

Double Taxation Relief

Some Key Points

Bilateral relief

Under this method, the Government of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. The Government of India has entered into such Double Taxation Avoidance Agreement (DTAA) with more than 70 countries so far.

The DTAA would override the general provisions of the Income-tax Act, 1961 and the assessee may choose the treaty or the regular provisions whichever is beneficial to him.

Bilateral relief may be granted in either one of the following methods.

- (a) **Exemption method** by which a particular income is taxed in only one of the two countries;
- (b) **Tax relief method**, under which, an income is taxable in both the countries in accordance with the agreement. However, the country of residence of the taxpayer would allow him the credit for the tax charged thereon in the country of source.

In India, double taxation relief is provided by a combination of the two methods.

Unilateral relief

This method provides relief of some kind by the home country even where no mutual agreement has been entered into between the two countries.

Question 1

Explain in the context of provisions of the Act:

- (i) *The underlying idea behind DTAA.*
- (ii) *Rate of tax in other country*

Answer

- (i) The underlying idea behind Double Taxation Avoidance Agreement entered between two countries is to promote mutual economic relations by relieving the tax payers from the burden of paying tax twice on the same income in two different countries.
- (ii) Rate of tax in the other country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force in that country after deduction of all relief due, but before deduction of any relief due in the said country on account of double taxation, divided by the whole amount of income assessed in that country.

15.2 Direct Tax Laws

Question 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 5,10,000. In view of tax planning, she has deposited ₹ 70,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000 along with subscription to notified long-term infrastructure bonds ₹ 25,000. She also contributed ₹ 18,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 21,000 to insure the health of her father, a non-resident aged 76 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2012-13.

Answer

Computation of tax liability of Nandita for the A.Y. 2012-13

Particulars	₹
Indian Income	5,10,000
Foreign Income	<u>1,10,000</u>
Gross Total Income	6,20,000
Less: <u>Deduction under section 80C</u>	
Deposit in PPF	70,000
<u>Under section 80CCC</u>	
Contribution to approved Pension Fund of LIC	<u>32,000</u>
	1,02,000
<u>Under section 80CCE</u>	
The aggregate deduction under section 80C, 80CCC and 80CCD has to be restricted to ₹ 1,00,000	1,00,000
<u>Under section 80CCF</u>	
Subscription to notified long-term infrastructure bonds, ₹ 25,000, restricted to ₹ 20,000, being the maximum deduction allowable under section 80CCF	20,000
<u>Under section 80D</u>	
Contribution to Central Government Health Scheme ₹ 18,000 is also allowable as deduction under section 80D, but restricted to ₹ 15,000	15,000
Medical insurance premium of ₹ 21,000 paid for father aged 76 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of ₹ 20,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 15,000.	<u>15,000</u>
	<u>1,50,000</u>
Total Income	<u>4,70,000</u>

Tax on Total Income			
Income-tax (See Note below)		22,000	
Add : Education cess @ 2%		440	
Add: SHEC @ 1%		<u>220</u>	22,660
Average rate of tax in India (i.e. $22,660/4,70,000 \times 100$)	4.82%		
Average rate of tax in foreign country (i.e. $11,000/1,10,000 \times 100$)	10%		
Rebate under section 91 on ₹ 1,10,000 @ 4.82% (lower of average Indian-tax rate or average foreign tax rate)			5,302
Tax payable in India (₹ 22,660 - ₹ 5,302)			17,358

Note:

The Finance Act, 2011 has increased the basic exemption limit for senior citizens from ₹ 2,40,000 to ₹ 2,50,000 and reduced the age criterion for qualifying as a "senior citizen" to be eligible for the higher basic exemption limit from 65 years to 60 years. Accordingly, Nandita will be eligible for the higher basic exemption limit of ₹ 2,50,000, since she is 60 years old.

Question 3

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2010. The Indian branch has filed return of income for assessment year 2011-12 disclosing income of ₹50 lacs. It paid tax at the 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 Taxation 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 favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus 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

15.4 Direct Tax Laws

applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, *Explanation 1* below sub-section (3) of 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% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 4

Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 75,000 from concerts performed outside India. Tax of ₹ 10,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 2,25,000. Compute tax liability of Kalpesh Kumar for the assessment year 2012-13 assuming he has deposited ₹ 10,000 in Public Provident Fund and paid medical insurance premium in respect of his father, aged 65 years, ₹ 20,000.

Answer

An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled :-

- The assessee is a resident in India during the relevant previous year.
- The income accrues or arises to him outside India during that previous year.
- Such income is not deemed to accrue or arise in India during the previous year.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
- There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In view of the aforesaid provisions, deduction under section 91 will be calculated as follows:

Particulars	₹	₹
Indian Income		2,25,000
Foreign Income		<u>75,000</u>
Gross Total Income		3,00,000
Less: <u>Deduction under section 80C</u>		
PPF Contribution	10,000	
<u>Deduction under section 80D</u>		
Medical insurance premium of father being a senior citizen	<u>20,000</u>	<u>30,000</u>
Total Income		<u>2,70,000</u>
Tax on total income		9,000
Add: Education Cess @ 2%		180

Secondary and higher education cess @ 1%		90
		<u>9,270</u>
Average rate of tax in India [i.e. ₹ 9,270/₹ 2,70,000 x 100]		3.43%
Average rate of tax in foreign country [i.e. ₹ 10,000/ ₹ 75,000 x 100]		13.33%
Doubly taxed income		75,000
Rebate under section 91 on ₹ 75,000 @ 3.43% (lower of average Indian tax rate and foreign tax rate)		2,573
Tax payable in India [₹ 9,270 – ₹ 2,573]		6,697

Question 5

An assessee, on fulfillment of certain conditions, can claim relief in respect of the income arising in those countries with which India does not have any double taxation agreement. Do you agree?

Answer

Yes, the assessee shall be allowed relief in respect of such income under section 91 provided all the following conditions are fulfilled :-

- The assessee is a resident in India during the relevant previous year.
- The income accrues or arises to him outside India during that previous year.
- Such income is not deemed to accrue or arise in India during the previous year.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
- There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

Question 6

Explain the purposes for which the Central Government as per section 90 of the Income-tax Act, 1961, can enter into an agreement with any foreign country.

Answer

Section 90(1) empowers the Central Government to enter into an agreement with the Government of any country outside India or specified territory outside India for any of the following purposes -

- granting of relief in respect of
 - income on which income tax has been paid both in India and in the other country or specified territory; or

15.6 Direct Tax Laws

- (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, to promote mutual economic relations, trade and investment.
- (b) the avoidance of double taxation of income under the Income-tax Act and under the corresponding law in force in the other country or specified territory;
- (c) 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 or investigation of cases of such evasion or avoidance; and
- (d) recovery of income tax under the Income-tax Act, 1961, of India and under the corresponding law in force in the other country or specified territory, as the case may be.

This section also empowers the Central Government to make such provisions as may be necessary for implementing the agreement, by notification in the Official Gazette.

Question 7

Specify all those instances which are generally incorporated in Article 5(2) of Double Taxation Avoidance Agreements to signify the presence of a permanent establishment.

Answer

The various instances of permanent establishment generally incorporated in Article 5(2) of Double Taxation Avoidance Agreements include -

- (a) a place of management,
- (b) a branch,
- (c) an office,
- (d) a factory,
- (e) a workshop,
- (f) a sales outlet,
- (g) a warehouse,
- (h) a mine, an oil or gas well, a quarry or other place of extraction of natural resources (but not exploration).

Question 8

Mr. Bansal, a resident Indian and aged 67 years, has derived the following income during the previous year 2011-12:

		₹
(i)	Income from business in India	2,50,000
(ii)	Commission (Gross) from a company in Hong Kong (Tax paid in Hong Kong ₹ 60,000)	3,00,000

(iii)	Dividend (Gross) from a company in Hong Kong (Tax paid in Hong Kong ₹18,000)	90,000
(iv)	Interest on fixed deposit and savings account with banks in India	2,00,000

India has no double tax avoidance agreement with Hong Kong. Compute the income and tax payable by Mr. Bansal for assessment year 2012-13.

Answer

Mr. Bansal is entitled to relief under section 91, since :-

- He is a resident in India during the relevant previous year.
- Income, by way of commission and dividend, accrues or arises to him outside India (in Hong Kong) during the previous year.
- Such income is not deemed to accrue or arise in India during the previous year.
- The income in question, namely, commission and dividend, has been subjected to income-tax in Hong Kong in the hands of Mr. Bansal and he has paid tax on such income in Hong Kong.
- There is no agreement under section 90 for the relief or avoidance of double taxation between India and Hong Kong.

Therefore, he is entitled to the deduction under section 91, from the Indian income-tax payable by him, of a sum, calculated on such doubly taxed income at the Indian rate of tax or at the Hong Kong rate of tax, whichever is lower.

Computation of total income and tax liability of Mr. Bansal for A.Y.2012-13

Particulars		₹
Income from business in India		2,50,000
Commission received from a company in Hong Kong		3,00,000
Dividend received from a company in Hong Kong		90,000
Interest on fixed deposits and savings account with banks in India		2,00,000
Total Income		8,40,000
Tax on the above:		
Upto ₹ 2,50,000	Nil	
Over ₹ 2,50,000 & upto ₹ 5,00,000 @ 10%	25,000	
Over ₹ 5,00,000 & upto ₹ 8,00,000 @ 20%	60,000	
Over ₹ 8,00,000 @ 30%	12,000	
		97,000
Education cess @ 2% and secondary and higher education cess @ 1%		2,910
Total tax liability		99,910

15.8 Direct Tax Laws

Average rate of income-tax in India: (99,910/8,40,000 x 100)	11.89%	
Average rate of income-tax in Hong Kong (78,000/3,90,000 x 100)	20%	
Double tax relief under section 91 shall be @11.89% or 20% of foreign income, whichever is less [i.e., 3,90,000 x 11.89%]		46,371
Net tax liability (₹ 99,910 – ₹ 46,371)		53,539

Question 9

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to explain whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per the scheme of section 91.

Question 10

The Income-tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X, excludes the income earned by X from the purview of tax. Is X liable to pay tax on the income earned by him? Discuss.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. X is, therefore, not liable to pay tax on the income earned by him.

Question 11

What is the circumstance in which it is not necessary for a non-resident Indian, whose total income is above the taxable limit, to file his return of income under section 139(1)?

Answer

Section 115G of the Income-tax Act, 1961 provides that it is not necessary for a non-resident Indian to furnish a return of income under section 139(1) if his total income only consisted of investment income or long-term capital gain or both and the tax deductible at source under Chapter XVII-B has been deducted from such income.

Question 12

Arif is a resident of both India and another foreign country in the previous year 2011-12. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lacs from rubber estates in the foreign country during the financial year 2011-12. He also sold some property situated in foreign country resulting in short-term capital gain of ₹ 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

The Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to state with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, 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 that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he

15.10 Direct Tax Laws

is deemed to be resident of that country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

- (a) the property is located and
- (b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2012-13.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460*, where the Supreme Court held that If an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2012-13 in respect of business income and capital gains arising in the foreign country.

Self-examination Questions

1. What is double taxation relief? Explain.
2. Explain the types of double taxation relief.
3. State the models on which tax treaties are generally based.
4. "Double taxation relief has now been extended to certain agreements adopted by the Government" - Discuss the correctness or otherwise of this statement.
5. How are IT-enabled Business Process Outsourcing units in India taxed? Are there any provisions in the Income-tax Act, 1961 governing taxation of such units?
6. Explain briefly the concept of permanent establishment.
7. Explain the meaning of the following terms in the context of provisions of double taxation relief - (a) Indian rate of tax; (b) Rate of tax of the said country.
8. An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists asks you to explain whether the credit of the tax paid on the income in that country will be allowed to him in India.
9. The Income-tax Act, 1961 provides for taxation of a certain income earned by Mr.X. The Double Taxation Avoidance Agreement, which applies to Mr.X, excludes the income earned by Mr.X from the purview of tax. Is Mr.X liable to pay tax on the income earned by him? Discuss.
10. Treaty Shopping is illegal and should be necessarily forbidden – Discuss the correctness of this statement.

11. Mr. Mahesh is a resident both in India and Malaysia. He owns some immovable properties (Rubber Plantations) in Malaysia. During the previous year 2010-11, he earned income from rubber estates in Malaysia. The Assessing Officer contended that the business income is assessable in India and brought the same to tax. Discuss the correctness of the contention of the Assessing Officer, taking into consideration the following -
- (i) Mahesh has no permanent establishment in India in respect of the business of rubber plantations.
 - (ii) Article 4 of the Double Taxation Avoidance Agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting States, he shall be deemed to be resident of the Contracting State with which his personal and economic relations are closer.

Answers

9. Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. X is, therefore, not liable to pay tax on the income earned by him.

10. Treaty shopping is a process by which a resident of a third country takes advantage of a fiscal treaty between two countries. The Supreme Court in *Union of India v. Azadi Bachao Andolan (2003) 132 Taxman 373*, observed that many developed countries tolerate or encourage "treaty shopping", even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to significant loss of tax revenue. The Court cannot judge the legality of "treaty shopping" merely because one section of thought considers it improper. The Supreme Court recognized that the Treaties are negotiated and entered into at political level and have several considerations as their bases. This was an important principle to be kept in mind in the interpretation of the provisions of an international treaty. The Court observed that if it was intended that a national of a Third State should be precluded from the benefits of a DTAA, then a suitable limitation to that effect must find place in the DTAA itself. In the absence of a limitation specifically provided in the DTAA, the same cannot be read into it.
11. The issue arising in this case is similar to the issue which has been settled by the Apex Court in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 137 Taxman 460*. In this case, the Apex Court observed the following -

15.12 Direct Tax Laws

- (1) Section 90(2) of the Income-tax Act, 1961 makes it clear that in case of any conflict between the provisions of Double Taxation Avoidance Agreement (DTAA) and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the provisions of the Act.
- (2) The tax liability arising in respect of a person residing in both the contracting States has to be determined with reference to that State with which his personal and economic relations are closer. The person shall be deemed to be a resident of that contracting State in which he has an habitual abode.
- (3) The immovable property in question (i.e. Rubber Plantations) is situated in Malaysia and income was derived from that property. Further, there was no permanent establishment (PE) in India in regard to the business of rubber plantations. Therefore, the business income from rubber plantations could not be taxed in India because of closer economic relations between the assessee and Malaysia, being the place where
 - (a) the property is located and
 - (b) the PE has been set up.These two factors go to determine the fiscal domicile.
- (4) If an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

Therefore, in this case, the contention of the Assessing Officer is not correct.