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Comparative Analysis Of Bilateral Tax Exemption Policy Of India And Its Effect With China, Us, Germany And Russia

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***Abstract-* In the present scenario cross-border transactions across the world takes place, due to which there is unique growth in international trade and commerce and increasing interaction among the nations, residents of one country extend their sphere of business operations to other countries where income is earned. Introduction noticeable impact of one country's domestic tax policies on the economy of another country is the product of globalization. Therefore, the consequence of taxation is one of the important considerations for any trade and investment decision in any other countries.**

***Keywords*— Bilateral Tax Exemption Policy Of India, Effects**

I. INTRODUCTION

In common parlance, treaty is a formally concluded agreement between two or more independent nations. The Oxford Companion to Law defines a treaty as "an international agreement, normally in written form, passing under various titles (treaty, convention, protocol, covenant, statute and declaration) concluded between two or more states, on subject of international law intended to create rights and obligations between them and governed by international law. For Example- DTAA[1]

The Double Tax Avoidance Agreement (DTAA) is essentially a bilateral agreement entered into between two countries. DTAA, is a tax treaty signed between India and another country so that taxpayers can avoid paying double taxes on their income earned from the source country as well as the residence country. At present, India has double tax avoidance treaties with more than 80 countries around the world.[2] A treaty is not a taxing statue, although it is an agreement about how taxes are to be imposed. It is an act between two sovereign states and terms and conditions mentioned therein have to be strictly followed.[3]

In simple words, a double tax avoidance treaty is a mutual agreement between two countries so that their citizens can avoid paying tax on the same income in two countries. Generally, each country allows their residents to claim a credit for taxes paid on the same income to the other country.[4]

II. NEED AND IMPORTANCE OF DTAA

The need and purpose of tax treaties has been summarized by the OECD in the 'Model Tax Convention on Income and on Capital' in the following words:

"*It is desirable to clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation.*"

The need for DTAA arises because of conflicting rules in two different countries about chargeability of income on basis of receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, this is approved internationally so it's not definite. Double taxation occurs when an individual is forced to pay two or more taxes for the same income, asset, or financial transaction in different countries. Double taxation occurs mainly due to overlapping tax laws and regulations of the countries where an individual operates his business[5]

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[1] By Rajkumar S. Adukiya on Double Taxation Avoidance Agreements and Taxation available at http://taxguru.in/income-tax/double-tax-avoidance-agreements-taxation.html last visited on 7th November 2016.

[2] https://www.bankbazaar.com/tax/double-taxation-avoidance-agreement.html.

[3] By Kinjesh Thakkar on Basic Aspect of International Taxation and DTAA available at http://taxguru.in/income-tax/basic-aspects-international-taxation-dtaa.html last visited on 7th November 2016.

[4] Explaination of DTAA by examples available at http://nriinformation.com/questions9/question643.htm last visited on 7th November 2016.

[5] http://carajput.com/DTAA.aspx#.WCmcNON97IU

III. OBJECTIVES OF DTAA POLICY

The object of a DTAA is to provide for the tax claims of two governments both legitimately interested in taxing a particular source of income either by assigning to one of the two the whole claim or else by prescribing the basis on which tax claims is to be shared between them.[6] The basic objective is to promote and foster economic trade and investments between two Countries by avoiding double taxation. It helps in avoiding and alleviating the adverse burden of international double taxation. Secondly, and equally importantly tax treaties help a taxpayer of one country to know with greater certainty the potential limits of his tax liabilities in the other country.[7]

IV. TYPES OF DTAA

1. Comprehensive DTAA: It covers almost all types of incomes covered by any model convention.[8] DTAA Comprehensive Agreements is to addressing all source of income.[9]
2. Limited DTAA: These are limited to only certain types of incomes, e.g. DTAA between India & Pakistan is limited to only shipping and aircraft profits. Limited Agreements scope to cover only: Income from operation of aircrafts and ships, estates, inheritance and gifts.

V. MODELS OF DTAA

Models developed over a period of time based on which treaties are drafted and negotiated between two nations. These models assist in maintaining uniformity in the format of tax treaties. They also serve as checklist for ensuring exhaustiveness or provisions to the two negotiating countries.

OECD Model is a treaty between two developed nations and it lays emphasis on right of state of residence of tax.

UN Model- (a) Taxation of income from foreign capital would take into account expenses allocable to the earnings of the income so that such income would be taxed on a net basis, that

(b) Taxation would not be so high as to discourage investment and that

(c) It would take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either foreign tax credit or exemption as in the OECD Model Convention.[10]

VI. COMPARATIVE ANALYSIS OF DTAA POLICY

Sl No	BASIS	CHINA	GERMANY	RUSSIA	U.S
1.	**Scope of Convention (Resident of one or both of the contracting states)**	Provided in Article 1	Provided in Article 1	Provided in Article 1	Given in Article 1. The Convention shall not restrict in any manner any exclusion,exemption, deduction, credit or other allowance. The term "citizen" shall include former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax, but for a period of 10 years following such loss.

[6] Ostime (Inspector of taxes) v. Australian Mutual Provident Society (1960) 39 ITR 210 (HL).

[7] By Kumar Sumeet On DTAA available at http://www.legalserviceindia.com/article/l304-Double-Taxation-Avoidance-Agreements.html last visited on 7th November 206.

[8] http://www.taxqueries.in/income-tax/dtaa-tax-rates/.

[9] http://www.caclubindia.com/articles/understanding-double-tax-avoidance-agreement-9804.asp.

[10] http://taxguru.in/income-tax/double-tax-avoidance-agreements-taxation.html

2.	**Taxes covered (in india- The income-tax including any surcharge thereon)**	Taxes on income, taxes on gains from the alienation of movable/immovable property, taxes on capital appreciation. a. In China (i).Individual income-tax; (ii).Income-tax for enterprises with foreign investment and foreign enterprises; (iii).Local income-tax; In India as provided.	Taxes on income and capital, taxes on gains from the alienation of movable/immovable property, and the pay roll tax. a.In Germany (i) Income-tax, (ii)Corporation-tax, (iii)Capital tax and (iv) Trade tax In India as provided.	Income imposed in contracting State. a. In Russia (i) Taxes on profits of enterprises and organisations; (ii)The income-tax on individuals In India as provided.	a. In United States, (i).The Federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes), (ii).The excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations Convention shall apply only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to exemption. (b) in India: (i) As provided but excluding income tax on undistributed income of companies imposed under IT Act; and (ii) the surtax
3.	**Resident (Resident of both contracting states: (i)Permanent home available or where economic relations are closer. (ii) State in which he has habitual abode. (iii) State of which he is a national. (iv)Settle the question by mutual agreement.)**	Resident of a Contracting State is liable to pay tax by way of residence, domicile, place of head office. Given in Article 4	Resident of a Contracting State is liable to pay tax by way of residence, domicile, place of management but it does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. Given in Article 4	Resident of a Contracting State is liable to pay tax by way of residence, domicile, place of registration and management. Given in Article 4	Given in Article 4.
4.	**Dividends**	As provided in Article 10 and the	As provided in Article 10 and the	As provided in Article 10 and	As providd in Article 10 and if beneficial

	(company paying the dividends is a resident and according to the laws of that State)	beneficial owner of the dividends the tax so charged shall not exceed 10% of the gross amount of the dividends.	beneficial owner of the dividends the tax so charged shall not exceed 10% of the gross amount of the dividends.	dividends paid out by a Russian company to a foreign company may be taxed both in Russia and in the country of which the foreign company is a resident. Dividends to which DTTs might apply may be taxed at rates lower than those set by national legislation, i.e, tax shall not exceed 10% of the gross amount of the dividends.	owner then tax shall not exceed a.15% of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 % of the voting stock of the company paying the dividends. b. 25% of the gross amount of the dividends in all other case
5.	**Capital gains (alienation of shares of a company which is a resident of a contracting state may be taxed in that state)**	Under Article 13, along with alienation of immovable property referred to in Article 6 and situated in the other Contracting State may also be taxed in that other State.	Under Article 13, along with alienation of immovable property referred to in Article 6 and situated in the other Contracting State may also be taxed in that other State.	Under Article 13, along with alienation of immovable property referred to in Article 6 and situated in the other Contracting State may also be taxed in that other State.	Under Article 13, except Article 8, capital gain may be taxed according to the domestic laws of the contracting State.
6.	**Non-discrimination (no person shall be subjected to obligations which are more than the obligations of the state of which he is a resident or would have been subject to under similar circumstances.)**	Under Article 24 it is expressly stated.	Stated under Article 24. This applies only to residents not on Article 1 or persons not the resident of one or both of the contracting states.	Stated under Article 24. This applies only to residents not on Article 1 or persons not the resident of one or both of the contracting states. Taxation of Russian companies owned by residents of one foreign country are subject to comparison (non-discrimination) with taxation of companies owned by residents of other foreign countries. This rule also extends to the activity of foreign entities which	Under Article 26, it is expressly stated.

				creates a permanent establishment in Russia.	
7.	**Exchange of Information (routine basis or on request with reference to particular cases or both)**	It is not expressly given in Article 26.	It is not given expressly given in Article 26.	It is provided in Article 26 and States shall agree from time to time on the list of the information or documents which is to be furnished on routine basis. Such information may be disclosed in the course of open court hearings or in court decisions. Exchange of information is not limited to information on the parties mentioned in the DTTs.	It is provided in Article 28 and States shall agree from time to time on the list of the information or documents which is to be furnished on routine basis. This Article will not apply on Article 2(Taxes Covered),ie, In India to income tax, wealth tax and gift tax. In US all taxes imposed under Title 26 of the United States Code.
8.	**Termination (a. any of the contracting state may terminate it b. written notice to be given c. In India Income arising in any previous year beginning on or after the first day of April next following the calendar.)**	By any of the State and on or before the thirtieth day of June in any calendar year beginning after the expiration of a period of five years from the date of its entry into force (a)In China Income arising in any taxable year beginning on or after the first day of January next following the calendar. In India, as provided in Article 29.	By any of the States and on or before the thirtieth day of June, in any calendar year beginning after the expiration of a period of five years from the date of its entry into force. (a)In Germany i. Taxes withheld at source amounts paid on or after the first day of January of the calendar year. ii. Taxes levied for periods beginning on or after the first day of January of the calendar year next. In India as provided in Article 29.	By any of the State or by giving notice of termination at least six months before the end of any calendar year after the expiration of a period of five years from the date of its entry into force. (a)In Russia i. Taxes withheld at source, to income arising on or after the first day of January in the calendar year next. ii. Taxes arising for any fiscal year beginning on or after the first day of January in the calendar year. In India as provided in Article 29.	By any of the State, on or before the thirtieth day of June in any calendar year beginning after the expiration of a period of five years from the date of the entry into force. (a)In US i. Taxes withheld at source amounts paid on or after the first day of January next following the calendar year. ii. Other taxes, for taxable periods begin following the calendar year. In India as provided in Article 31.

VII. DOUBLE TAXATION AVOIDANCE AGREEMENT OF RUSSIA

1. *Permanent establishment*

Under the DTT, profit tax is not levied on the profit of foreign companies obtained from business activity in Russia, except in cases when a company is engaged in business activity via a permanent establishment set up in Russia. The DTTs set certain thresholds above which foreign organizations are recognized as having a permanent establishment.

Generally, the term "permanent establishment" means a fixed place of business through which an enterprise from a Contracting State regularly (partially or completely) engages in business activity in another Contracting State. It is provided in Article 5 of DTAA.

The term "permanent establishment" includes specifically: a) place of management; b) branch;
c) office; d) factory; e) workshop; f) mine, oil or gas well, quarry, or any other place for extracting natural resources.

In case the national legislation sets higher thresholds for recognizing the existence of a permanent establishment (that is, ones less favorable for the taxpayer), the provisions of the appropriate DTT are applied (more favorable ones).

The profit received through a permanent establishment is taxed only for that portion which the permanent establishment could have received if it had existed as an independent entity under similar conditions.

2. *Loan interest*

Interest payable to a foreign resident is taxed at the source of the payment in Russia. Moreover, DTTs might stipulate an exemption from tax in Russia or a reduced tax rate at the source. Exemption and a reduced tax rate do not apply to interest related to the permanent establishment of a foreign resident in Russia. In a situation where companies are interdependent, interest is exempt from taxation only to the extent which would be agreed to between independent entities; for the remaining excess portion, the accrued interest is taxed as profit tax in accordance with Russian law.

3. *Royalties*

Income from royalties paid by a resident of Russia to a foreign resident is subject to Russian taxation at the source of payment. DTTs may envisage tax exemption in Russia or a reduced tax rate at the source. Exemption and a reduced tax rate do not apply to royalties related to the permanent establishment of a foreign resident in Russia.

In the event that the payer of royalties and the recipient have special (dependent) relations, then the amount of income paid in the form of royalties is not taxed only on the portion that would have corresponded to the amount of royalties paid under similar conditions between independent entities.[11]

4. *Beneficial Owner*

As a rule, DTTs grant exemption or a reduced tax rate for dividends, interest and royalties provided that the recipient of the income acts as a beneficial owner. A beneficial owner is recognized to be any individual or legal entity enjoying benefits of receipt of income. The concept of beneficial owner is intended to limit the application of DTTs in cases when an agent or nominee acts as the recipient of the income, as well as to prevent tax evasion with the help of conduit companies.

5. *Capital gains*

Russian profit tax is levied on income received by a foreign resident from alienation of real property located in Russia. This rule extends likewise to income arising from the sale of shares or other corporate rights in Russian companies whose assets principally consist of real estate located in Russia. Moreover, some DTTs allow one to avoid paying profit tax in Russia in connection with a foreign resident's sale of shares or other corporate rights in Russian companies whose assets principally consist of real estate located in Russia.[12]

VIII. DOUBLE TAXATION TREATY INCREASE FOREIGN DIRECT INVESTMENT TO DEVELOPING COUNTRIES

Developing countries invest time and other scarce resources to negotiate and conclude double taxation treaties (DTTs) with developed countries. They also accept a loss of tax revenue as such treaties typically favours residence-based over source based taxation and developing countries are typically net capital importers. The incurred costs can only pay off if developing countries can expect to receive more foreign direct investment (FDI) in return. Developing countries that have signed a DTT with the US or a higher number of DTTs with important capital exporters actually do receive more FDI from the US and in total.[13] Developing countries that are signing a DTT with the United States are getting benefit from a higher FDI stock and share of FDI stock originating from US investors.

- The elimination of double taxation and the other advantages offered to taxpayers – in particular reductions in compliance costs – from the treaty are expected to encourage inflows of investment.
- If the tax treaty shifts taxing rights from the developing to the developed country, and the latter avails itself of these taxing rights, that

[11] http://www.incometaxindia.gov.in/DTAA/Comprehensive%20Agreements/108690000000000074.htm.

[12] http://legalknowledgeportal.com/2013/06/14/double-taxation-treaties-in-russia/.

[13] http://eprints.lse.ac.uk/3054/1/Do_double_taxation_treaties_increase_foreign_direct_investment_to_developing_countries(LSERO).pdf

may create an incentive for investors to reallocate capital to the developing country, where the tax cost is lower.

- In the case of developing countries, the conclusion of a treaty may have a signaling effect by indicating that the country is creating an encouraging environment for investment.
- Tax treaties also offer stability for investors in tax treatment, since in most instances unilateral changes to domestic law cannot override the treaty unless it is renegotiated.[14]

IX. CASES

Automated *Securities clearance Inc. v. Income Tax Officer*

The question was whether a non-resident company could be given the benefit under Section 80 HHE on the basis of the non-discriminatory clause under Article 26(2) of the Indo-US DTAA. Rejecting the claim of the assesse the Hon'ble ITAT held that Section 80HHE did not attract the non-discrimination clause under Article 26(2) of the Indo-US DTAA. The ITAT held that: "It is thus clear that in order to establish discrimination not only that a taxpayer has to demonstrate that he has been subjected to different treatment vis-à-vis other taxpayers but also that the ground for this differentiation in treatment is unreasonable, arbitrary or irrelevant. In our considered view irrespective of whether at the end of the day such a differentiation turns out to be a very wise and pragmatic differentiation or not there is a reasonable basis of this approach of granting tax incentives to exporters only in the cases where exports are made by the resident taxpayers."

1. *Raman Chopra v. Deputy Commissioner of Income-tax*[15]

The assesse, derived income from salary and income from other sources. During year 2010-11, the assesse was working in USA from 1-4-2010 to 1-7-2010 and the assesse claimed exemption as per article 16(1) of DTAA between India and US.

Contention of Income Tax Department (ITD) was that since the period of assesses stay in India was more than 183 days, his entire global income should be taxed in India and as such assesses claim for exemption under article 16(1) was disallowed and said sum was added back to the total income of the assesses. Based on above disallowance, the Assessing Officer (AO) also initiated penalty proceeding under section 271(1)(c) and levied penalty.

ITAT in this case ordered As the assese may be considered liable to tax both in India and US as per the tax laws in each jurisdiction, a determination of the residential status as per the India – USA DTAA has to be done based on the tie breaker analysis as contained in Article 4(2) of the DTAA.

Based on the tie breaker analysis, the assesse is tie-breaking to USA for the period 1-4-2010 to 30-6-2010. Accordingly, the assesse shall be considered as a resident of USA for the period 1-4-2010 to 30-6-2010 as per the Treaty.

Since the assesse was a resident of USA for the period 1-4-2010 to 30-6-2010 and had exercised his employment in USA during the above period, he was entitled to claim exemption of salary in India as per article 16(1).

Section 271(1)(c) postulates imposition of penalty for furnishing of inaccurate particulars and concealment of income. On the facts and circumstances of this case, assesses conduct cannot be said to be contumacious so as to warrant levy of penalty. It was held that even if assesse qualifies as a resident as per Indian tax rules, he need not report USA salary in Indian tax returns if he qualifies as a resident of USA for that period as per Article 16(1) of India USA DTAA.

3. *Hapag Lloyd Container Linie Gmbh v ACIT* [16]

The Tribunal held that provisions of the Act should apply to the extent they are more beneficial to that taxpayer as per Section 90 (2) of the Act. The Tribunal observed that the taxpayer was not engaged in the business of obtaining tax refund and earning interest. The Tribunal also observed that the payment of tax is the responsibility of the foreign company, which is determined after computation of its income. The tax is not expenditure but is an item of appropriation of profits. Interest in Income Tax refund is includible under Article 11 & not under Article 8-3 of DTAA.

4. *ADIT v Chiron Behring Gmbh & Co KG*

Royalty income earned by a resident of Germany from India has to be assessed to tax at the rate of 10% as provided in Article 12 of DTAA.

5. *Asst. DIT vs. Delata Airlines Inc* [17]

It had been decided that charter of aircraft would alone fall within the ambit of paragraph 2(b) of Article 8 of Indo-US Treaty. Deposit of amount in FDR could not be said to be connected with operation of aircrafts paragraph 5 of Article 8 would not apply.

6. *Factset Research Systems Inc*[18]

Subscription fee received by applicant from the licensee (customer) for providing database containing financial and economic information of companies worldwide was

[14] https://martinhearson.wordpress.com/2012/11/27/do-tax-treaties-increase-foreign-investment-in-developing-countries/

[15] [2016] 69 taxmann.com 452 (Delhi – Trib.)

[16] 9 Taxmann.com 126.

[17] 124 ITD 114.

[18] 25 DTR 146

not royalty within the meaning of s. 9(1)(vi), Explaination. 2 or art 12 of DTAA between India and USA as no exclusive right or copyright was made over to customer and it did not amount imparting of information concerning the applicant's own knowledge, experience or skill in commercial and financial matters.

7. *UOI vs. Azadi Bachao Andolan*[19]

It has been clarified that wherever a certificate of residence is issued by Mauritius Authority, such certificate will constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying DTAA accordingly. Hence a number of cases of treaty shopping had been observed which is very legal.

8. *DDIT v Reliance Industries Limited*[20]

Payment made by assessee for purchase of a software program from A non resident, having no PE in India, cannot be considered as a royalty either under income tax act or under DTAA.

9. *Rajeev Sureshbhai Gajwani v. ACIT*[21]*(ITAT Ahmedabad – Special Bench)*

It was held that despite bar in Section 80HHE, non-residents are eligible for deduction in view of non-discrimination clause in DTAA. The assesse, a citizen of America and a non-resident, exported software from a PE in India and claimed deduction u/s 80HHE in respect of the profits earned from export of computer software by invoking the provisions of Article 26(2) of the India-USA DTAA. He claimed that in view of Article 26(2), he could not be treated less favorably than a resident assesse. Section 80HHE is available only to domestic companies.

Held by the Special Bench: "Article 26(2) of the India-USA DTAA provides that the taxation of a PE of an enterprise of a Contracting State in the other Contracting State shall not be less favorably levied in that other State than the tax levied on enterprises of that other Contracting State carrying on the same activities. In simple language, Article 26(2) means that taxation of a PE of a USA resident shall not be less favorable than the taxation of a resident enterprise carrying on the same activities. The result is that the exemptions and deductions available to Indian enterprises would also be granted to the US enterprises if they are carrying on the same activities. As the assessee was carrying on the "same activities" of export of software as done by residents it was entitled to Section 80HHE deduction as admissible to a resident assesse.

Thus, as per this Ruling:

(1) If there are certain exemptions and deductions that are not available to a non-resident and would have been available to the non-resident had it been an Indian company then it can be held that it is less favorably treated.

(2) For the application of Article 26(2), it is sufficient to show that the non-resident is engaged in the same business as the resident it is treated less favorably to. The different circumstance in which the business may be being performed is not to be considered.

(3) There is no scope of reasonable differentiation.

X. CONCLUSION

The treaty with India, which had underpinned the emergence of Mauritius as the dominant channel for FDI into India, has been under attack from Indian tax authorities as a result of alleged abuses by Indian-resident investors. After a series of high-profile court hearings, the status quo appeared to have been restored. However, rumblings from the Indian authorities with regard to the alleged 'abuses' are still continuing in 2011 and 2012 and it was announced in June 20122 that discussions between the two countries to amend the treaty are to commence soon. For the purpose of claiming a tax treaty benefit, it is necessary for a person non-resident in India to obtain a certificate of being resident of the other country or specified territory.

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[19] 263 ITR 706 (SC).

[20] 8 taxmann.com 182

[21] 2011-TII-38-ITAT-AHM-SB-INTL

