

NAVIGATING THE INTRICACIES OF DOUBLE TAXATION AVOIDANCE AGREEMENTS: AN ANALYSIS OF INDIA APPROACH

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ABSTRACT

In the context of globalization and internationalization in particular, the key factors for further development at the micro and macro level, are fundamental for the free movement of capital, goods, services and people. However, the concept of cross-border investment entails the movement of business and related transactions across national borders; this is one of the more frequent causes of double taxation. This situation remains a major issue as it discourages FDI, imposes a burden on international business, and slows down the optimal flow of resources in the global economies. As a result, to alleviate repercussions of the phenomenon of DTA and encourage the appropriate climate for international economic cooperation various countries have concluded rather complex bilateral contracts, known as the Double Taxation Avoidance Agreements¹ (DTAA). They also provide a legal structure for the sharing of taxation rights between two contracting partners which makes it easier for the nation, individuals and business entities involved in transactions between the two partner countries to define and understand their tax responsibilities. As one of the leaders of economic globalization and open-door policy, India has endeavoured and has ratified the DTAA with many countries² to protect the rights of its taxpayers and enhance a favourable business environment for investment. This research work will discuss India's vast network of DTAA with several countries and present provisions of the DTAA and its impact on the country and issues encountered during the process of implementation.

INTRODUCTION

International taxation provokes cross-border distortions, which refer to systems of comparable taxes set by different governments on revenue and other property that are in more than one nation. Not only does it increase the degrees of taxation on the aforementioned economies, but

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¹ <https://www.indiafilings.com/learn/double-taxation-avoidance-agreements-dtaa-types-benefits-and-claim-procedures/>.

² [https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=\(b\)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C](https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=(b)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C)

it also puts in traditional measures that bring about uncertainty and complexity in the global investment climate hence serving to limit the freedom of capital and resources mobility across borders. For a way forward in the solution of this problem and to foster the needed conditions for international economic collaboration, governments of the countries have realized early enough the need for bilaterals that define taxation rights and method openness to tackle issues relating to cases of double taxation.

To address this issue, comes the essence of the Double Taxation Avoidance Agreement³ (DTAA), whereby a contract is made between two nations to determine the right of taxation of the profits of the specific company. These agreements sought for the reduction or eradication of double taxation which is advantageous to the promotion of trade and investment between countries as well as the efficient use of resources. DTAA is helpful in that it gives clear and concrete provisions about the tax responsibilities of the involved parties, making it a lot easier to transfer money, goods, and services across nations.

India, being one of the largest economies in the world and being surrounded by opportunities for foreign investments has been an active participant in signing DTADs with several countries for the protection of the country's taxpayers as well as to encourage more investment. This paper provides insight into the structure of India's DTAA atmosphere and explores its salient features, consequences, and issues arising from them and their application.

India has signed over 90⁴ Double Taxation Avoidance Agreements (DTAA) with different countries to circumscribe the possibility of having to pay taxes on income generated by resident companies/individuals in India as well as in other countries. The income tax treaties are prepared by following the rules mentioned in the Model Tax Convention of the OECD and the UN Model Convention⁵.

³ <https://www.indiafilings.com/learn/double-taxation-avoidance-agreements-dtaa-types-benefits-and-claim-procedures/>

⁴ [https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=\(b\)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C](https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=(b)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C)

⁵ https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf

MAJOR FEATURES OF THE DTAA'S PROPOSED FOR INDIA

Residency Rules: DTAAs offer guidance on testing an individual's or Company's residential status through factors such as Place of Effective Management, Place of Incorporation, Place of Control and Place of Substantial Presence among others.

1. Permanent Establishment (PE): The conventions set the rules from which a 'permanent establishment' is defined in an attempt to justify the taxing rights concerning base profits in the source or residence country. This can comprise fixed location PEs such as places of management, offices, production units, and construction/assembly PE based on temporal criteria.
2. Taxation of Various Incomes⁶:
 - Business profits are liable to tax in the country of PE. This is in line with the conditions postulated by Adi and Sundaram to formulate the Nigeria tax law that Business Profits are taxable in the country where the PE is situated; this is the 7th condition.
 - Generally, dividends are taxed according to the specific country's taxation policies of the adopting nation with some hold-back tax in the country of origin.
 - Interest and Royalties are either limited to the source country's tax or limited to the residence country alone.
 - Movable Capital Gains resulting from the disposal of business structures are charged to tax in the residence country while Immovable Capital Gains are paid to the situs country.
4. Elimination of Double Taxation⁷: This can be done by either stripping the income that is taxed twice or by providing a credit on the taxes on income paid in the residence state to that paid in the source state.

⁶ <https://www.indiafilings.com/learn/double-taxation-avoidance-agreements-dtaa-types-benefits-and-claim-procedures/>

⁷ Ibid

5. Non-Discrimination⁸: Even where applied to such grounds, there are provisions for non-discrimination where the doing of the activities concerned are similar irrespective of nationality.
6. Exchange of Information: This makes it possible for treaty partners to exchange tax information with a bonus of their exemption from disclosure.

INDIA'S DTAA PARTNERS⁹

India's major DTAA partners include Mauritius, Singapore, Netherlands France Germany UK UAE USA Japan, etc The India Mauritius DTAA has been revised in 2016 CPL and source-based taxation of capital gains.

TAX RESIDENCY CERTIFICATE¹⁰

Whenever a person who is a non-resident earns income locally in India, such a person is required to secure the Tax Residency Certificate from the home country revenue authority and that is how he or she can access the DTAA in the country.

CONTROVERSIES & CHALLENGES

Some of them include tax treaty overrides by domestic laws, issues of new forms of digitized business models, handling dual residencies and PE issues as well as the problem of treaty shopping for tax avoidance.

India is also engaged with the OECD to remodel international tax policies and DTAAs under the BEPS project. It has also acted through measures such as an equalization levy on certain digital transactions, implementing a multi-lateral instrument to modify the existing DTAA, and a safe harbour regime to assess arm's length profit.

DTAAs are still very useful in ensuring an efficient flow of investment and goods across borders by coming up with clarity on taxing rights and negative consequences such as double

⁸ Ibid

⁹[https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=\(b\)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C](https://sansad.in/getFile/loksabhaquestions/annex/6/AS92.pdf?source=pqals#:~:text=(b)%3A%20India%20has%20signed,%2C%20Germany%2C%20Greece%2C%20Hungary%2C)

¹⁰[https://nritaxservices.com/Double%20Taxation%20Avoidance%20Agreement%20\(DTAA\)%20and%20Tax%20Residency%20Certificate%20\(TRC\)/M_105](https://nritaxservices.com/Double%20Taxation%20Avoidance%20Agreement%20(DTAA)%20and%20Tax%20Residency%20Certificate%20(TRC)/M_105)

taxation. Nonetheless, there is still the need for continuous research and amendment in line with the changing business structures for preventing BEPS.

CASE LAW

Vodafone International Holdings B.V. v. Union of India & Anr. (2012) 6 SCC 613¹¹

This particular case is also referred to as the Vodafone-tax case and was a case of pure law concerning the provisions and operation of the India–Netherlands DTAA. It was a landmark judgment of the Supreme Court of India which was marked with significant consequences and implications as far as extending the compliance of Indian taxation law to cross-border transactions and the principles of the DTAA in particular was concerned.

Here the Indian tax authorities attempted to establish an enormous tax claim on Vodafone for acquiring interest in an Indian firm, Hutchison Essar Ltd. from an organization set in the Cayman Islands. The tax authorities selected it for its investigation stating that the transaction was the indirect transfer of Indian assets and thus should be liable for capital gains tax in India. However, Vodafone did not pay the tax demand and instead invoked the provisions of the India-Netherlands Double Taxation Avoidance Agreement (DTAA) which applied for the taxation of gains arising from the sale of shares. The basics of the argument focused on the determining factor of a tax resident and the relevance of the DTAA to the given transaction.

Finally, the Supreme Court of India settled the constitutional issue in favour of Vodafone by holding that the transaction did not amount to the generation of capital gains that could attract tax in India. The rationale for the court's decision can be summarized by reference to the detailed exploration of the India-Netherlands DTAA, the twin principles of fiscal neutrality, and the importance of adopting the purposive approach to the interpretation of the tax treaties.

The court pointed out properly the principles of the treaty interpretation treaty of the Vienna Convention on the Law of Treaties. It also underlined many features of ambiguity and unpredictability in the application of DTAA which are vital for encouraging cross-border investments and cooperation.

¹¹ <https://itatonline.org/digest/vodafone-international-holdings-b-v-v-uo-2012-341-itr-1-204-taxman-408-247-ctr-1-66-dtr-265-6-scc-613-vol-42-tax-l-r-305-sc/>

The fact that the Indian Supreme Court was willing to nullify a treaty solely based on the via media finding the old 1996 DTAA non-contractual provided clear evidence that Vodafone would not be the last multinational company that would face tax claims from India. While affirming that national laws of the contracting partners are applicable, and international legal provisions do not directly pertain to international relations of states, the signatures' provision made clear provision for the precedence of tax treaties over domestic legislation and set legal precedents for handling future disputes over the taxation of cross-border transactions. The case also raised issues and concerns regarding India's DTAA policy and further discussions and debates were held about the viability of making Indian DTAA more transparent and open, and the possibility of modifying or altering new provisions to meet the new challenges.

SEVERAL FACTORS AND NEW TENDENCIES OF THE GLOBAL ECONOMY AND TAXATION SYSTEMS HAVE BEEN CONSIDERED TO HAVE AN IMPACT ON THIS TREND ¹²

Addressing the Digital Economy: The aspects of digital-related businesses, and e-business concerns, remote employment have transformed the taxation based on PE and source taxation. Future DTAA will also call for the inclusion of provisions that deal with the taxation of transactions, services, and income from other digital operations in future DTAA.

1. **Aligning with Global Tax Reforms:** Today it can be stated that such activities as the OECD's BEPS project and the Two-Pillar Solution, still to a great extent affect the current international tax regimes. DTAA will have to be adapted in the sense of these reforms in as much as they affect the taxation of multinational companies and other matters concerning the addressing of disputes and anti-treaty abuse provisions.

MULTILATERAL APPROACH¹³

Preceding focuses on DTAA as exclusively bilateral arrangements, future developments may incline toward the multilateral instrument as the MLI. They are for instance helpful in enabling the different nations to make simultaneous alterations to the tax treaties as required more efficiently.

¹² <https://itatororders.in/blog/dtaa-double-tax-avoidance-agreement-insights/>

¹³ <https://sortingtax.com/different-types-and-methods-of-double-taxation-avoidance-agreements-dtaa/>

1. **Increased Transparency and Exchange of Information:** To tackle issues of tax avoidance and the attainment of compliance there will be enhancement of the exchange of information on taxes between treaty partners. The features such as automatic exchange of information, country-by-country reporting, and high levels of confidentiality requirements can be expected to be incorporated into the design of future DTAA's.
2. **Incorporating Environmental and Social Considerations:** In the context of rising sustainability and corporate social responsibility, DTAA's might contain provisions stimulating or restricting specific economic activities about the externalities. This may include provisions for investment promotion which targets environmentally friendly investments or provisions for promotion of environmentally unfriendly activities.
3. **Dispute Resolution Mechanisms:** As the risk for more tax controversies stems from the developing series of transactions across borders, the next generation of DTAA could focus on the provision of strong and quick means of solving disputes like mandatory binding arbitration or mutual agreement procedures.
4. **Adapting to Emerging Technologies:** Since emerging technologies such as blockchain, cryptocurrencies, and artificial intelligence among others are innovations, DTAA's will have to define the taxation policies for the use of such technologies. This can mean moving to create rules or standards of JUST taxation and MINIMIZE tax avoidance or tax evasion.
5. **Balancing Tax Certainty and Flexibility:** Though getting tax certainty is one of the main goals of DTAA's in the future, DTAA may also contain more flexibility measures for adjustment to other conditions and contingencies. This may include such features as providing working for future review, one-party limited-time provisions known as sunset provisions or clauses for reopening under certain circumstances.

Thus, the prospects of DTAA's shall be determined by the necessity to adapt to new economic conditions, enhance tax justice, and develop cooperation in the sphere of taxation. While being aware of these trends and challenges, DTAA's can remain efficient tools for enhancing international transactions, investments, and economic development and avoiding dual taxation and uncertainty in the taxation system.

CONCLUSION

At the end of the article, it is important to stress how DTAA's are crucial in providing a favourable environment for businesses, investment, and economic relations between nations. It will also underscore the necessity for periodic examination and modification of India's DTAA structure based on the new and changing landscape of the international taxation system. Thus it can be concluded that an efficient and properly designed DTAA regime can make a huge impact for India in terms of growth and development of its economy as well as in enhancing the country's competitiveness in the global market.

As will be explained, the area of International Tax Law, and more specifically the scope of Double Taxation Avoidance Agreements is complex and highly nuanced since on the one hand there is a need to encourage cross-border investment and on the other, there is the need to protect national revenues. The Indian government has adequately understood the importance of DTAA's to provide a favourable business environment as well as the FDI inflows, and therefore, has energetically and diligently sought and cultivated a wide network of tax treaties with selected trading partners.

Nevertheless, for DTAA's to be effectively implemented, there is a need to constantly review the provisions of the treaties about the changing international taxation practices, deal with new issues like avoidance of taxes and eroding of the base, and ensure treaty provisions are uniformly interpreted and applied. Thus, by attaining I best practice, a multilateral approach in bilateral negotiations, and a transparent and cooperative nature India can enhance its DTAA structure and advance its position as an exceptional investment location.

Thus, a properly developed and functioning DTAA regime can play a great role in the further dynamics of the Indian economy's growth, competitive increase, and integration into the world economy. To summarize, it is a critical tool for the promotion of cross-border transactions of goods and services, promotes efficient utilization of resources, and provides assurance and stability to all the players in the international business world.

In the course of continued globalization and liberalization of the world economy, the subject of DTAA's shall remain an important element in the achievement of India's objectives aimed at expanding opportunities for further economic cooperation with foreign subjects and attracting investments in the activities of various industries to support the sustainable growth and development of the Indian economy.