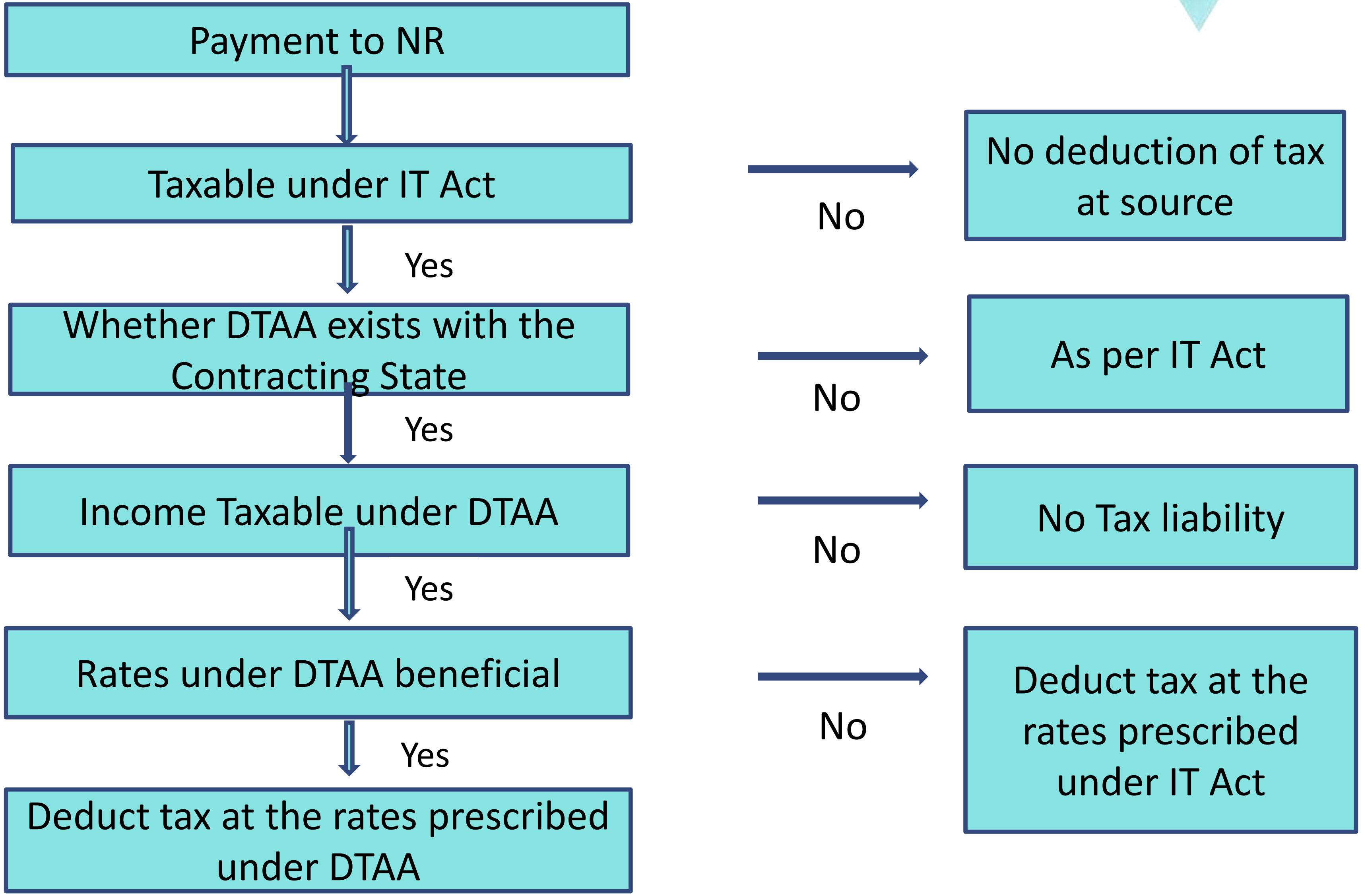

Illustration on withholding obligation

INDIA

UK

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

Mr. Roy

Ms. Karen

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

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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 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 income 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

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.**
- SC concurred with the AP HC and dismissed Department’s petition

Visakhapatnam Port Trust *[1983] 144 ITR 146 (AP)*

Facts

- Assessee entered into a contract with the German Company for purchase of a plant
- Indian company, neither related to the assessee nor to the Germany company, shall install the items of the German company to the plant
- AO observed that the assessee was required to withhold tax u/s 195 of the Act towards the payment for German company
- On appeal, Tribunal accepted assessee's contention of being immune from tax liability wrt to the Germany-India DTAA
- Appeal to HC

Findings

- Section 4 and 5 of the Act are subject to the provisions of the Act, and hence they are subject to the provisions of Section 90 of the Act
- Hence, they shall be subject to the terms of the DTAA
- **HC took a view that though u/s 9(1) income shall be deemed to accrue or arise in India, Sec 4 as well as definition of "total income" in Sec 5 are expressly made subject to provisions of the Act & therefore to the provisions u/s 90**

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT *[2020] 120 taxmann.com 338 (Delhi Trib)*

Giesecke & Devrient GmbH → **GmbH owns 100% shares** → **Giesecke & Devrient [India] Pvt Ltd**

Facts

- Assessee declared dividends to its German parent and discharged DDT at the rate specified in section 115-O of the Act
- Before Tribunal, assessee raised an additional ground challenging the rate of DDT u/s 115-O on the basis that a lower rate of tax (10%) on dividend is prescribed in Indo-Germany DTAA.
- Additional ground was admitted for adjudication
- Tribunal held that DDT is tax '*on the company*' and not '*on the shareholder*' and relied on the Bombay HCs ruling in *Godrej and Boyce [2010] 328 ITR 81***.**

Findings

- In case of inconsistency between the DTAA and the Income-tax Act, the DTAA shall prevail over the Act.
- Tribunal observed that Indo-Germany DTAA which provides for the lower tax rate of 10% on dividend predates the introduction of DDT in 1997 and held that the statutory amendment cannot override the treaty provisions.
- ITAT expressed a considered view that tax rates specified in DTAA in respect of dividend must prevail over DDT.

Emerging Issues

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Emerging Issue

Explanation 2A inserted in the definition of “business connection” by FA 2020 wef 2022

For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean

- *transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction exceeds two crore*
- *systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India exceeds three lakhs*

whether or not

- *the agreement for such transactions or activities is entered in India*
- *the non-resident has a residence or place of business in India*
- *the non-resident renders services in India*

Has the Tax Net increased by virtue of unilateral amendment or beneficial provisions of DTAA will be applicable?

Thank you!

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