NALSAR

Elimination of Double Taxation

Key highlights

Apr 2024

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Background

Types of Double Taxation

Economic Double Taxation

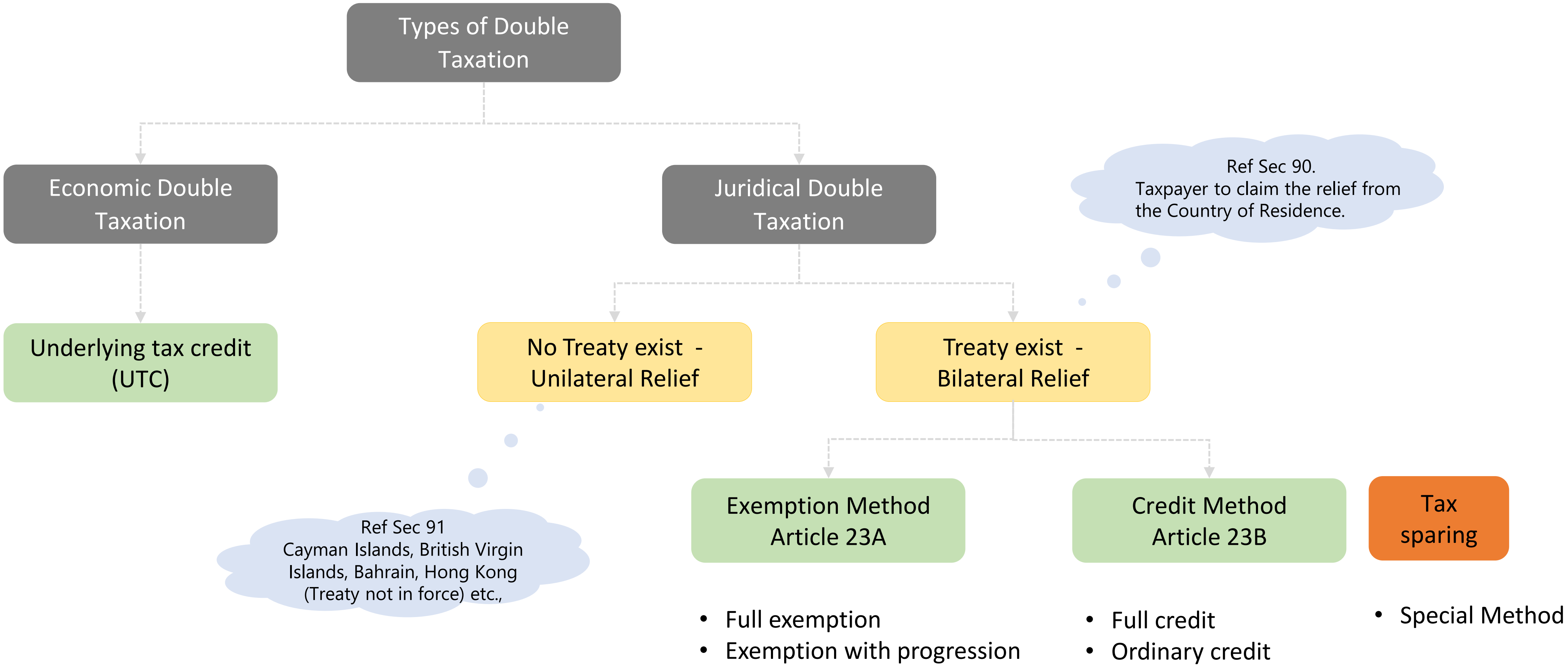
- Same income being taxed in the hands of different persons
- Taxing the income of PF firm in the hands of PF as well as Partners
- Taxing the income of a Company in the hands of Company as well as shareholders

Juridical Double Taxation

- Same income being taxed in different jurisdictions. i.e., Taxes are levied in both source and residence countries in respect of the same income.
- Residence country taxes the global income of its tax resident whereas source country taxes the income which is sourced in its jurisdiction

Elimination of Double Taxation

Elimination of Double Taxation - Types of Relief



Underlying tax credit (UTC)

India - Singapore Synthesised DTAA*:

- Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in Singapore, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Singapore tax paid, whether directly or by deduction.
- Where the income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Singapore tax paid in respect of the profits out of which the dividend is paid.
- Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable to the income which may be taxed in Singapore.

India - Mauritius Comprehensive DTAA*:

- In the case of a dividend paid by a company which is a resident of Mauritius to a company which is a resident of India and which owns at least 10 per cent of the shares of the company paying the dividend, the credit shall take into account in addition to any Mauritius tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph the Mauritius tax payable by the company in respect of the profits out of which such dividend is paid.

* Reciprocal UTC provisions available under the respective DTAAs of Singapore and Mauritius. However, in case of India-UK Syntesised DTAA, only UK provides for UTC

Illustration - UTC

Particulars	Full credit
Source Country	
Profit before tax	100
Corporate tax in Source country @ 30%	30
Profit after tax	70
Dividend distributed	70
WHT on dividend @10%	7
Cash received the Shareholder	63
Residence Country	
Dividend income received	70
Add: Corporate tax attributable	30
Dividend income (Grossed up)	100
Corporate tax in Residence country @ 40%	40
Less: FTC (UTC + WHT)	37
Net additional tax payable in the country of Residence	3

Unilateral Tax Relief - Sec 91

Unilateral relief would be granted if:

- The taxpayer is an Indian tax resident during the period in which such income is taxable
- The income accrues or arises to him outside India (which is not deemed to accrue or arise in India)
- The taxpayer "paid" tax on the income in any country with which there is no agreement u/s 90 of the Act

he shall be entitled to the deduction from the Indian income-tax payable by him of 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 the lower, or at the Indian rate of tax if both the rates are equal.

Indian rate of tax	rate determined by dividing the amount of Indian Income Tax under the provisions of the Act but before deduction of any relief due under this [chapter IX], by the Total Income.
Rate of tax of the other country	Amount of income-tax and super-tax actually paid less all relief due, divided by the whole amount of income as assessed in the said country.

Sec 90 r.w Rule 128 follows Source-wise and Country-wise computation. Sec 91 follows average rate of tax

Bilateral Tax Relief - Sec 90

Notification No. 91 of 2008

When any term used but not defined either in the Income tax Act or in the agreement:

- Section 90(3) - Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.
- Notification No 91 / 2008 dated 28 August 2008 issued in the context of defining the term ‘may be taxed’
- As per the Notification, such income shall be included in taxpayers’ total income chargeable to tax in India in accordance with the provisions of the Act and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Bilateral Tax Relief - Sec 90

- India does not follow full exemption method (few countries left out are moved to credit method by MLI). Ref Annexure 1A
- India-Brazil in case of dividend income still follows full exemption method. Ref Annexure 1B

Exemption Method (at Income level)

Full exemption method	Income which is taxed in the country of source is not included in taxable income of country of residence
Exemption with Progression	Country of residence does not impose tax on such foreign income but includes such exempt income for the purpose of computing the tax rate applicable on other income.

Credit Method (at Tax level)

Full credit method	Residence country allows a deduction of entire amount of tax paid in source country on such income, which is doubly taxed
Ordinary credit method	Residence country allows a deduction of the taxes paid in source state. However, the credit shall not exceed that part of the income tax which is attributable to the doubly taxed income.

India-Namibia follows

(a) Full credit method for Indian residents.

(b) Ordinary credit method for Namibian residents.

Ref Annexure 2A

India-Canada follows

(a) Full credit method for Canadian residents.

(b) Ordinary credit method for Indian residents.

Ref Annexure 2B

Illustration - Full credit vs. Ordinary credit

Particulars	Full credit	Ordinary credit	Remarks
Income earned in the Resident Country	100	100	
Income from Source Country	20	20	
Total Income	120	120	
Tax liability in Residence country @30%	36	36	
Tax liability in Source country @ 40%	8	8	
Less: Foreign Tax Credit	8	6	FTC restricted to 30% in case of Ordinary credit
Net tax liability to be discharged	28	30	

Tax Sparing

a) **Meaning of 'Tax sparing credit'**

- If income earned in Country of Source is exempted under the domestic laws, the actual tax payment in Country of Source would be Nil and yet the Country of resident will give credit of an amount of tax which would have been paid in Country of Source had there been no such exemption in domestic tax laws

b) **Features of 'Tax sparing credit**':

- Principal objective of any Tax treaty is to avoid double taxation
- Sometimes there will be a case of double non-taxation arising from the application of the tax treaty due to the peculiar facts of the case. For these type of situations, MLI proposes certain measures like PPT (Principal Purpose Test etc.,)
- Tax sparing is a case of intended double non-taxation to promote investment and economic development

c) **India's position**:

- India's position in general is not to have Tax sparing credit provisions. This is evident from the statement made by the Finance Minister while amending the Tax treaty between India and Swiss*.

  "Our earlier treaties used to cover tax sparing provisions where if the income is exempt in one country, the other country used to provide corresponding relief even if such taxes are not paid due to exemption. However, India no longer supports this method and is moving away from profit based exemption. Tax sparing (to the extent of 10% of interest income) is currently there in the existing DTAA. Therefore, it is sought to be deleted in the Article concerning elimination of double taxation."

- However, not all tax sparing clauses have been omitted from the DTAA. Some DTAAs still have the Tax sparing provisions

* https://taxguru.in/income-tax/text-of-the-statement-made-by-fm-in-reply-to-lok-sabha-and-rajya-sabha-regarding-protocol-for-avoidance-of-double-taxation-between-india-and-switzerland.html

Tax Sparing

India - Oman Comprehensive DTAA (Article 25) - Two way:

2. Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in the Sultanate of Oman, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the Sultanate of Oman, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the Sultanate of Oman.

3. Where a resident of the Sultanate of Oman derives income which, in accordance with the provisions of this Agreement, may be taxed in India, the Sultanate of Oman shall allow as a deduction from the tax on the income of the resident an amount equal to the income-tax paid in India, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in India.

4. The tax payable in a Contracting State mentioned in paragraph 2 and paragraph 3 of this Article shall be deemed to include the tax which would have been payable but for the tax incentives granted under the laws of the Contracting State and which are designed to promote economic development.

India - Malaysia Comprehensive DTAA (Article 23) - One way:

3. For the purposes of paragraph 4, the term "tax paid in Malaysia" shall be deemed to include the tax which would, under the laws of Malaysia and in accordance with this Agreement, have been payable on any income derived from sources in Malaysia had the income not been taxed at a reduced rate or exempted from Malaysian tax in accordance with the provisions of this Agreement and the special incentives under the Malaysian laws for the promotion of economic development of Malaysia which were in force at the date of signature of this Agreement or any other provisions which may subsequently be introduced in Malaysia in modification of, or in addition to, those laws so far as they are agreed by the competent authorities of the Contracting States to be of a substantially similar character.

India DTAAs with Australia, Belgium, Canada, France, Spain, UK etc. also provide for 'Tax sparing' for respective residents of those countries w.r.t certain exemptions viz., Sec 10 and Sec 80 Deductions. India does not provide for any reciprocal tax sparing provisions for its residents

Tax sparing provisions available under the **India-Swiss** Tax treaty (2011) and **India-Thailand** Tax treaty (2015) have been omitted. Also refer PCIT v. Polyplex Corporation Ltd., [2023] 152 taxmann.com 479 (Delhi HC) in the context of India-Thailand DTAA.

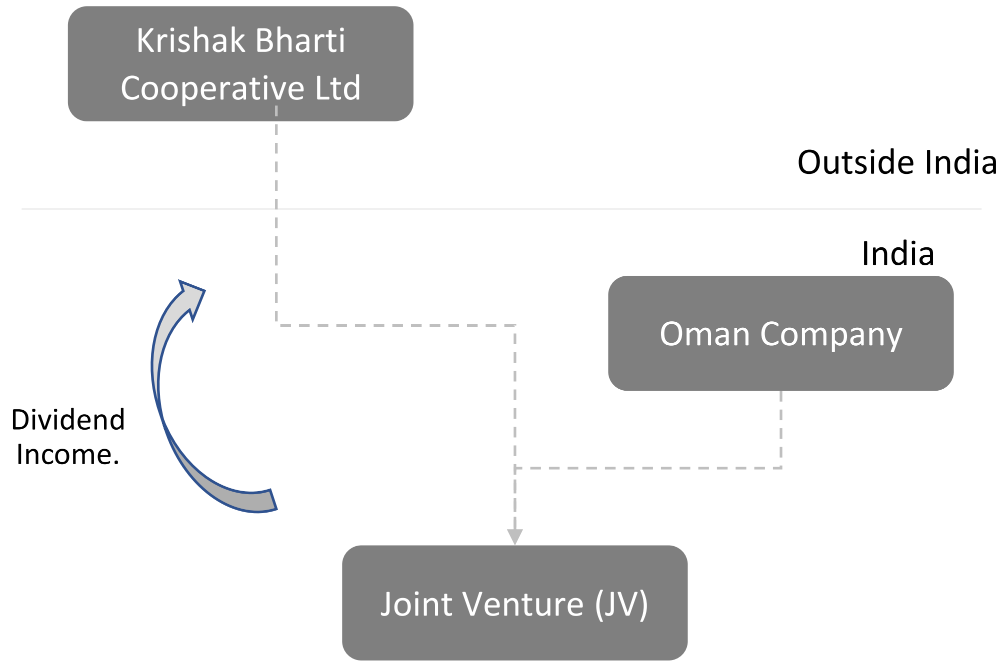
PCIT v. Krishak Bharti Cooperative Ltd (Civil Appeal No. 836 of 2018)

Facts of the case:

- The Taxpayer, a multi-state co-operative society registered in India, entered into a JV with a company registered in Oman, for conducting its business of manufacturing fertilizers.
- During the relevant year, the Taxpayer received dividend income from the JV registered in Oman.
- The said dividend income was exempt from tax under the domestic laws of Oman.

Arguments of the Tax authorities:

- The tax authority held that dividend income is taxable in India and granted FTC of taxes spared in Oman by virtue of Article 25(2) r.w. Article 25(4) of the India-Oman DTAA
- Principal Commissioner of Income Tax (PCIT) challenged the same, by arguing that no FTC shall be available to the Taxpayer under Article 25, as the tax was payable on the dividend income in Oman but was not actually paid.
- The decision of PCIT was overruled in subsequent appeals filed before the Tribunal and High Court.
- On further appeal to the Supreme Court (SC), the tax authority argued that the dividend received by the Taxpayer is taxable in India and no exemption thereon is available under Article 25 as dividend is not designed as a tax incentive in Oman to promote development in Oman.



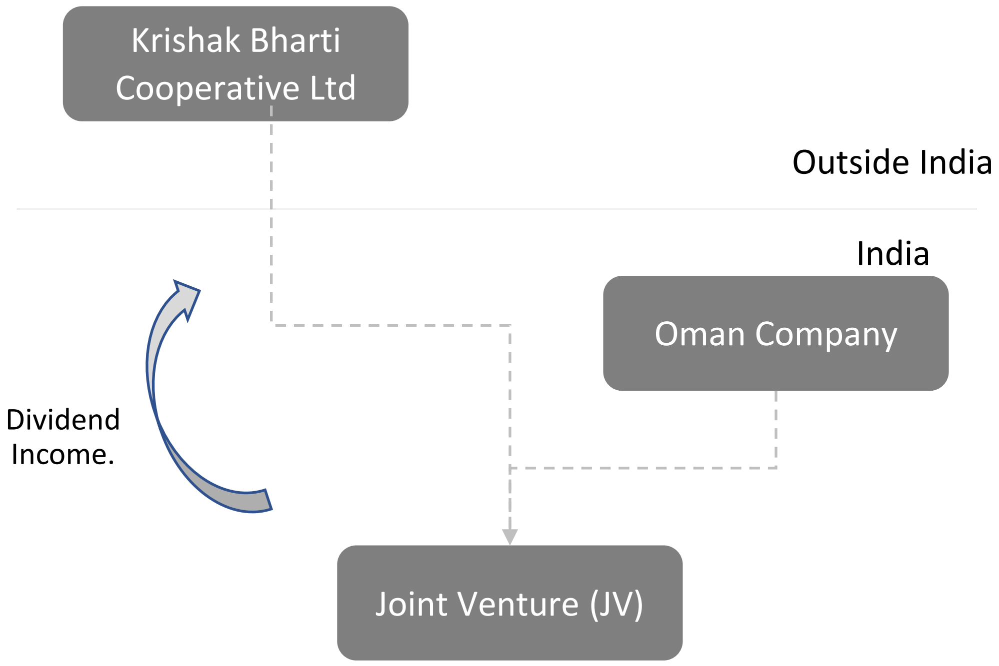
PCIT v. Krishak Bharti Cooperative Ltd (Civil Appeal No. 836 of 2018)

Arguments of the Tax authorities:

- Further, the tax authority argued that a letter issued by the Ministry of Finance (MoF) Oman to the Taxpayer, specifying the rationale for granting exemption to dividend income, did not have a statutory force as per the Omani Tax Laws and, hence, cannot be relied upon.

Ruling of the Hon'ble SC:

- Exemption under Article 25 of the treaty is contingent upon whether the tax on dividend income is not paid in Oman due to a tax "incentive" (granted for promotion of economic development in Oman).
- The Hon'ble SC observed that the term "incentive" is neither defined in the Omani Tax Laws nor in the Indian Income Tax Laws, and it is in such circumstances that the Taxpayer sought clarification by way of a letter from the MoF, Oman.
- The Hon'ble SC upheld the statutory force of the letter (a clarificatory communication).



FTC Rules & Practical Issues

FTC Rule

Rule128 - FTC Rules

#	Issue	Sub-Rule reference	Details
1	Year of granting FTC (Income could be offered to tax in different years for various reasons viz., Method of accounting etc.)	128(1)	• In the year in which the income corresponding to such tax is offered to or assessed to tax in India; Same is in-line with the principles laid down in **CIT v. Petroleum India International [2013] 351 ITR 295 (Bom.)** • Where the corresponding income is offered to tax in more than one year, credit shall be granted in the same proportion as that of doubly taxed income.
2	Tax against which FTC is available	128(3) and (6)	• Income-tax (including MAT and AMT), Surcharge and Cess. In other words, Interest, Penalty etc., are ineligible for FTC.
3	Mode of computation of FTC	128(5)	• <u>Country-wise and Source-wise</u>: FTC shall be computed separately for each source of income arising from a particular country • <u>Emphasis on Credit method</u>: Credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income • <u>Conversion rate</u>: TTBR on the last day of the month immediately preceding the month in which such tax has been paid or deducted
4	When Tax is payable under MAT / AMT	128(7)	• FTC available against tax payable u/MAT or AMT exceeds the amount of FTC available under the normal provisions, such excess shall be ignored for computing MAT or AMT credit

Digital Service tax

FTC Rule

Form 67

#	Issue	Sub-Rule reference	Details
5	Documentation required for claiming FTC	128(8)	• Form 67 (statement of income from foreign country along with foreign tax deducted) to be submitted online; • Certificate or statement specifying the nature of income and the amount of tax deducted therefrom (or) paid by the assessee from the tax authority of the source country or from the Deductor*
6	Due date for filing Form 67	128(9)	• The above two shall be filed on or before the due date u/s 139(1). It may be noted that the due date mandate is coming from the Rules and not from the provisions of the Act. • Belated filing of Form 67 may not be a reason for denying the FTC. The said principle is upheld by the Bangalore and Surat Tribunals in the case of **Brinda Ramakrishna (ITA. No. 454/Bang/2021)** and **Sanjay Patil (ITA No.189/SRT/ 2021)** respectively.
7	FTC against taxes which have been disputed in the source country	128(4)	• No credit shall be allowed against disputed taxes • Credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute.

* Where it is not feasible to obtain such certificate, a statement signed by the taxpayer along with the proof of payment of taxes in source country shall be submitted.

Illustration - Excess FTC against MAT is ineligible for MAT credit [Rule 128(7)]

Particulars	Full credit
Source Country	
Tax liability under Normal provisions	100
Tax liability under MAT	140
FTC available	125
MAT credit to be carried forward (40-25)	15

Other Issues

What if DTAA benefit could not be accessed ?

Section 90 vs. Section 91

- Section 90 provides relief in case of Bilateral situations.
- The pre-condition is accessing the DTAA benefits, which depends upon various factors (viz., proving the residential status, beneficial ownership, principle purpose test, LOB clauses, if any.)
- Upon failing on any of the conditions above, DTAA benefits would not be available.
- Section 91 specifies that unilateral relief is available only when there is no DTAA between India and such country.
- Thus a question arises as to how will the relief be provided on the doubly taxed income in such cases ?

The Hon'ble UK Tribunal in the case of **Aozora GMAC Investments Limited** (TC/2016/06360 / [2021] UKFTT 0099 (TC) had an occasion to deal with a similar issue. The taxpayer failed to satisfy the LOB clause under US-UK DTAA. However, the Tribunal provided unilateral relief in respect of the taxes paid in the source country

Other Issues

Relief against State taxes ?

Section 90 vs. Section 91

- Taxpayer can claim FTC only in respect of ‘taxes’ covered under DTAA. Article 2 of the respective DTAA defines the taxes covered
- For example, **India - US** DTAA covers the <u>Federal income taxes</u> imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes), and the exercise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations.
- Taxes levied by Cantons in USA are not covered under Article 2, scope of taxes under India-US DTAA and hence not eligible for FTC
- Thus a question arises as to whether a Unilateral relief can be claimed on taxes levied by Cantons (in the nature of income-tax)?
- Explanation to Sec 91 states that 'income tax' in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

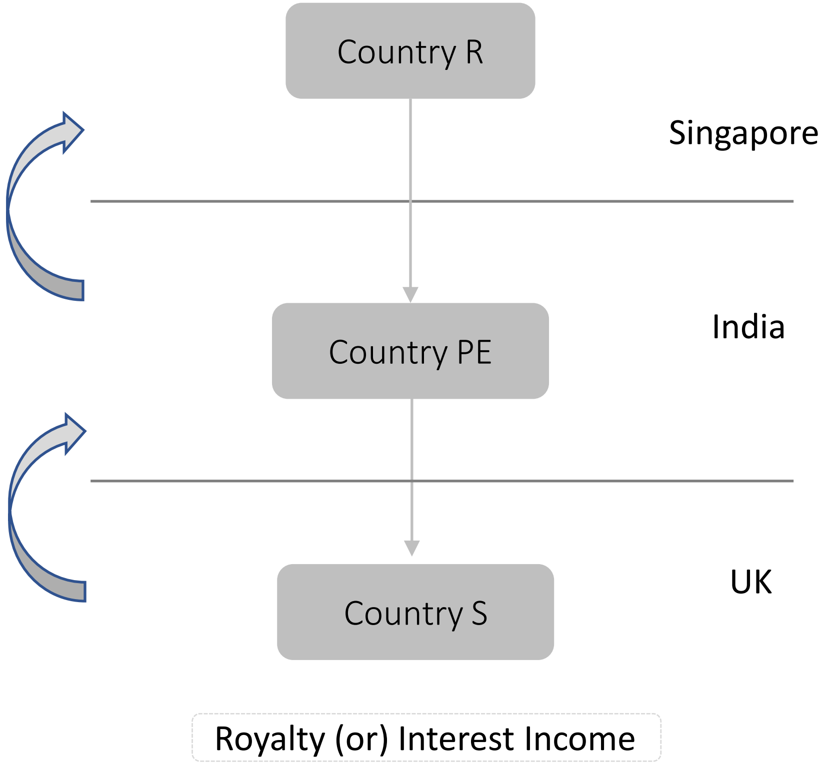
The Hon’ble Karnataka High Court in the case of **Wipro Ltd.** [2015] 62 taxmann.com 26 upheld the view that Unilateral relief can be claimed on the State taxes. Similar principle has been followed by the Hon’ble Delhi Tribunal in the case of **Aditya Khanna** [2019] 105 taxmann.com 323 and **Tata Sons Ltd**. [2011] 10 taxmann.com 87 (Mum.) and Delhi Tribunal in the case

Other Issues

What if taxes are paid in two other jurisdictions ?

Triangular cases

- Taxability in Country S: While determining the withholding tax at Country S, the DTAA between **Country R and Country S** shall apply.
- Taxability in Country PE: While determining tax liability in Country PE, FTC limit shall be as per **Country PE and Country S**.
- Taxability in Country R: While determining tax liability in Country R, FTC shall be given for the taxes paid in
  - Country S **(DTAA between Country R and Country S)** &
  - Country PE **(DTAA between Country R and Country PE)**.



For claiming the FTC benefit between Country PE and Country S, a **non-discrimination article under 24(3)** between Country R and Country PE shall be invoked

Annexures

Annexure 1A - Impact of MLI

Article 5 - Multilateral Convention (certain countries moved from exemption method to credit method)

Date of Finalisation : 08.01.2019

Article 5 – Application of Methods for Elimination of Double Taxation

Notification of Choice of Optional Provisions

Pursuant to Article 5(10) of the Convention, India hereby chooses under Article 5(1) to apply Option C of that Article.

For jurisdictions choosing Option C:

Pursuant to Article 5(10) of the Convention, India considers that the following agreement(s) contain(s) a provision described in Article 5(7). The article and paragraph number of each such provision is identified below

Listed Agreement Number	Other Contracting Jurisdiction	Provision
11	Bulgaria	Article 25(2),(3)
18	Egypt	Article 24(1),(2)
26	Greece	Article XVII (2),(4)
70	Slovak Republic	Article 23(2),(3)

Annexure 1B - India - Brazil DTAA

Article 23 - Methods for the Elimination of Double Taxation

1. Subject to the provisions of paragraphs 3 and 4, where a resident of a Contracting State derives income which, in accordance with the provisions of this Convention may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to the income which may taxed in that other State.

2. For the deduction mentioned in paragraph 1, the tax paid in that other State shall always be deemed to have been paid at the rate of 25 per cent of the gross amount of interest referred to in paragraph 2 of Article 11 and of royalties referred to in paragraph 2(b) of Article 12, provided however, that the tax so deemed to have been paid shall not exceed the tax leviable on that income in the first-mentioned State.

3. Where a company which is a resident of a Contracting State derives dividends which, in accordance with the provisions of paragraph 2 of Article 10 may be taxed in the other Contracting State, the first-mentioned State shall exempt such dividends from tax.

4. Where a resident of India derives profits which, in accordance with the provisions of paragraph 5 of Article 10 may be taxed in Brazil, India shall exempt such profits from tax.

Annexure 2A - India - Namibia DTAA

Article 23 - Methods for the Elimination of Double Taxation

1. In Namibia, double taxation shall be eliminated as follows :

Where a resident of Namibia derives income or capital gains from India, the amount of tax on that income or gains payable, whether directly or by deduction, in India in accordance with the provisions of this Convention, may be credited against the Namibian tax imposed on that resident. The amount of credit, however, shall not exceed the amount of the Namibian tax on that income or gains computed in accordance with the taxation laws and regulations of Namibia.

2. In India, double taxation shall be eliminated as follows :

Where a resident of India derives income or capital gains from Namibia, which, in accordance with the provisions of this Convention may be taxed in Namibia, then India shall allow as a deduction from the tax on the income of that resident an amount equal to the tax on income or capital gains paid in Namibia, whether directly or by deduction.

Annexure 2B - India - Canada DTAA

Article 23 - Methods for the Elimination of Double Taxation

2. In the case of Canada, double taxation shall be avoided as follows:

(a) Subject to the existing provisions of the law of Canada regarding the deduction from tax payable in Canada of tax paid in a territory outside Canada and to any subsequent modification of those provisions which shall not affect the general principle hereof - and unless a greater deduction or relief is provided under the laws of Canada, tax payable in India on profits, income or gains arising in India shall be deducted from any Canadian tax payable in respect of such profits, income or gains.

Article 23 - Methods for the Elimination of Double Taxation

3. In the case of India, double taxation shall be avoided as follows:

(a) The amount of Canadian tax paid, under the laws of Canada and in accordance with the provisions of the Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Canada which has been subjected to tax both in India and Canada shall be allowed as a credit against the Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax.

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