DOUBLE TAXATION: RELIEF UNDER DOMESTIC AND INTERNATIONAL LAWS

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ABSTRACT

Double taxation creates a hardship on the taxpayers by increasing the tax burden on them. Such multiple taxations decrease the flow of investment within the country because no person will have an interest in investing right after paying taxes twice just because he has earned income outside the country. Also, it may increase the price of goods or decrease the person's capacity to spend, discourage cross-border investment, and even violate the tax fairness principle. This Article's prime objective is to analyze the challenges of double taxation and study the legality and benefits of double taxation avoidance treaties in the way of bilateral treaties and statutory provisions.

KEYWORDS

Income Tax, Double Taxation, Unilateral Relief, Bilateral Relief, Double Taxation Avoidance Agreement.

1. INTRODUCTION

The strength of a nation's economy depends upon its system of taxation. The correct approaches taken towards it ensure the inflow of revenue and manage growth in our economy.

The term *"tax"* refers to something having monetary value and is paid by people to the government. The taxation system in India involves two kinds of taxes *i.e.,* Direct Tax and Indirect Tax. The Direct Tax is a tax in which the liability to pay tax does not shift and is payable by the persons who earns an income beyond a limited amount, otherwise not payable. The levying of such tax is based on the ability of the taxpayer, higher the income of a person, higher his ability to pay the tax. Indirect Taxes are the taxes wherein the burden to pay tax shifts ultimately to the consumers. With the 101st Amendment to the Constitution of India, all indirect taxes have been submerged into the Goods and Services Tax Act, 2017.

There must be a law to levy tax.[2] Without proper legislation, it shall be unlawful to impose tax. Paying tax on income earned is a characteristic of a responsible citizen but when the same individual is subjected to tax twice on the same income, it creates a burden on him and also refrains such person from making future investments in the country. Such payment of tax twice by the same individual on the same income is referred to as Double Taxation.

2. THE CONCEPT OF DOUBLE TAXATION

Double Taxation refers to the imposition of taxes more than once on the same income assets or financial transactions. It is a situation where an income is subjected to tax twice. In other words, it is a situation where an income is susceptible to being taxed twice. Double Taxation occurs in two ways, namely, Economic and juridical. Economic double taxation is when an income is taxed twice in the same country, whereas juridical double taxation refers to taxation when an income is taxed twice in different countries. Both these kinds of double taxation create an undue burden on the taxpayer.

In the absence of any specified definition of the term "Double Taxation", the Apex Court has made an attempt towards the same. He observed that "the traditional view regarding the concept of 'Double Taxation' is that to constitute double taxation, objectionable or prohibited, the two or more taxes must be (1) imposed on the same property, (2) by the same State or Government, (3) during the same taxing period and (4) for the same purpose. There could be no double taxation where (1) the taxes have been imposed by different states, (2) one of the impositions is not tax, (3) one is against the property and the other is not a property tax or (4) double taxation is indirect rather than direct", as observed in the case of ***Commissioner, Income Tax v. P.V.A.L. Kulandagan Chettiar***.[3]

Double Taxation could occur in two forms *i.e.,* Corporate Double Taxation and International Double Taxation. Corporate profit is subjected to tax twice, firstly on the corporate net earnings as Corporate Tax and secondly, when the dividend is distributed to its shareholder as dividend pay-outs. The argument behind such double taxation is that the corporation in the form of a company is a separate legal entity from its shareholders, therefore taxation on both the income are justified.

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[2] AIR 1961 SC 552.

[3] ***Kunnathat Thathunni Moopil Nair v. State of Kerala,*** [2004] 267 ITR 654 (SC).

International Double Taxation refers to the tax levied on the foreign income in the country where it has been derived as well as the country where the person resides. International double taxation mainly occurs in case of multinational entities that operate in jurisdictions other than their home country, but it can also have an effect on the income of a person earned in a foreign country. It is an issue that a single income is being taxed twice, i.e., at the place where it has been derived as well as where the income earning person resides.

3. BASIS ON WHICH INCOME IS TAXED

The income tax is assessable in India on the basis of residential status of an assessee. The residential status of a person is determined in accordance with the fulfillment of certain conditions.

The persons are divided into 3 basic categories, namely, resident and ordinarily resident, resident but not ordinarily resident and non-resident of India (NRI).

A person may be called a resident if he fulfills either of the below mentioned conditions.

a) If he has stayed in India in the previous year for 182 days or more; or
b) If he has stayed in India for at least 365 days during 4 years preceeding the previous year and for at least 60 days during previous year.[4]

However, there exists an exception to the above 60 days rule for the individuals who are resident of India but have left the country in any previous year for indulging into employment activities or as a crew member of an Indian ship or an Indian citizen or foreign national of Indian origin, living outside India, comes to visit India in the PY, they must have stayed in India for at least 182 days during the PY in lieu of 60 days. The term "employment" includes self-employment in the way of business or profession performed or practiced in abroad as held in ***Commissioner of Income Tax v. Abdul Razak & Co.***[5]

In India, income tax is levied on the basis of residence. So, even if a foreigner is staying in India and fulfilling any of the above mentioned conditions, s/he will be subjected to income tax. However, it is not necessary that the stay should be for a continuous period of time.

Any person who is not able to fulfill any of the above mentioned conditions, he shall be called a non-resident and he will not be subjected to lax liability. In the case of ***Manoj Kumar Reddy v. IT Officer***,[6] it was held that the term 'day' doesn't include a fraction of day. The assessee's total stay was only for a period of 59 days in the previous year as he arrived at 4:00 AM and that's why he was declared to be a non-resident.

In order to determine a person to be a resident and ordinarily resident, the additional conditions are to be fulfilled apart from the basic conditions mentioned above.

Both of the additional conditions are to be fulfilled in order to declare a person resident and ordinarily resident. The conditions are:

a) He has been a resident of India in at least two out of ten previous years preceding the relevant previous year; and
b) He has been in India for at least 730 days in all during the seven previous years preceeding the relevant previous year.[7]

If a person fulfills either of the basic conditions but is not able to fulfill both the additional conditions, he will be called a resident but not ordinarily resident.

Considering Double Taxation, the jurisdiction regarding taxation of income can either be based on the relationship of the income to the taxing state or the relationship of tax payer to the taxing state based on residence or nationality. Under the source principle, the tax is levied on the basis of income generating in that particular state *i.e.* the state within whose boundaries a person is earning has the power to levy tax because of the assets or opportunities are generated within the territories of that state only.

Under the residence principles, the income tax is levied on the basis of residence. In other words, the state's claim to tax income is based on the relationship of the state to the person deriving such income.

4. RELIEF AGAINST DOUBLE TAXATION

Although it is rather a simple point, it should be highlighted that the Supreme Court has made it clear that if a foreign person doesn't owe any income on a payment received, the Indian resident making the payment to the foreign person has no withholding requirement as declared in the case of ***GE India Technology Centre (P) Ltd. v. Commissioner of Income Tax***.[8]

The issue of Double Taxation can be avoided if there exists either a domestic legislation regarding the same or

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[4] S. 6(1), Income Tax Act, 1961.
[5] 1982 136 ITR 825 (Guj).
[6] (2009) 132 TTJ 328.
[7] S. 6(6)(a), Income Tax Act, 1961.
[8] [2010] 327 ITR 456 (SC).

any bilateral treaty binding the member countries.

- **Unilateral Relief**

In accordance with Section 91 of the Act, a relief is granted to an individual, exempting him from paying tax twice irrespective of the fact that there exists no DTAA between India and the foreign nations.
For the fulfillment of the provisions under Section 91, the following conditions are mandatory:

1. The individual or corporation seeking unilateral relief must be a resident of that state in the previous year.
2. The income on which the tax is levied should have been earned by the individual in a foreign country i.e., outside India, in the previous year.
3. The income should have been taxed twice i.e., in the residence country and the foreign country where there is no Double Taxation Avoidance Agreement.
4. The income tax levied in the foreign country has been paid by the individual.

Countries with which no agreement exists (Section 91)

The relief provided under Section 91 is a unilateral relief and is granted to the tax payers when there is no DTAA between India and the country where that income is being earned.
If any person, being a resident of India in any previous year proves that, in respect of his income which has accrued or arose during such PY outside India, he has paid income tax on such income in any country which does not have any agreement with India under Section 90 of the Act, for the avoidance of double taxation, he shall be entitled to deduction from Indian income tax levied on him of a sum calculated on such double taxed income at the rate prescribed in India or in the other country, whichever is lower and if, in case, the rates are equal, then at the Indian tax rate.[9] "If a person, resident of India in any PY in respect of his income accruing or arising during that PY in Pakistan, he proves that he has paid tax in that country, by deduction or otherwise, tax payable to the government under any law for the time being in force relating to taxing of agricultural income, he shall be entitled to deduction from Indian income-tax of all the amount of tax paid in Pakistan on such income liable to tax in India as well or of a sum calculated on such income at the tax rate of India, whichever seems to be less."[10]
Further, if a non-resident is assessed on his income share of a registered firm which is assessed as a resident in India in any PY and such share of income includes any income accruing or arising outside India during such PY , which is not deemed to accrue or arise in India, in a country with which there is not DTAA under Section 90 for the avoidance of double taxation and he proves that he has paid tax on such income by deduction or by otherwise under the law in force in such country , he shall be entitled to deduction from the income tax levied in India on the rate of such country which is lower or if they are equal, at the rate prescribed in India.[11]
Various statements have been interpreted in the section as explanation in order to provide a specific meaning to the terms enumerated under the said provision. The term "Indian Income Tax" means income-tax charged according to the provisions of this Act".[12] "*Income Tax Rate*" refers to the rate which was settled or 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.[13] Also, "*rate of tax of the said country*" means the rate that has been prescribed in the place which is outside the territory of India or any specified territory. In other words, it refers to the tax rate set on and actually paid in the foreign country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before subtraction 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.[14]

- **Bilateral Relief**

The Bilateral relief refers to the relief granted by both the residence country and the source country though Double Taxation Avoidance Agreements (DTAA) and has been enumerated under Section 90. Such relief could either be on the basis of Exemption Method and Tax Credit Method.

Agreement with Foreign Countries and Specified Territories (Section 90)

The Central Government is vested with the power to enter into an agreement with the government of any foreign country or any specified territory which is outside India, for providing relief with regards to income on which tax has been levied both in India and the other country or specified territory which is outside India or providing relief on the income tax chargeable under this Act and under the law in force in the other country for promoting

[9] S. 91(1), Income Tax Act, 1961.
[10] S. 91(2), Income Tax Act, 1961.
[11] S. 91(3), Income Tax Act, 1961.
[12] S. 91, Expln. 1, Income Tax Act, 1961.
[13] S. 91, Expln. 2, Income Tax Act, 1961.
[14] S. 91, Expln. 3, Income Tax Act, 1961.

mutual economic relations, trade and investment.[15] Treaty is basically a negotiated document, wherein governments of two countries agree to share their taxing rights. However, for the application of such treaty, the ratification done by the member countries is mandatory. In accordance with international laws, the ratification is required in order to make such treaty binding on the parties to it and therefore, the countries which have ratified such Double Taxation Avoidance Agreements are adhered by such treaties.

The Central Government may also indulge into DTAA with other nations for avoiding Double Taxation of income under the Income Tax Act, 1961 and under corresponding law in force in the foreign country with no scope for creating opportunities for non-taxation or tax avoidance or tax evasion.[16] Further, the agreement may be useful in order to share the information between the countries through such DTAA regarding the exchange of information for the prevention of tax evasion or avoidance or for the investigation of such cases of evasion and avoidance.[17] At present, India has entered into Double Taxation Avoidance Agreement with more than 80 countries, including Malaysia, Bhutan, The united States of America, Singapore *etc.*

The Central Government may also enter into an agreement with the government of other nations regarding recovery of income tax under the said Act or under any corresponding law in force in the other country.[18]

Section 90, Sub-section 2 of the Act[19] states that where the Central Government has come into an agreement with the government of any foreign country or any specified territory outside India, in accordance with the provisions of Sub-section 1, for providing relief from tax, or avoiding double taxation, then, in relation to that assessee to whom such agreement applies, the provisions shall apply to the extent that they are more beneficial to the assessee. However, the provisions of Chapter X-A, shall apply despite the fact that those provisions are not beneficial to that assessee.[20]

There are certain conditions in order to receive a relief from double taxation, an assessee, not being a resident, to whom an agreement referred to in Sub section (1) applies, shall not to entitled to receive any sort of relief under such DTAA unless he submits a certificate of his residence in any country outside India or specified territory outside India which has been obtained by him from the government of that foreign country or specified territory.[21] Apart from the certificate of residence, the assessee shall also provide other documents as are required.[22]

Section 90 has enumerated various explanations which are beneficial in literal interpretation of the provisions of the section. There are four explanations stated under the said provision wherein, the term “Specified Territory” means any area which is outside India which may be notified as such by the central government.[23]

Keeping it specific, the Section 90 of the Act provides relief to the tax payers by entering into an agreement which is basically called as Double Taxation Avoidance Agreement with the government of other countries and thus avoiding Double Taxation. This section provides bilateral relief to the tax payer, bilateral because it is done on the basis of an agreement made between the governments of two countries.

With the view of summarizing the scope of Section 90 of the Income Tax Act, 1961, Section 90 is intended to grant relief in reference to the following situations:

1. Income on which tax has been levied and paid in accordance with the Income Tax Act, 1961 as well as the corresponding law in force in the territory or in other specified territory.
2. Such income tax is chargeable under the stated laws in order to enhance mutual economic relations, trade and investments.
3. For exchanging information in regards to tax evasion and tax avoidance or for investigations of such cases.
4. For recovery of income tax which has been tried to be evaded or avoided in both the countries parties to such Double Taxation Avoidance

Adoption by Central Government of agreement between specified associations for Double Taxation Relief (Section 90A)

Section 90A has been inserted in Chapter-IX of the Income Tax Act, 1961 and it came into effect from the 1st of June, 2006. The provisions of the stated section states that any specified association present in India may enter into an agreement with any specified association in the specified territory situated outside India. The central government may, through a notification in the Official Gazette, make provisions which are deemed to be necessary for adopting and implementing such double taxation avoidance agreement in regards to:

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[15] S. 90(1)(a), Income Tax Act, 1961.
[16] S. 90(1)(b), Income Tax Act, 1961.
[17] S. 90(1)(c), Income Tax Act, 1961.
[18] S. 90(1)(d), Income Tax Act, 1961.
[19] S. 90(2), Income Tax Act, 1961.
[20] S. 90(2-A), Income Tax Act, 1961.
[21] S. 90(4), Income Tax Act, 1961.
[22] S. 90(5), Income Tax Act, 1961.
[23] S. 90, Expln. 4, Income Tax Act, 1961.

a) Grating relief in respect of-
   i) Income on which income tax has been paid both in India and in the specified territory outside India; or
   ii) Income on which income tax is chargeable under this Act or under any corresponding law in force in the foreign country in order to promote mutual economic relations, trade and investments; or
b) Avoidance of double payment of tax on income under this Act or under the corresponding law in force in the specified territory outside India, or
c) The exchange of information for preventing tax evasion and tax avoidance under Indian law or Foreign law, or
d) The recovery of income-tax under the provisions of this Act or under the corresponding law in force in the territory outside India.[24]

The term "*specified association*" means "any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of any specified territory outside India and which may be notified as such by the Central Government for the purposes of this Section."[25]

In cases where there has been an agreement between a specified association in India and an association of any specified territory outside India under Sub-section (1) and such agreement has been notified for the grant of relief from double taxation or for the avoidance of tax evasion then, in relation to the assessee on whom such agreement is applicable, the provisions of this Act shall apply to an extent which is beneficial to such assessee.[26] However, any assessee who is not a resident and on whom such terms of agreement apply, he shall not be entitled to any relief under such agreement unless he provides a certificate of him being a resident of a foreign country which has been provided to him by the government of such foreign country.[27] Along with the certificate of residence, the assessee shall also provide such other documents and information as and when required by the authorities for claiming benefit under such agreements.[28]

The sub-section (2A) of Section 90A[29] states that notwithstanding anything stated under sub-section (2), the provisions of Chapter X-A shall be applicable on the assessee even if such provisions deem to be not fruitful or beneficial to such assessee.

5. MEASURES TO AVOID DOUBLE TAXATION

When it comes to reliefs from international double taxation, there are two basic reliefs, *viz.*, the exemption method and the credit method. These reliefs are to be sought on unilateral basis or within the framework of bilateral treaties.

- **Exemption Method**

By the very name, it suggests that exemption method involves exemption of certain items of income by its residents in another state. It may be done in accordance with the domestic legislation or by a treaty. Under domestic legislation, the exemption would be granted without reference to the state where it has generated, whereas an exemption granted *via*. treaty would be limited to treaty states only. While typically considering the effects of exemption method, it could be stated that where an item of income is generate in the state, the source state owns an exclusive right to levy tax on that item of income.

- **Tax Credit Method**

In the tax credit method, the foreign income tax paid by the residents in the source country, is treated as if the tax is paid of the resident country itself. Within statutory provisions or bilateral agreements, if the domestic tax rate is quite higher than the foreign tax rate, only the excess of such tax is payable by the resident to the residence state. If the foreign tax rate is relatively higher than the domestic tax rate, in such case no tax is levied on the residents by the residence country.

The states which follow the tax credit method reduce their tax claims on their residents by the tax amount which the residents have already paid as a tax to the country where the income has been earned *i.e.,* the source country.

6. CONCLUDING REMARKS

Despite the existence of provisions supporting double taxation of income, according to the general principles of taxation, it would be unreasonable to tax an individual twice on the same income earned in different countries since the income was only one. Similarly, the double taxation levied on corporations is against the principle of equality just because the mode behind such business is different, the taxability is higher. If, in place of a

[24] S. 90A(1), Income Tax Act, 1961.
[25] S. 90A, Expln. 2(a), Income Tax Act, 1961.
[26] S. 90A(2), Income Tax Act, 1961.
[27] S. 90A(4), Income Tax Act, 1961.
[28] S. 90A(5), Income Tax Act, 1961.
[29] S. 90A(2A), Income Tax Act, 1961.

company, there would have been a firm, then such firm wouldn't have been subjected to tax twice on the same level of income. It could be deciphered that the double taxation of income is a serious issue which needs to be tackled in an effective and efficient manner providing relief to the tax payers and thus, fostering the investment flow within the country by providing laws and regulation friendly towards the tax payers of the country.
With an aim to provide relief to the tax payer, the Income Tax Act, 1961 has within it enumerated reliefs mentioned under Sections 90, 90A and 91, in compliance with various Double Taxation Avoidance Agreements. However, it is well established that domestic laws shall prevalence over the international laws in tackling the issue of double taxation.