DOUBLE TAXATION AVOIDANCE AGREEMENTS

The following are the two methods for avoidance of double taxation:-

(i) **Bilateral Relief:** Countries are entering into Double Taxation Avoidance Agreement (DTAA) with each other. (Section 90 and 90A)

Bilateral relief can be given in either of the following methods:

- **Exemption Method:** A particular **income is taxed in only one of the two countries.**
- **Tax Credit Method:** Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement. However, the **country of residence of the tax payer, allows him credit for the tax charged thereon in the country of source.**

(ii) **Unilateral Relief:** When there is no agreement between two countries, **country of the residence itself provide relief.** (Section 91)

SECTION 90: AGREEMENT WITH FOREIGN COUNTRIES (DTAA)

(1) The Central Government may enter into an agreement with the Government of **any country outside India or specified territory outside India –**

(a) **for the granting of relief in respect of**

(i) income on which have been paid both income-tax under this Act and income-tax in that country **or specified territory**, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, **to promote mutual economic relations, trade and investment,** or

(b) for the **avoidance of double taxation** of income under this Act and under corresponding law in force in that country or specified territory, as the case may be, **without creating opportunities for 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),** or

(Amended by Finance Act, 2020)

(c) for **exchange of information** for the **prevention of evasion** or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or **investigation of cases of such evasion** or avoidance, or

(d) **for recovery of income-tax** under this Act and under the corresponding law in force in that country or specified territory, as the case may be.

Note 1: The effect of Double Taxation Avoidance Agreements is that

(i) Income is taxed in only one country or

(ii) If income is being taxed in both the countries, then the tax paid in one country is allowed as deduction from the tax payable in the other country, a per the agreement.

Note 2: With specified territories outside India e.g. Hong Kong, Macau, etc. Government has entered into Tax Information Exchange Agreement (TIEA).

(2) The provisions of this Act shall apply to the extent they are more beneficial to that assessee. **DTAA or I.T. Act, whichever is more beneficial to the assessee shall apply. For example,** if as per DTAA with a foreign country or specified territory; the royalty is to be taxed @ 35% then it will be beneficial to apply section 115A of the Income Tax Act where royalty is taxed @ 10%.

If provisions of DTAA are beneficial, then DTAA will apply. For example, if as per the DTAA with foreign country or specified territory, the royalty is to be taxed @ 10%, then it will be beneficial to apply DTAA instead of section 115A of Income Tax Act since 10% rate of DTAA will apply without surcharge and education cess.

(2A) Notwithstanding anything contained in sub-section (2), the provisions of Chapter of GAAR shall apply to the assessee even if such provisions are not beneficial to him.

(3) **Any term used in the Agreement to have the meaning:**

- If the term is defined in the Agreement: Meaning **as assigned to it in the Agreement**

- If the term is not defined in the Agreement but is **defined in the Income-tax Act**: Meaning **as assigned** to it **in the Income-tax Act**

- If the term is neither defined in the Agreement nor in the Income-tax Act: Meaning **as assigned to it in the Notification issued**, if any

  Whenever any term is assigned a meaning through a notification issued under Section 90(3), it shall have the effect of **clarifying the term from the date of coming in force of the agreement in which such term is used.**

(4) An assessee, not being a resident, to whom DTAA applies, shall not be entitled to claim any relief under such agreement **unless a tax residency certificate,** of his being a resident in any country outside India or specified territory outside India, as the case may be, is **obtained by him from the Government of that country or specified territory.**

CLARIFICATION:

The Tax Residency Certificate produced by a resident of a contracting state will be accepted as evidence that he is a resident of that contracting state and

the Income Tax Authorities in India will not go behind the TRC and question his residential status.

Explanation 1—The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Illustration:
Cosmos Limited, a company incorporated in Mauritius has a branch office in Hyderabad opened in April, 2017. The Indian branch has filed return of income for assessment year 2023-24 disclosing income of ₹ 50 lacs. It paid tax at rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of the Article 24 (Non-Discrimination) of the Double Tax Avoidance Agreement between India and Mauritius, which reads as follows:

> *"The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstance."*

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a Foreign Company i.e. 40% plus health & education cess. Is the action of the Assessing Officer in accordance with law?

Answer:
Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), **it appears** that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this Explanation, the action of the Assessing Officer in levying tax @ 40% (plus surcharge, if any, plus health & education cess) on the Indian branch of Cosmos Ltd. is in accordance with law.

KEY NOTE:
1. **If the rates of DTAA are applicable then, such rates shall not be increased by surcharge and education cess.**

SECTION 91: COUNTRIES WITH WHICH NO AGREEMENT EXISTS

SECTION 91(1)

- If there is a country with which **India does not have a DTAA,**
- and the assessee (resident in India) in respect of **income arising outside India,**
- **pays income tax in foreign country and also in India,**

- then he shall be entitled to **deduct** the **lower of the following** amount
- **from Income tax payable by him in India** in respect of such doubly taxed income;

(i) Tax on such doubly taxed income at the rates applicable in India which shall be computed as under:

$$\frac{\textbf{Tax on Total Income in India}}{\textbf{Total Income in India}} \times \textbf{Such doubly taxed income}$$

(ii) Tax on such doubly taxed income at the rates applicable in foreign country which shall be computed as under:

$$\frac{\textbf{Tax paid in foreign country}}{\textbf{Total income assessed in foreign country}} \times \textbf{Such doubly taxed income}$$

Notes:

1. **Doubly Taxed incomes means the income computed after allowing all expenses and deductions under Chapter VI-A, if applicable.**
2. **CIT vs. Bombay Burmah Trading Corpn. Ltd. (Bom.)**
   On the amount of the doubly taxed income so ascertained, income tax is calculated at the Indian rate of tax and the rate of tax of the foreign country. The foreign tax rate has to be calculated separately for each country.

SECTION 91(2)

Where a person who is resident in India in any previous year has **any agricultural income in Pakistan** in respect of which he has paid the tax in Pakistan as per laws of taxation of agricultural income in Pakistan, he shall be entitled to a **deduction from the Indian income-tax payable by him:**

(i) of the amount of **tax paid in Pakistan** on such income which is liable to tax under this Act, also; or
(ii) of a **sum calculated on that income at the Indian rate of tax,**

whichever is less.

If a resident of India has agricultural land in Pakistan and has agricultural income of 10 Lakh in Pakistan. Such agricultural income has been taxed in Pakistan under the laws of taxation of agricultural income @ 10% i.e. ₹1,00,000. Now this resident also has other Indian Income of ₹5,00,000.

Now, his income in India is

Other Income	5,00,000
Agricultural Income in Pakistan	10,00,000
	15,00,000
Tax there on	2,73,000

Since he has paid tax in Pakistan not as per Pakistan Income Tax Act but as per law of taxation of agricultural Income in Pakistan, he shall not be entitled to relief under section 91(1), He shall get relief under section 91(2) being lower of:

(a) 1,00,000
(b) Average Rate of Indian Tax on ₹10,00,000 i.e. 18.2% = 1,82,000.

Therefore, tax payable by him after relief under section 91 is ₹ 1,73,000.

POSITION AS PER DTAAs

In terms of Article 5(2) of the Convention, the term **PE includes:**

- a place of management
- a branch
- an office
- a factory
- a workshop
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources

The DTAAs provide that income of a non-resident or foreign company received from India shall be taxable in India, only if, the non-resident or foreign company has a PERMANENT ESTABLISHMENT IN INDIA. The profit attributable to such PE shall be taxable in India. The DTAA, therefore, provides that if the Non-Resident or Foreign Company does not have a Permanent Establishment in India, then income earned in India is not taxable in hands of non-resident or foreign company in India.

The above Rule applies to all kinds of business income, except:

(i) Royalty
(ii) Fee for Technical Services (FTS)
(iii) Interest

POSITION AS PER SECTION 9(1)(i) OF INDIAN INCOME TAX ACT
Section 9(1)(i) provides that any income arising to a non-resident or foreign company from **BUSINESS CONNECTION IN INDIA** shall be taxable in India. The term "Business Connection" is very wider than the word "Permanent Establishment" used in DTAA.

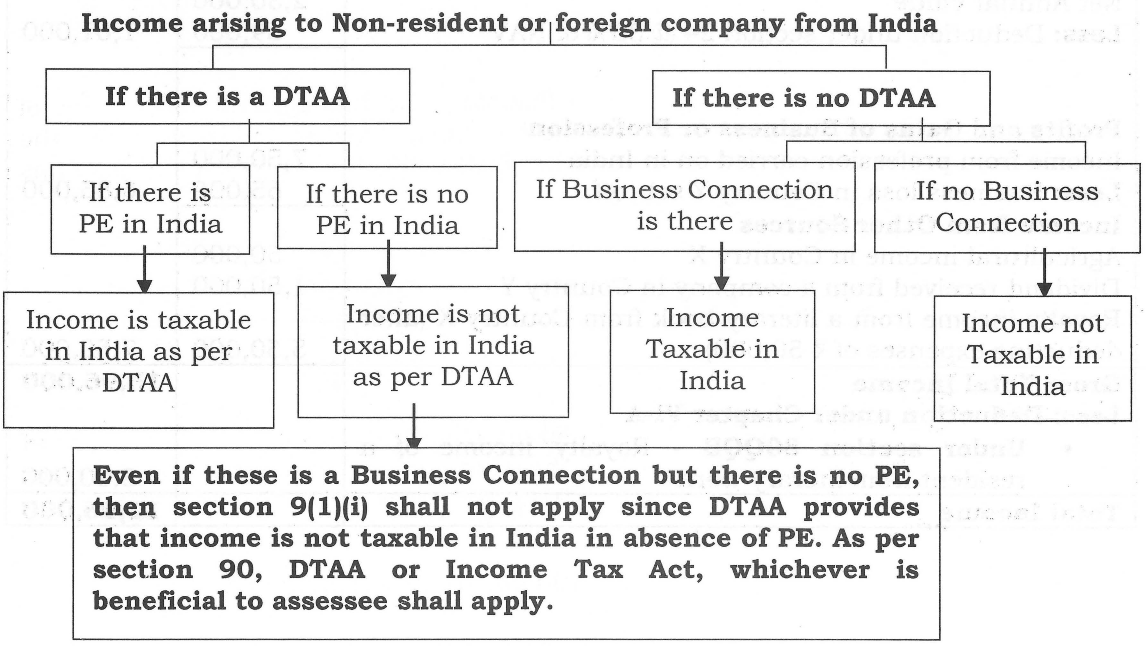

Illustration:

Mr. Kamesh, individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2022-23. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	₹
Income from profession carried in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend received from a company incorporated in country "Y" (gross)	1,50,000
ROYALTY income from literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
Municipal tax in respect of the above house (not allowed as deduction in country Y)	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law that country.

The rates of tax in Country "X" and Country "Y" are 10% and 25% respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment year 2023-24.

Answer:

Computation of Total Income of Mr. Kamesh for Assessment Year 2023-24

Particulars	₹	₹
Income from House Property (House situated in Country Y)		
Gross Annual Value	2,40,000	
Less: Municipal taxes (assumed as paid in that country)	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 @ 30% of NAV	69,000	1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Less: Business loss in Country Y set- off	65,000	6,85,000
Income from Other Sources		
Agricultural income in Country X	50,000	
Dividend received from a company in Country Y	1,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	7,50,000
Gross Total Income		**15,96,000**
Less: Deduction under Chapter VI-A		
• **Under section 80QQB** - Royalty income of a resident from literary work		3,00,000
Total Income		**12,96,000**

Computation of Tax Liability of Mr. Kamesh for Assessment Year 2023-24

Particulars	₹
Tax on total income (30% of ₹ 2,96,000 + ₹ 1,12,500)	2,01,300
Add: 4% Health & Education Cess	8,052
	2,09,352
Less: Rebate under section 91 (See Working Note below)	69,738
Tax Payable	1,39,614
Tax Payable (rounded off)	**1,39,610**

Working Note: Calculation of Rebate under section 91:

Particulars		₹
Average rate of tax in India (i.e., ₹2,09,352/ ₹12,96,000 × 100)	**16.1537%**	
Average rate of tax in Country X	**10%**	
Double taxed income pertaining to Country X		
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) - ₹ 3,00,000 (deduction under section 80QQB)]	2,50,000	
	3,00,000	
Rebate under section 91 on ₹ 3,00,000 @ 10% [being the lower of average Indian tax rate (16.1537%) and foreign tax (10%)		30,000
Average rate of tax in Country Y	**25%**	
Doubly taxed Income pertaining to Country Y^		
Income from house property	1,61,000	
Dividend	1,50,000	
Less: Business Loss in Country Y	**65,000**	
	2,46,000	
Rebate under section 91 on ₹ 2,46,000 @16.1537% (being the lower of average Indian tax rate (16.1537%) and foreign tax rate (25%)]		39,738
Total rebate under section 91 (Country X + Country Y)		**69,738**

Note:

(i) It is assumed that the royalty earned outside India been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

(ii) Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount **CIT v. Dr. R.N. Jhanji (Raj)**.

AMENDMENT BY FINANCE ACT, 2019

SECTION 228A : RECOVERY OF TAX IN PURSUANCE OF AGREEMENTS WITH FOREIGN COUNTRIES

a. **Where an agreement is entered into by the Central Government with the Government of any country outside India** for recovery of income-tax under this Act and the corresponding law in force in that country and the Government of that country or any authority under that Government which is specified in this behalf in such agreement sends to the Board a certificate for the recovery of any tax due under such corresponding law from **A RESIDENT, OR** a person having any property in India, the Board may forward such certificate to any Tax Recovery Officer **HAVING JURISDICTION OVER THE RESIDENT, OR** within whose jurisdiction such property is situated and thereupon such Tax Recovery Officer shall—

   (a) proceed to recover the amount specified in the certificate in the manner in which he would proceed to recover the amount specified in a certificate drawn up by him under section 222; and

   (b) remit any sum so recovered by him to the Board after deducting his expenses in connection with the recovery proceedings.

b. Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee **IS A RESIDENT OF A COUNTRY** (being a country with which the Central Government has entered into an agreement for the recovery of income-tax under this Act and the corresponding law in force in that country), **OR HAS ANY PROPERTY IN THAT COUNTRY**, forward to the Board a certificate drawn up by him under section 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.