

DECODING DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAA)

SOME FUNDAMENTALS - DTAA

- All treaties allocate tax revenue between Country of Source (COS) and Country of Residence (COR).
- COR & COS both get their jurisdiction to tax from their domestic legislation. DTA does not grant jurisdiction.
- DTA places restrictions on the rights of COS to levy tax on a Non – Resident. The COR has right to levy full tax – and has the responsibility to give credit for tax paid in COS or exempt the income taxed at the COR.
- Section 90 gives right to the Central Government to enter into DTAA for the following:-
 - ❖ For the granting of relief in respect of income which has suffered income-tax in India and other country;
 - ❖ For the avoidance of double taxation of income; w.e.f. 01.04.21 it states that without creating opportunities for or non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory.
 - ❖ For exchange of information for the prevention of evasion or avoidance of income-tax or investigation of cases of such evasion or avoidance;
 - ❖ For recovery of income-tax.
- Treaty or Act whichever is more beneficial to the assessee shall prevail but w.e.f. 01.04.2016 the provisions of Chapter X-A of the Act i.e. General Anti Avoidance Rule (Section 95 to 102 of the Act) shall apply to the assessee even if such provisions are not beneficial to him. [Section 90(2) & 2A]

SOME FUNDAMENTALS - DTAA

- A non resident shall not be entitled to claim any relief under DTAA unless a certificate of residency is obtained by him from the Government of his country of residence. [Section 90(4)]
- Rule 21AB of the IT Rules provides that the following information shall be provided in Form No. 10F by the non resident, namely:—
 - (i) Status (individual, company, firm etc.) of the assessee;
 - (ii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);
 - (iii) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;
 - (iv) Period for which the residential status, as mentioned in the certificate referred to in sub-section (4) of section 90 or sub-section (4) of section 90A, is applicable; and
 - (v) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.
- A resident can obtain a certificate of residence for the purposes of DTAA by applying in Form No. 10FA to the AO who on being satisfied in this behalf, shall issue a certificate of residence in Form No. 10FB

Section - 91 Countries with which no agreement exists

- If any resident person proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no DTAA than 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. 91(1)
- The expression "Indian income-tax" means income-tax charged in accordance with IT Act;
- The expression "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this Chapter, by the total income;
- The expression "rate of tax of the said country" means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of the income as assessed in the said country;
- The expression "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.

DTAA vis-à-vis Domestic Law

DTAA	Domestic Tax Law
Agreement between two States	Act of Legislation
Involves negotiation process	No negotiation
Relief from double tax	Charge of tax
Sharing of tax revenue	Earning of tax revenue
No frequent amendments	Frequent amendments
International law	National Legislation
Dispute settled by MAP/arbitration	Dispute settled by appellate forum/ Court

DTAA – Protocols and Notes

- ❑ The double tax treaties are generally accompanied by one or more exchanges of notes and/or protocols, which clarify/expand/restrict application of the main DTAA.
- ❑ When two countries want to change their double tax DTAA, they can do so in either of two ways:
 - ❑ enter into a new DTAA and terminate the old DTAA; or
 - ❑ make amendments to the existing DTAA.
- ❑ If (ii) is followed, a protocol is used to make the relevant amendments.

TYPES OF TAX TREATIES

- **Limited Treaties** – which cover –
 - a)** income from operation of aircrafts and ships,
 - b)** estates,
 - c)** inheritance and
 - d)** Gifts.
- **Comprehensive Treaties** – which are wider in scope addressing all sources of income

Organization for Economic Cooperation & Development ('OECD') MODEL

- ❑ Starting with the 1963 edition, the OECD model Treaty has been published with a commentary to each article
- ❑ The OECD Model is essentially a model Treaty between two developed nations.
- ❑ This model advocates residence principle, that is to say, it lays emphasis on the right of state of residence to tax.
- ❑ The OECD Commentaries have been referred to as an aid to interpretation by the courts in many OECD countries and in some non-OECD countries (e.g. Malaysia).

United Nations ('UN') MODEL

- ❑ Focused on double tax treaties between developed and developing countries.
- ❑ Gives more weight to the source principle as against the residence principle of the OECD model allowing greater source country taxation
- ❑ Commentaries on UN model treaties – more or less similar to OECD model Treaty commentaries

Others

- ❑ Other international model treaties –
 - ❑ ASEAN model
 - ❑ Andean model
- ❑ Some countries have published their own model Treaty –
 - ❑ US model
 - ❑ Netherlands model

Important Concepts to understand a DTAA

Term	Meaning
Contracting States	The Countries that are parties to a Tax Treaty.
Credit Methods	Foreign taxes paid by a resident of a country are credited against the residence country's tax on the resident's foreign-source income.
Deduction Method	Foreign taxes paid by a resident of a country are deductible in computing the resident's taxable income in the resident country.
Dual-resident taxpayers	A taxpayers who is a tax resident of two or more countries for the same tax year.
Exemption method	Exemption from domestic tax of some or all foreign-source income derived by residents.
Exemption with progression	An exemption method under which certain foreign-source income is exempt from tax but is taken into account in determining the rates of tax applicable to other income.

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Term	Meaning
Non-discrimination	A generally-accepted notion that a country should tax non residents, foreigners and foreign-owned domestic corporations in a manner that is the same as or is functionally equivalent to the treatment afforded to residents, citizens or domestically-owned corporation in similar circumstances.
Most Favored Nation Clause / MFN Clause	A most-favored-nation (MFN) clause mandates that contracting states provides benefit of a beneficial or restrictive clause entered into with any other country. For e.g. Clause 7 of the protocol to the India - France DTAA states that if a lower rate of tax or a restricted scope is provided for in any other treaty that India enters into with any other OECD Member country, then that lower rate or restricted scope will be applicable for the purposes of the India - France DTAA (“Most Favored Nation Clause / MFN Clause”).
Residence country	The country of which tax payer is resident on the basis of either citizenship or no. of days of stay in a country and possess certificate of residency from the government of country of residence.
Source country	The country where income arises.

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Term	Meaning
Tie-breaker rules	Rules in tax treaties that establish the residence of a dual-resident taxpayer in one country for Treaty purposes.
Treaty shopping	The use of a tax Treaty by a person who is not resident in either of the Treaty countries, usually through the use of conduit entity resident in one of the countries.
Tax havens	Countries which subject income (or some forms of income) or entities (or certain entities) to low or no taxation.
Withholding tax	A tax levied by the source country at a flat rate on the gross amount of dividends, royalties, interest, or other payments made by residents to non residents. The tax is collected and paid to the government by the resident payer.
Tax Sparing	The allowance of a credit for the amount of foreign taxes that were not paid because of a tax incentive or holiday in the foreign country.
Thin capitalization rules	Restriction on the deductibility of interest payments made by corporations with excessive debt to equity ratios to their substantial non resident shareholders.

APPLYING TAX TREATIES

- Step 1 What is the nature of income ?
- Step 2 Does the treaty apply ?
- Step 3 Determine which Article applies ?
- Step 4 How are taxation rights assigned
- Step 5 How is the income Calculated

Articles - Classification

Application articles	Definition provision	Anti Avoidance provisions	Elimination of double taxation	Miscellaneous provisions
Article 1 – Applicability	Article 3 – General definition	Article 9 – Associated enterprise	Article 23 – Elimination of double taxation	Article 24 – Non discrimination
Article 2 – Taxes covered	Article 4 – Residence	Article 26 – Exchange of information		Article 28 – Diplomats
Article 30 – Entry into force	Article 5 – Permanent Establishment	Article 27 – Assistance for collection of tax		Article 25 – Mutual agreement
Article 31 – Termination				Article 29 – Territorial extension

Distributive articles

Article 6	Income from immovable property
Article 7	Business Profit
Article 8	Shipping, inland waterways transport and air transport
Article 10	Dividends
Article 11	Interest
Article 12	Royalties / Fee for Technical Services
Article 13	Capital Gains
Article 14	Independent personal services
Article 15	Income from employment
Article 16	Director's Fees
Article 17	Artistes and Sportsmen
Article 18	Pensions
Article 19	Government Service
Article 20	Students
Article 21	Other Income
Article 22	Capital