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Double Taxation, DTAA's and Double Dipping with Special Allusion to India-UAE DTAA

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ABSTRACT

The India-UAE Double Taxation Avoidance Agreement (DTAA), established under Section 90 of the Income Tax Act, 1961, aims to prevent double taxation and ensure equitable tax treatment. However, complexities like "double-dipping" — where taxpayers exploit legal ambiguities to claim deductions in both jurisdictions — pose significant challenges. This research examines the legal frameworks, judicial interpretations, and case studies, such as CIT v. Patni Computer Systems, to analyze the loopholes in the current taxation regime. Focusing on the India-UAE DTAA, the study critiques the efficacy of the "credit method" for tax elimination, which may inadvertently enable double-dipping. The paper offers recommendations to refine legislative and administrative mechanisms, including explicit prohibitions against double-dipping, enhanced collaboration between tax authorities, and robust taxpayer education. These measures aim to uphold the DTAA's integrity while fostering fiscal cooperation and preventing tax base erosion.

***Keywords**: Double Taxation, Double-dipping, DTAA.*

I. INTRODUCTION

'Entry 14 in List I of the Constitution' provides for "entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries"[2]. The union is empowered to deal with all matters pertaining to relationship with any state or foreign affairs vide Entry 10 of the Union list[3]. With these entries as the epitome of international relations, nevertheless the union is sanctioned to enter into agreements with the government of other countries 'outside India or a specified territory outside India' vide 'Section 90 and 91 of the Income Tax Act, 1961' into the bargain. 'Section 90 of the Income Tax act' delegates upon the 'Central Government', the power to enter into an agreement with the 'government of any other country' outside India or 'specified territory' outside India for the purpose of granting of relief as regarding '1) the income on which both income tax has been

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[2] Indian Constitution, Entry 14, List 1, Schedule VII
[3] Indian Constitution, Entry 10, List 1, Schedule VII

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paid under this act and in that country or 'specified territory' or 2) for the avoidance of double taxation of income or 3) for exchange of information' owing to the 'prevention of evasion' of income tax or 4) for recovery of income tax both under this act and under the corresponding law in force in that country or 'specified territory'[4]. The United Kingdom incorporates an international agreement or treaty into its domestic law either by parliament through legislation or by the judges through the common law[5]. Whereas in India, this accomplishment is possible by translating a treaty or agreement into an act of parliament. The cumbersome process has paved way for the legislature to delegate the burden upon the central government to issue such notifications to that effect under Section 90[6]. It is erroneous to contend that Article 265 only empowers the parliament to grant tax exemptions since the former can delegate upon the central government, the power to grant exemptions by way of notification subject to the doctrine of permissible delegation. Although the discourse pertaining to the delegation, powers of the union to enter into agreements with any state outside India or 'specified territory' is indubitable, the issue revolves around these agreements and their abortive implementation. This article seeks to redress one such issue of implementation of the law pertaining to Double Taxation Avoidance Agreements.

(A) Research Objectives

1. To comprehensively unveil and understand the perplexities revolving around DTAA's and 'Double-Dipping'.
2. To offer a new perspective towards addressing this quivering discourse
3. To identify the scope for tax-avoidance in the India-UAE Double Taxation Avoidance Agreement

(B) Research Problem

It is a well settled position that the provisions of the 'Income Tax Act, 1961' has to be applied to an extent beneficial to the assess. This could culminate curious situations. One such hitch is 'Double-dipping' observed in CIT V. Patni Computer Systems[7]. In the Patni Computer Systems case, the court observed that the "OECD commentaries reflect that the question of 'double-dip' is the one left for the domestic laws of the country concerned"[8]. The courts are hesitant to render their intuition for this purpose on a rationale that the legislature's wisdom has not prohibited

[4] Income tax act § 90 (1961).
[5] Principles of International Law: A Brief Guide, HC [Number 9010], at [03] (UK).
[6] India Const. art. 253.
[7] (2007) 109 TTJ (PUNE) 742
[8] Ibid.

double dip[9]. The author seeks to infuse a neo-perspective to this quivering discourse,

(C) Research Methodology

The author adopts doctrinal method of research writing and relies upon primary and secondary sources for the purpose of this research. The author has examined profuse Double Taxation Avoidance Agreements between India and other states. The study will compare the provisions of different DTAAs to identify commonalities and differences. Sufficient focus has be invested towards analysis of specific case studies where DTAAs have been applied or where disputes have arisen due to double taxation.

II. India-UAE Double Taxation Avoidance Agreement

The 'Government of the Republic of India' and 'Government of the United Arab Emirates' have entered into an agreement for the purpose of 'avoidance of double taxation' and 'prevention of fiscal evasion' on 22nd September, 1993 vide powers conferred under 'Section 90 of the Income Tax Act, 1961' read together with 'Entry 14 and 10 of the Union list'[10]. Article 1 elucidates that this agreement extends to 'resident of one or both of the contracting states'. A resident of a contracting state is defined under Article 4 and any person who is liable to tax therein by virtue of him domicile, residence or 'place of effective management' in India is deemed to be an Indian resident[11]. A resident of UAE is any person who has resided in UAE for a period of at least 183 days or a company that is registered under UAE laws or wholly managed and controlled in UAE[12]. It is pertinent to note that 'person' is defined under Article 3(e) of the agreement and naturally, it includes an 'individual', 'company' or 'any other entity' that is liable to tax under the respective domestic laws of the contracting states i.e. India and UAE[13]. The agreement acknowledges the scope for bi-polar residence[14] and when an individual is a resident of both contracting states, the determinative criteria is their 'permanent home'. If a resident has a 'permanent home' in both the contracting states, the state where his 'personal and economic relations' are closer shall be looked into. If the position is still unclear, the 'habitual abode' of a resident in either of the contracting state is determinative of their residence. Duality of

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[9] Ibid.

[10] Income tax act § 90 (1961).; Indian Constitution, Entry 14, List 1, Schedule VII.; Indian Constitution, Entry 10, List 1, Schedule VII

[11] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 4, Sept. 18, 1992, 1993 U.N.T.S. 107.

[12] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 4(b), Sept. 18, 1992, 1993 U.N.T.S. 107.

[13] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 3(e), Sept. 18, 1992, 1993 U.N.T.S. 107.

[14] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 4(3), Sept. 18, 1992, 1993 U.N.T.S. 107.

‘habitual abode’ necessitates a resort to the nationality of a resident. If a resident is a national of both the contracting states, which one cannot be since India does not recognise dual citizenship[15], the final benchmark for determination of residency status is trivial. The competent authority’s decision reached based on mutual agreement would be the final benchmark in determining the residential status of a person. While, residential status for an individual is decided based on the tests elucidated in article 4(3), for an artificial person, the ‘place of effective management’ test is to be applied if it is a resident of both the contracting states. Article 7 provides for the treatment of ‘business profit’. Profits of an enterprise of a state is taxable only in that state unless the business carries on business in the other contracting state through a ‘permanent establishment’[16]. Article 5 provides for an inclusive definition of a ‘permanent establishment’. A ‘permanent establishment’ means,

“a fixed place of business through which the business of an enterprise if wholly or partly carried on”[17].

Such an establishment must be treated as a ‘distinct and separate entity’, performing similar activities[18]. The ‘permanent establishment’ is to be allowed deductions expenses that are incurred in carrying on business. Article 25 provides for the method of ‘elimination of double taxation’.

International organisations had taken efforts to issue guidance as to the purpose and form of ‘Double Taxation Avoidance Agreements’. The suggested form of agreement is referred to as the ‘model convention’. ‘Articles 23A and 23B of the OECD Model Convention’ prescribes different methods of ‘elimination of double taxation’. Under the ‘Exemption method’, the ‘state of residence’, does not tax that part of income which according to the convention may be taxed in the other state. Whereas in the ‘Credit method’, the ‘state of residence’ calculates its tax on the total income of the tax payer including the income that is taxable by the other contracting state, but it later on allows deductions to an extent of tax paid to the latter state. The India-UAE agreement has adopted the credit method under ‘Article 25 of the agreement’[19].

Any difficulties, disagreements, or doubts in interpretation of the terms shall be resolved by the

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[15] India Const. art. 9.

[16] ‘Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income’, India-U.A.E., art. 7, Sept. 18, 1992, 1993 U.N.T.S. 107.

[17] ‘Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income’, India-U.A.E., art. 5, Sept. 18, 1992, 1993 U.N.T.S. 107.

[18] ‘Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income’, India-U.A.E., art. 7(2), Sept. 18, 1992, 1993 U.N.T.S. 107.

[19] ‘Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income’, India-U.A.E., art. 25, Sept. 18, 1992, 1993 U.N.T.S. 107.

'competent authority' by mutual agreement[20]. 'Competent authority' is defined under Article 3(j), in the case of UAE, the 'Minister of Finance and Industry' or his authorised representative and in the case of India, the 'Central Government in the Ministry of Finance' or their authorised representative[21].

III. Double-dipping and its scope under the India-UAE DTAA

The 'Pune bench of the Income Tax Appellate Tribunal' has coined the term 'double-dipping of losses' for the first time in CIT V. Patni Computer Systems Pvt.ltd[22]. Double-dipping refers to a situation when the regime of taxation is used for receiving benefits more than once in a way regarded unethical.

(A) CIT V. Patni Computer Systems Pvt.Ltd[23]

The assessee company was a resident of India and during the fiscal year 2001-02, it had established a permanent establishment and carried on its business in Japan. The Japan arm of the Indian company suffered only loss during the previous year. The company claimed that it shall be entitled to deductions under the Indian law for the loss incurred in Japan but the assessing officer replied in negative since the profits of the foreign arm were to be taxed in Japan as per the Indo-Japan DTAA, the loss should also be appropriated under Japan tax law. In appeal, the Commissioner (appeals) held in affirmative. Since, the assessee was a 'resident in India', his 'global income' was taxable in India only. Thus, the loss shall be allowed as deductions while computing the assesses 'total income' taxable in India.

The Pune Income Tax Appellate Tribunal has upon the reach of appeal relied on CIT V. R.M.Muthiah[24] and CIT V. S.R.M.Firm[25]. The Karnataka and Madras High Courts held that when it is provided that tax may be charged by a particular state viz-a-viz the respective taxable income, it is implied that the 'other contracting state' does not impose tax on the same income. This legal disposition has been affirmed by the 'Supreme Court in Union of India V. Azadi Bachao Andolan'[26].

The prevailing legal position can be explained as follows; once an income is held to be taxable by a particular state under a 'Double Taxation Avoidance Agreement', unless it is explicitly

[20] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 27, Sept. 18, 1992, 1993 U.N.T.S. 107.
[21] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 3(j), Sept. 18, 1992, 1993 U.N.T.S. 107.
[22](2013) 215 Taxman 108 (Bombay).
[23] Ibid.
[24](1993) 202 ITR 508 (Mad.).
[25] (1994) 208 ITR 400 (Mad.).
[26] 2003 AIR SCW 5766

mentioned that the other contracting state can also enjoy its tax jurisdiction over the same taxable income, the latter is 'denuded of its powers to tax the same'. Another significant question of law dealt in this instant case was 'whether the assessee can be forced to go for taxation in accordance with the provisions of the tax treaty with the said PE state'? The court has referred to 'Section 90(2) of the Income tax act, 1961'. The *lex fori* clearly establishes that the provisions of the act maybe applied 'to an extent beneficial for the assessee'[27]. Section 90 grants relief rather than imposing a liability. Merely because the 'Government of India' has entered into a tax treaty with the government of Japan, the assessee can be forced to observe the treaty. Thus, the treaty cannot be thrust upon the assessee. In the instant case, it was beneficial for the assessee to be assessed under the taxing provisions of the 'Income tax act, 1961'. Therefore, the provisions maybe applied to such an extent[28]. The court has acknowledged the scope for double-dipping of losses that could occur in light of the judicial precedents and law as such.

"*It is interesting to note that, as per the law which prevails now in the light of the judicial precedents, adouble dip of foreign losses may indeed occur"*[29]

(B) Double-dipping of losses

'Japan branch (Permanent Establishment)' of the Indian company has reported a loss of Rs.54lakhs and the Indian arm has reported a profit of Rs.3Crores. Tax rate in India was charged at 34% for the assessment year 2001-02 and the tax rate in Japan was concluded at 30%. Since the Indo-Japan DTAA adopts 'Credit method' for 'elimination of double taxation', the computation shall be as follows;

Table 1:

	India	**Japan**
Year 1		
'Indian Income'	300.00	
'Japanese Loss'	(54.00)	(54.00)

[27] Income tax act § 90(2) (1961).
[28] Ibid.
[29] Ibid. para 7.

'Total Income'	246.00	(54.00)
'Tax on above'	83.64	-
'Loss to be c/f'		(54.00)
Year 2		
'Indian Income'	300.00	
'Japanese Income'	100.00	100.00
'Year 1 loss set/off'		(54.00)
'Total Income'	400.00	46.00
'Tax on above'	136.00	13.80
'Credit of tax paid in Japan'	(13.80)	
'Tax payable'	122.20	
'Total tax paid in both countries	**219.64'**	

It is pertinent to note that the PE situated in Japan has to be treated as a 'distinct and separate entity' involved in 'similar business' activities in lieu of Article 5[30]. The company is a 'resident of India' thus its 'global income' is taxable in India. The Japanese loss incurred by the permanent establishment shall be deducted from the profits generated by the Indian arm for the purpose of computation of net taxable income. The Government of Japan would not tax the

[30] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 5, Sept. 18, 1992, 1993 U.N.T.S. 107.

losses incurred by the PE but it would be carried forward for assessment to the next 'assessment year'. Therefore, the net taxable income in India will be Rs. 2Crores and 46lakhs. During Year 1, the net tax payable by the Indian company at 34% is Rs. 83lakhs and 64thousand.

In Year 2, the company has earned a profit of Rs.3Crores and the Japan PE has also generated a profit of Rs.1Crore. Thus, the global income (Rs.4Crores) of the company will be taxed in India. The tax to be paid in India is Rs.1Crore and 36lakhs. The loss incurred by the Japan PE during the previous year has to be 'set off' against the current year's income of Rs.1Crore. Therefore, the taxable income in Japan will be Rs.46lakhs.

This would lead to a double taxation of the income of Rs.46lakhs earned in Japan. To 'eliminate this double taxation', India will have to give 'credit' for tax paid in Japan[31].

Based on the Patni Computer systems ruling, the computation would be as follows;

Computation as per Patni Computer's ruling:

Table 2:

	India	**Japan**
Year 1		
'Indian Income'	300.00	
'Japanese Loss'	(54.00)	(54.00)
'Total Income'	246.00	(54.00)
'Tax on above'	83.64	-
'Loss to be c/f'		(54.00)
Year 2		
'Indian Income'	300.00	

[31] 'Convention Between the Government of the Republic of India and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-Japan, art. 23, Mar. 7, 1989, 1989 U.N.T.S.

'Japanese Income'		100.00
'Year 1 loss set/off'		(54.00)
'Total Income'	300.00	46.00
'Tax on above'	102.00	13.80
'Total tax paid in both countries	**199.44'**	

Considering the same facts, the position in Year 1 will be the same as discussed above. However, in the second year, when the Permanent establishment earns a profit of Rs.1Crore, the company would choose to be 'governed by the DTAA'. Thus, the profits attributable to the permanent establishment will not be taxed in India.

The total tax paid in both countries under the Credit method was Rs.2Crores 19lakhs and 64thousand. However, computation as per the ruling in CIT V. Patni Computer Systems[32], would conclude a tax liability of Rs. 1Crore 99lakhs and 44 thousand to be paid in both countries. The assessee claimed benefits under both the treaty and the domestic jurisdiction thereby entitling him to a huge benefit. Such benefit is unethical as regards in law. The court's response to double-dipping of losses is controversial and unsatisfactory.

IV. ANOMALOUS LEGAL POSITION VIZ-A-VIZ DOUBLE-DIPPING

The 'Pune Bench of the Income Tax Appellate Tribunal' has acknowledged the situation of double-dipping of losses that would emanate based on the contemporary legal position and judicial precedents.

"*It is interesting to note that, as per the law which prevails now in the light of the judicial precedentsdiscussed above, a double dip of foreign losses may indeed occur. When the assessee incurs losses abroad in acountry with which India has entered into a tax treaty, the assessee may as well go for taxation of worldwideincome and thus effectively claim deduction of loss*

[32] Ibid. para 7.

abroad from its total income liable to tax in India."[33]

The judiciary's justification for the same is 'Section 90(2) of the Income tax act' which provides that the 'provisions of this act may be applied to an extent it is beneficial for the assessee'[34]. It was further argued for legislature's wisdom to address the quivering legal position but the tribunal would not comment on it.

The issue is exacerbated when the 'exemption method' for 'elimination of double taxation' is adhered to in Double Taxation Avoidance Agreements between countries. The India-UAE DTAA tread on the heels of 'exemption method[35]. A resident of India might establish a 'fixed place of business' as tax havens in the Emirates and thereby distance itself from payment of tax at the UAE for the income earned there. The exemption method implies that the country of residence i.e. India exempts payment of tax too. This opens up the gate for finance scandals.

Although the tribunal attributes the nature of 'tax planning' to this instant legal discourse, tax legislations should explicitly prohibit the deduction of loss in more than one jurisdiction. This should include clear definition and guidelines on what constitutes double-dipping. Once, double-dipping has been expressly prohibited by a legislation, any instance of it would be treated as a 'tax evasion', rather than deeming it to be a quivering legal position.

Tax authorities across various jurisdictions that have entered into agreements with India need to collaborate to identify and prevent instance of double dipping. This could be effectively done through the 'exchange of information and mutual assistance'. The initiatives should not be merely restricted to one side. The taxpayer must be educated about the implications of double-dipping and the legal consequences of attempting to do the same. Where double-dipping is detected, tax authorities should disallow the deductions and impose penalties wherever necessary to discourage such behaviour.

While these are some of the progressive recommendations, the countries must come into mutual agreement in devising a neo-model that leaves no scope for double-dipping of losses or any other method that allows a tax-payer dual benefit under more than one jurisdiction.

V. Conclusion

The India-UAE 'Double Taxation Avoidance Agreement' (DTAA) aims to prevent 'double taxation' on income earned in both countries. However, issues like "double dipping of losses"

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[33] Ibid.
[34] Ibid. page 7.
[35] 'Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income', India-U.A.E., art. 25, Sept. 18, 1992, 1993 U.N.T.S. 107.

arise, where taxpayers claim deductions in both jurisdictions, leading to tax avoidance. The DTAA seeks to address this by ensuring fair tax distribution and preventing misuse of provisions. Strengthening compliance and refining provisions are essential to prevent tax base erosion while fostering economic cooperation between India and the UAE. Effective implementation and regular updates to the DTAA can ensure that it serves its intended purpose without unintended loopholes.

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