INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

Volume 2 | Issue 1

2020

Analysis of Double Taxation Avoidance Agreement between the US and India in Relation to International Taxation

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ABSTRACT

Cross-border commercial transactions are nothing new. Residents of one country trade not only in their own jurisdiction, but are increasingly trading with residents of other nations as well. This means that income being earned in one country is being received in another country. One significant impact of this kind of transaction can be seen on the way taxes are imposed because it leads to a possibility of double taxation. Double taxation creates a burden on the taxpayer and hinders trade. Thus, it becomes increasingly important for traders to analyse the tax regime of various jurisdictions to determine whether or not they would trade with a particular country.

I. INTRODUCTION

There are two basic rules which give rise to a problem of double taxation- the source rule and the residence rule. As the names suggest, the source rule allows taxation of an income where it arises, irrespective of whether it is earned by a resident or non-resident; whereas residence rule provides that tax should be imposed in the country where the taxpayer resides.[2] If both these rules are applied on one income, a taxpayer would have to pay double tax on the same income, thus deterring a trader from engaging in cross border trade. Thus, due to this unique growth in international trade, a need to assess international tax regimes has arisen. This is where Double Taxation Avoidance Agreements (hereinafter "DTAA") come into picture. A DTAA is a tool used by nations to coordinate their rights of imposition of taxes, while at the same time guarding against tax evasions.These are negotiated under the sphere of Public International Law, and are governed by the principles laid down under the Vienna Convention on the Law of Treaties, 1980.[3]

Fiscal jurisdiction is one of the most aggressively protected jurisdictions for any country, and

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[2]Sarbapriya Ray, *A Close Look into Double Taxation Avoidance Agreements with India: Some relevant Issues in International Taxation*, 2 INTERNATIONAL AFFAIRS AND GLOBAL STRATEGY 1, 1 (2011).
[3]*Id.*

India, being a developing country, is often forced to accommodate the claims of other nations by means of DTAA to bring down its barriers to global trade. Keeping this in mind, this essay is an attempt to provide a brief account of, and evaluate the DTAA between India and the United States of America (hereinafter the "Indo-US DTAA"). The essay begins with a general examination of the concept of DTAA and its necessity in today's globalised world. It then goes on to assess some common features of India's DTAAs and finally provides an account of the Indo-US DTAA. In providing such account, the essay examines some important provisions of the DTAA with the help of judgments.

II. Double taxation avoidance agreements: the concept

The Fiscal Committee of the Organisation on Economic Cooperation and Development (OECD) in the Model Double Taxation Convention on Income and Capital, 2017 defined double taxation as 'the imposition of comparable taxes in two or more States on the same tax payer in respect of the same subject matter and for identical periods.'[4] In other words, double taxation means the systematic imposition of more than one tax on the same income in the case of income tax, same asset in the case of capital tax, or the same financial transaction in the case of sales tax.[5] As stated above, the taxpayer's own country, referred to as the home country, has the sovereign right to tax him under the residence rule, while the source rule allows the country of the source of income, referred as host country, to impose a tax on the taxpayer. Such double taxation leads to reduced global trade and it is thus becomes important for nations to take steps to avoid such practice.

Relief from double taxation can be provided in two ways:[6]

1. Bilateral Relief: Under this method, governments of two countries enter into "Tax Treaties" or DTAAs to mutually work out the basis on which relief is to be granted. This may result in:
    a. The income being taxed in one country only; or
    b. The income being exempt in both countries; or
    c. The income being taxed in both countries, but credit for tax paid is allowed by the home country for tax charged by the host country.

[4]*Model Tax Convention on Income and on Capital*, ORGANISATION ON ECONOMIC COOPERATION AND DEVELOPMENT (Nov. 21, 2017) https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1.
[5]Ray, *supra* note 1, at 3.
[6]*Id*.

2. Unilateral relief: In the absence of any mutual agreement, unilateral relief of some sort is provided by the home country.

DTAAs are used by countries to eliminate international double taxation and promote global trade and commerce and investment. DTAAs are categorised into Comprehensive DTAA and Limited DTAA, depending on their scope. Comprehensive DTAAs ensure that taxpayers in both countries are treated equally, and cover almost all types of income including wealth tax and gift tax, among others. On the other hand, Limited DTAAs only provide for income from shipping and air transport, estates, inheritance and gifts. Where a DTAA is entered into, various methods may be adopted to eliminate double taxation[7]:

1. Exemption Method: Under this method, the home country gives exclusive right to the host country to tax the foreign income of its resident and altogether excludes that income from its own tax base. This method is mostly used for profits attributable to Permanent Establishments or income from immovable property.
2. Credit Method: Under this method, the home country allows credit for tax paid by its resident in the host country. This is based on the underlying concept that the resident of a nation remains liable to the country for its global income.
3. Tax Sparing: One of the aims of a DTAA is to stimulate the flow of foreign investment into a country. Tax sparing is one way of achieving this aim. Under this method, the regular tax credit is extended to the taxes which are spared by the host country itself. In other words, credit is extended by the home country not only for the taxes paid in the host country, but also for the taxes that the host country forwent due to its fiscal incentive provisions. Thus, by extending the relief granted by the source country to the home country as well, tax sparing promotes foreign investment flows.

III. WHY ARE DOUBLE TAXATION AVOIDANCE AGREEMENTS NECESSARY?

To avoid the hardship double taxation causes to taxpayers, countries enter into DTAAs. The need and purpose of DTAAs was summarised by the OECD in the Model Tax Convention on Income and on Capital, 2017. It said,[8]

> *"…[I]t 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*

[7] *Id*.
[8] *Model Tax Convention on Income and on Capital*, ORGANISATION ON ECONOMIC COOPERATION AND DEVELOPMENT (Nov. 21, 2017) https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1.

cases of double taxation."

Thus, the major objective of a DTAA can be said to lay down clear guidelines as to the steps to be taken where both countries have a legitimate tax claim. In addition, DTAAs are necessary to give certainty to a taxpayer as to the tax liabilities that will arise from his trade, and also protect foreign taxpayers and Permanent Establishments against discrimination vis-à-vis domestic taxpayers. Further, by clarifying the manner of imposition of taxes, and encouraging regular exchange of information, DTAAs help in preventing tax evasions and tax avoidance. This is done through rules like the General Anti-Avoidance Rule (GAAR) which allows tax authorities to determine whether a transaction is undertaken for the sole purpose of tax avoidance. More importantly, DTAAs ensure that countries adopt common definitions for factors that determine taxing rights and taxable events, for example, the definition of a 'Permanent Establishment'. Most DTAAs also provide for a Mutual Agreement Procedure (MAP) which is invoked where there is dispute regarding interpretation of treaty terms.[9]

IV. India's double taxation avoidance agreements

The tax regime in India, like in other countries, provides for the imposition of tax on the "total world income" of a resident u/S.5 of the Income Tax Act, 1961 (hereinafter the "IT Act").[10] This means that for a resident of India, his income arising from anywhere in the world would be taxed in India under the residence rule.[11] This income however, is almost definitely also taxed in the host country under the source rule. Thus, India has taken steps to avoid this undue hardship u/S.90 and S.91 of the IT Act, which provide for bilateral relief and unilateral relief respectively. India has entered into DTAAs with several countries u/S.90 of the IT Act. At the time of writing, India has DTAAs with 88 countries, of which 86 are in force.[12]

A look at the trend of DTAAs signed by India shows that India has not had any major benefits from the signing of such agreements. India signed its first DTAA with Greece in the year 1965 under which the right to tax shipping income was given to the home country. This was beneficial only to Greece, it being a major shipping economy. The next five treaties signed by India, with Egypt, Tanzania, Libya, Zambia and Sri Lanka, also seemed to offer no

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[9] Ray, *supra* note 1, at 4.
[10] Income Tax Act 1961, No.43, Acts of Parliament, 1961 (India).
[11] KD Raju, *Intellectual Property Taxation: Need for a Comprehensive Policy and Law in India*, 13 JOURNAL OF INTELLECTUAL PROPERTY RIGHTS 563, 566 (2008).
[12] *Guide to Double Taxation Treaty in India*, INDIA FILINGS, https://www.indiafilings.com/learn/guide-to-double-taxation-treaty-in-india/ (last accessed March 30, 2020).

clear advantage to India given its limited cross-border transaction with these countries. Further, the next treaty that India signed was with Mauritius in the year 1982, which turned out to be a major source of revenue loss for India. However, an examination of this treaty is outside the scope of this essay. It was only in the 1990s that India signed worthy DTAAs with countries which could provide it with investment and technology, or countries which could use India's labour and capital.[13]

A typical DTAA with India is guided by the UN Model of Double Taxation and only covers residents of the two contracting countries. A taxpayer, who is not a resident of either country, cannot claim any benefit under such DTAA. These residents are, unless provided otherwise, governed by the laws of either of the two countries. Thus, the domestic laws of both Contracting Parties to a DTAA come into play to enable the effective functioning of the DTAA. For instance, when different tax rates are given in the IT Act and the DTAA, S.90 of the IT Act provides that the lower of the two is levied on the taxpayer, irrespective of the country of which he is resident. However, a discrepancy arises due to the general scheme applicable to Tax Deductible at Source, according to which tax had to be deducted at the rate prescribed in the IT Act, despite the rate in the DTAA being lower.[14] This resulted in larger taxes being deducted from sums remitted to foreign companies, requiring them to file claims of refund.[15] This situation was remedied by the Finance Act, 2017,[16] which inserted S.2(37A) into the IT Act, which ensured that tax is deducted at source at the lower of the two rates provided in the DTAA or the IT Act.

V. THE DOUBLE TAX AVOIDANCE AGREEMENT BETWEEN INDIA AND THE UNITED STATES OF AMERICA

India and the US entered into a Comprehensive DTAA in the year 1989 which came into effect on December 18, 1990. Various amendments were made to the DTAA over the years, with one of the most important ones being the inclusion of the Foreign Account Tax Compliance Act (FATCA) notification in 2015.[17] FATCA addresses the tax compliance requirements of US residents by requiring them to disclose specific interests in banks and financial accounts and foreign financial assets while filing their personal returns.The

[13] Ray, *supra* note 1, at 9.
[14]*Id.*, at 2.
[15]*Id.*, at 5.
[16]Finance Act 2017, No.7 of 2017, Acts of Parliament, 2017 (India).
[17]*What is Double Taxation Avoidance Agreement?*, COMPARE REMIT, https://www.compareremit.com/money-transfer-guide/double-taxation-avoidance-agreement/ (last accessed April 1, 2020).

agreement is designed to increase transparency between the two nations on tax matters.[18]

The provisions of the DTAA apply to any individual or an estate, a trust, a partnership, a company, any other body of persons, or other taxable entity having income in both India and the US. One thing to note about the Indo-US DTAA is that it only covers income tax and not GST or other types of indirect taxes.[19] As per Art.2 of the DTAA, it encompasses the following taxes levied by the two countries[20]:

- The Federal Income Taxes imposed by the Internal Revenue Code, 1986 of the United States. The DTAA also applies to the excise taxes imposed on insurance premiums paid to foreign insurers, and with respect to private foundations, to the extent that the risks covered by such premiums are not reinsured with a person not entitled to exemption from such taxes; and
- In India, the income tax including surcharge and surtax, except the income tax on undistributed income of companies, imposed under the IT Act.

One issue with the DTAA is the "savings clause" given under Paragraphs 3 and 4 of Art.1. As per Paragraph 3 of this clause, India and the US reserve their right to tax their residents and citizens as provided in their domestic laws, notwithstanding any DTAA provisions to the contrary. However, this is balanced by the exceptions given in Paragraph 4 of this clause, which come into play where the Savings Clause would contravene policies reflected in the treaties which are intended to extend a Contracting State's benefits to its citizens and residents.[21]

VI. MAJOR PROVISIONS OF THE INDO-US DTAA

Article 4: Residence

Determining the residential status of a taxpayer having income from two countries is one of the first steps that need to be taken to determine its taxing liability. According to Art.4 of the DTAA, resident of a country means any person who, under the laws of that State is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of

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[18]Peter Harper and JanpriyaRooprai, *Interaction of Indian and U.S. Tax Laws*, ASENA ADVISORS, https://asenaadvisors.com/knowledge-centre/whitepapers/interaction-of-indian-and-us-tax-laws/ (last accessed April 1, 2020).
[19]*India USA DTAA – Double Tax Avoidance Agreement*, INDIA FILINGS, https://www.indiafilings.com/learn/india-usa-dtaa/ (last accessed April 1, 2020).
[20]Agreement for Avoidance of Double Taxation of Income with USA, India-USA, art.2, Dec. 20, 1990, GSR 992(E) [hereinafter India-USA DTAA].
[21]*Help with Common US Tax Issues for US-Indian Persons*, IRS MEDIC, https://www.irsmedic.com/kb/services/international-tax-issues/country/india.html (last accessed April 1, 2020).

incorporation, or any other criterion of a similar nature.[22] Thus, if a taxpayer falls under the definition of a resident as per the IT Act, it would qualify as a resident of India for the purposes of the DTAA.[23]Art.4(2) of the DTAA provides further rules for determination of the residential status where the above definition of resident doesn't apply.[24] The decision regarding a taxpayers residential status must follow the sequence of the four tests envisaged in Art.4(2), each of which must be conducted based on the facts of each case. The four tests in the order of their applicability are, the Permanent Home Test, the Centre of Vital Interests (CVI) Test, the Habitual Abode Test, and the Nationality Test. Further, Art.4(3) provides that where a company is a resident of both India and the US, it shall be considered outside the scope of the DTAA for most purposes.[25]

The tests envisaged in S.4(2) were applied by the Bangalore Income Tax Appellate Tribunal (ITAT) in the *DCIT* v. *Shri Kumar SanjeevRajan*.[26] The assesse had been living and working in the US for nearly 20 years, after which he was deployed on an assignment in India for 6 years. On completing his assignment in August 2012, the assesse moved back to the US, and a question arose regarding the taxability of his income for the year 2012-13. Since the assesse qualified as a resident according to the national laws of both USA and India, recourse had to be taken to the rules u/Art.4(2) of the DTAA.

On application of the Permanent Home Test, the Assessing Officer (AO) found that though the assessee's house in the US was let out for the time when he was in India, he nevertheless had a permanent home in India as well as the US post August 2012. The AO thus moved on to the second test. As per the CVI Test, a taxpayer is deemed to be the resident of that country with which he has closer personal and economic interests. The AO interpreted "personal and economic interests" to mean a "long and continuous relation" nurtured by an individual with a country which cannot be broken upon mere temporary relocation to another country. On this basis, the AO held that since the assesse was an Indian resident for the entirety of the year 2011-12, relocation to the USA for eight months in 2012-13 does not change its residential status. The AO thus took a holistic view of the phrase "personal and economic relations". The AO further observed that the IT Act does not recognise split residency, and hence the tax year cannot be split so that income from four months in 2012-13

[22] India-USA DTAA, art. 4.
[23]*India USA DTAA – Double Tax Avoidance Agreement*, INDIA FILINGS, https://www.indiafilings.com/learn/india-usa-dtaa/ (last accessed April 1, 2020).
[24]*What is Double Taxation Avoidance Agreement?*, COMPARE REMIT, https://www.compareremit.com/money-transfer-guide/double-taxation-avoidance-agreement/ (last accessed April 1, 2020).
[25] India-USA DTAA, art. 4.
[26](2019) 104 taxmann.com 183.

could be taxed in India, while the rest in the US. Hence, the assessee's income for the year 2012-13 was taxed under the IT Act.

The decision was later overturned by the Commissioner of Income Tax (Appeals), who held that the assessee's CVI was closer to the US. For reaching this conclusion, the Commissioner relied on various facts like the holding of two house properties and a car in the US and the assessee's exercise of voting rights in the US, among other things. This order was further unsuccessfully challenged by the department before the ITAT. The ITAT clarified that the CVI of a taxpayer could be changed within the financial year, and residence in prior years was not relevant to such assessment. This case is one of the many examples of how in the wake of increased globalisation, individuals are often entrapped in dual residency. While Art.4(2) of the DTAA gives clear guidance on the manner of application of the test, subjectivity still remains in the determination of the CVI. A tribunal needs to make an appropriate decision based on the facts of each case looking at the evidence that the taxpayer provides.[27]

Articles 5: Permanent Establishment

Globalisation is not only leading to movement of individuals across nations, but also an increase in cross-border economic activity by corporations. Both the OECD and UN Model Tax Conventions use the concept of a Permanent Establishment to determine the right of the host country to tax a foreigner's business profits.[28] These models restrict the jurisdiction of the Contracting States to taxing the income of a foreign enterprise in their jurisdiction, only if such enterprise carries on the business through a Permanent Establishment.

Art.5 of the Indo-US DTAA exhaustively defines a "Permanent Establishment". Similar to the definition given u/S.92F of the IT Act, according to Art.5, the basic Permanent Establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. However, there might be some activities, which despite being carried on from a fixed place of business, do not qualify as a Permanent Establishment. For instance, a facility merely used for storage by an enterprise would not qualify as its fixed place of business. Similarly, a wholly-owned subsidiary or a joint-venture company of a foreign entity in India may not necessarily qualify as a Permanent Establishment of the

[27]DakshaBaxi, KunalSavani and SanjanaRao, *The Dilemma of Dual Residence – Can Vital Interests Fluctuate Overnight?*, India Tax Law A Cyril AmarchandMangaldas Blog (May 13, 2019), https://tax.cyrilamarchandblogs.com/2019/05/dual-residence-tax-dilemma-nri/.
[28] Dinesh V. Patil, *Overview of Double Tax Avoidance Agreements Provisions*, Western India Regional Council of the Institute of Chartered Accountants of India (Dec.12, 2018) https://www.wirc-icai.org/images/material/Overview-DTAA-Provision-Dec18.pdf.

foreign entity.[29]

The concept of Permanent Establishment was discussed by the Supreme Court in *ADIT* v. *E-Funds IT Solutions Inc.*[30] In this case, two American entities, namely E-Funds Corp and E-Funds IT Solutions entered into international transactions with E-Funds International India Pvt. Ltd., an Indian entity. A question arose as to the taxability of the income of E-Funds International India. Both the Assessing Officer, and on appeal the Commissioner of Income Tax (Appeals), were of the view that the two American entities had a Permanent Establishment in India by way of a fixed place. The Commissioner further observed that in addition to having a fixed place, the American entities also had agency and service Permanent Establishments in India as per Art.5 of the DTAA.

The matter reached the Supreme Court where it was overruled. The Supreme Court rejected the finding that the American entities had a fixed place at their disposal in India, observing that a mere outsourcing of certain activities to India does not give rise to a fixed place Permanent Establishment. The Court further noted that a service Permanent Establishment is created only when customers receive services in India. However, in the present case, since none of the customers of the taxpayer were in India, the Court held that no service Permanent Establishment was created. Lastly, the Court observed that even if there were to be a Permanent Establishment, as per Art.7 of the DTAA, no additional income could be attributed to the taxpayer since the services were remunerated at arm's length.[31]

Article 7: Business Profits

Most DTAAs entered into by India do not contain a definition of the term "Business Profits".[32] However, the Indo-US DTAA is an exception to this norm. The DTAA u/Art.7(7) defines the term "Business Profits" as income from any trade or business including income from furnishing of services, other than included services as defined u/Art.12, and including income from rentals of tangible personal property other than property described u/Art.12.[33] Art.7 incorporates the Limited Force of Attraction Principle, and provides that any Business Profits derived from the assets and activities of a Permanent Establishment in a Contracting State are subject to tax in that Contracting State irrespective of whether or not the

[29] India-USA DTAA, art. 5.
[30](2017) 399 ITR 0034.
[31] CA Krishna Upadhya S, *Article 7 of DTAA – Major Issues and Recent Judicial Pronouncements* (Presented at Bangalore Branch of ICFAI, Feb.6, 2019), http://bangaloreicai.org/assets/uploads/newsletters/3a1bd730-e74a-477b-9f7f-421199c1a9c7.pdf (last accessed April 1, 2020).
[32]*Id*.
[33] India-USA DTAA, art. 7.

transactions are routed and performed through the Permanent Establishment.[34]

Art.7 further provides for the applicability of the domestic Transfer Pricing Regulations on transactions of the Permanent Establishment with its overseas head-office, and provides that where such transactions are not based on the arm's length principle, adjustments need to be made to determine taxable profits in the Contracting State. Further, Business Profits made on purchase of goods or merchandise for the foreign entity are not attributable to the Permanent Establishment of the foreign entity.[35] Since, considerable subjectivity exists in attribution of profits of the Permanent Establishment to the various activities carried out by it, this provision has been a matter of dispute in India.[36] Art. 7 also allows for deductions for expenses incurred for the purposes of the Permanent Establishment, subject to domestic tax laws of the country in which the Permanent Establishment is situated.[37] As per S.44C of the IT Act, the deductibility of common head-office expenses attributable to the Permanent Establishment is restricted to 5% of the adjusted total income.

Applicability of Art.7 of the DTAA can be understood from the case of *Galileo International Inc.* v. *Deputy Commissioner of Income Tax*.[38] Galileo International Inc., the Assesse, was a resident of the US and provided online booking services to hotels and airlines via its Computerised Reservation System (CRS). The Assessee entered into a distribution agreement in 1995 with Interglobe Enterprises Pvt. Ltd., to market and distribute its CRS services in India. The Income Tax Appellate Tribunal (ITAT) held that the Assessee had a Permanent Establishment in India, and thereafter went on to discuss the profit attributable to the Permanent Establishment u/Art.7 of the DTAA. It held that not the entire activity of the Assessee was carried on in India and so only the profit attributable to the functions carried out by its Permanent Establishment would be taxable in India. Upon deliberation, the ITAT reached the conclusion that 15% of the "booking" revenue generated to Assessee was taxable in India, and since the Assessee remunerated Interglobe, which was its agent in India, more than what is attributable to a Permanent Establishment, no further assessment on that front was required.[39]

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[34]*India-US Cross Border Business- A Guide to the Indian Tax and Regulatory Aspects*, RSM, https://www.rsm.global/india/sites/default/files/media/india_-_us_cross_border_business_-_a_guide_to_the_indian_tax_and_regulatory_aspects.pdf, (last accessed March 31, 2020).
[35]*India-US Cross Border Business- A Guide to the Indian Tax and Regulatory Aspects*, RSM, https://www.rsm.global/india/sites/default/files/media/india_-_us_cross_border_business_-_a_guide_to_the_indian_tax_and_regulatory_aspects.pdf, (last accessed March 31, 2020).
[36]*Id*.
[37] India-USA DTAA, art. 7.
[38] (2008) 19 SOT 257 (Del.).
[39] R. Kumar, *Analysis of the Word "Permanent Establishment"*, TAX GURU, https://taxguru.in/income-tax/permanent-establishment-parti.html (last accessed April 1, 2020).

Article 12: Royalties and Fees for Included Services

Taxability of Royalty or Fees for Included Services in the home country of the recipient depends on the domestic tax laws of the home country. The terms Royalty and Fees for Included Services are defined u/Art. 12(3) and Art.12(4) of the DTAA respectively. In simple terms, Royalty refers to the sum of money paid by a Licensee to the Licensor of Intellectual Property Rights, for the benefits derived or sought to be derived by the Licensee through the existence of such rights.

The Delhi High Court in the case of *DIT* v. *Infrasoft Ltd.*[40]discussed the scope of Royalty under Art.12 of the DTAA. In this case, the Assesse, a US Company, was supplying software in India through a Branch office. The Branch imported the software in the form of floppy disks or CDs, customized it as per the requirements of the customer, and then delivered it. The Branch was also providing software installation services and training to the customers. Holding the software to be copyright, the Assessing Office and the Commissioner of Income Tax (Appeals) held that the income from its license was taxable as Royalty u/Art.12 of the DTAA. This Order was appealed before the Delhi High Court. The Court observed that Royalty meant a payment for the transfer of all or any rights in respect of a copyright of a literary, artistic or scientific work. A mere right to use a copyrighted article or product with the owner retaining his copyright was not the same as transferring the rights in relation to the copyright. On this basis, the Court held that merely authorizing or enabling a customer to have the benefit of data, or the instructions contained therein without any further right to deal with them independently did not amount to transfer of rights in relation to copyright. Thus, the given situation merely represented a transfer of a copyrighted article and not a transfer of copyright rights. Hence, the payment made was not considered Royalty u/Art.12 of the DTAA.[41]

A “Fee for Included Services” u/Art.12(4) of the DTAA means “payments of any kind to any person in consideration for the rendering of any technical or consultancy services, including through the provision of services of technical or other personnel” if such services are “ancillary and subsidiary to the application or enjoyment of the right, property, or information” for which a royalty payment is made, or “make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a

[40] 220 taxmann 273 (Del.).

[41] *Non-exclusive & Non-transferable License to use Customized Software not Taxable as "Royalty" under Article 12 of India-USA DTAA*, KHANDAR MEHTA & SHAH, http://www.kmsindia.in/portfolio/non-exclusive-non-transferable-license-to-use-customized-software-not-taxable-as-royalty-under-article-12-of-india-usa-dtaa/ (last accessed April 1, 2020).

technical plan or technical design." [42] Under this provision, payments for "Fees for Included Services" may be subject to a 10% or 15% withholding tax rate, depending on the type of services provided.[43]

The Kerala High Court in the case of *US Technology Resources Private Ltd.* v. *The Commissioner of Income Tax, Thiruvananthapuram*[44] held that payments made for management, financial, treasury and risk management services, and advice on legal matters or undertaking public relations activities by a non-resident to or for an Indian entity do not qualify as Fees for Included Services under this provision. The facts of this case were that the taxpayer, who was a resident of India, did not withhold tax while making payments for such services to a US entity. The High Court on an examination of the DTAA held that the concept of Fees for Included Services in the DTAA had an additional condition that services had to be made available to the recipient, and so was narrower than the concept of Fees for Technical Services in the IT Act. The Court observed that the services provided by the entity were merely advisory in nature, and no technology, plan or strategy was transferred to the recipient. Hence, even though the services provided by the entity fell within the scope of the IT Act, they were not in the nature of Fees for Included Services as per the DTAA.[45]

Article 15: Independent Personal Services

Art.15 of the DTAA provides two conditions under which foreign individuals or firms providing "Professional Services" in independent capacity in India will be subject to tax in India. These two conditions are:

- The activity is performed from a "Fixed Base" regularly available for that purpose to the person rendering the service; or
- The person rendering the service had stayed in India, in the relevant previous year, for a period of 90 days or more.

"Professional Services" as defined u/Art.15(2) contemplates existence of professional skill and the receipt of payments for the performance of such professional skills. However, the definition given is not exhaustive. Further,"Fixed base" connotes something akin to a professional's chamber i.e. a place from where a professional can conduct his independent

[42] India-USA DTAA, art. 12.

[43]*A Roadmap to a U.S.-Brazil Tax Treaty*, BRAZIL-U.S. BUSINESS COUNCIL AND U.S. CHAMBER OF COMMERCE (March, 2019) https://www.brazilcouncil.org/wp-content/uploads/2019/03/Roadmap-U.S.-Brazil-Tax-Treaty_1.pdf.

[44]MANU/KE/2004/2018.

[45]Majmudar India, *Fees for Included Services, Technical Services and Preparatory Activities Explained* (Majmudar& Partners, Nov.15, 2018), https://www.majmudarindia.com/insight/india-tax-update/.

activities.[46]

The taxability of software development services was explored in the case of *ITO* v. *SusantoPurnamo*.[47] In this case, the Ahmedabad Income Tax Appellate Tribunal (ITAT) answered the question whether software development services would be taxable u/Art.12 or u/Art.15 of the DTAA. To begin with, the ITAT held that software development services which require predominant intellectual skill and are therefore dependent on individual characteristics of the person pursuing software development, qualify as Professional Services and are covered by Art.15 of the DTAA. Further, since the services are rendered by an individual, Art.12(5)(e) exemplifies that they will be covered by Art.15 and not Art.12. However, for income from such services to be taxable under this provision, the two conditions laid down u/Art.15 needed to be fulfilled. Applying these principles to the given case, the Tribunal held that even though the services were covered u/Art.15, due to the non-fulfilment of the two conditions of that provision, the income from the services could not be taxed u/Art.15. The Tribunal further noted that once it has been found that the services are covered u/Art.15, the same shall stand excluded from the ambit of Art.12 of the DTAA.

Art.12 and Art.15 of the DTAA are two provisions where considerable litigation has occurred due to the apparent overlap in their scope. This conflict occurs due to the similar nature of professional services and other technical, consultancy and managerial services. These conflicts, however, are less apparent under the DTAA due to Art.12(5)(e) which acts as a specific exclusion clause between the two provisions. In cases, where such exclusion is not made clear, Courts generally take the view that the provision most beneficial to the taxpayer shall be applied.[48]

Article 25: Relief form Double Taxation

Art.25 provides for relief from double taxation by way of Underlying Tax Credit for the residents of the US, and by way of deduction from the tax for the residents of India. According to this provision, subject to the limitations of its domestic law, the US shall allow the income tax paid to India by its resident, as a credit against tax payable in the US. Art.25 further provides that credit will be granted to an Indian resident if the income derived by it is taxed in the US. Deduction of an amount equal to the income tax paid in the US shall be

[46] India-USA DTAA, art. 15.
[47]TS 438 ITAT 2016 (Ahd.).
[48]*Software Development Services are not Taxable under 'Independent Personal Services' Article of the India-USA tax Treaty Since Conditions Given Under the Said Article are not Fulfilled*, KPMG, http://www.in.kpmg.com/taxflashnews/KPMG-Flash-News-Susanto-Purnamo-2.pdf (last accessed April 2, 2020).

allowed, whether directly, or by deduction.[49] The said provision does not make tax being paid by the Indian resident under the IT Act a condition precedent to claiming such benefit. Therefore, this provision is in conformity with S.90(1)(a)(ii) of the IT Act.[50]

In a recent case,[51] the taxpayer who was an Indian resident advanced a certain amount to its wholly owned subsidiary in the US. As per Art.11 of the DTAA, the subsidiary remitted the interest income after withholding taxes at 15%. While filing its income tax return in India, the taxpayer claimed u/Art.25 of the DTAA, a credit of the taxes withheld by the subsidiary. The credit was denied by the Tax Officer on the ground that no return of income was filed in the US. On appeal, the Delhi Income Tax Appellate Tribunal observed that u/Art.25(2), if a resident of India derives income which *may be* taxed in the US, then India has to grant credit of taxes withheld in the US. Thus, the Tribunal held that the resident taxpayer would be eligible to claim the credit of the taxes withheld outside India on furnishing proof that the taxes were withheld in the US in accordance with the laws of the US. The matter was thus remitted to the Taxing Officer to examine the withholding tax certificate to reach a conclusion as to whether the said requirement was met by the taxpayer, and make a ruling accordingly.[52]

VII. Conclusion

Double taxation in the international arena is avoided by way of Tax Treaties or Double Taxation Avoidance Agreements (DTAAs), most of which are based on either the OECD or the UN Models. This essay provides a thorough examination of the major provisions of the India-USA DTAA which is based on the UN Model Tax Convention. The DTAA uses the tax-sparing or the elimination method to avoid double taxation between the two countries. For India, the DTAA has specifically been useful to facilitate free flow of capital into India and from India to the USA. Thus, both countries have made an appreciable effort to accommodate the tax claims of each other in a way that would lead to increase in global trade.

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[49] India-USA DTAA, art. 25.
[50] CA Sachin Kumar, *International taxation*, MCA, https://www.mca.co.in/images/International_Taxation.pdf (last accessed March 30, 2020).
[51] ITA Nos. 201,202,203,204&205/Del/2015.
[52] *Credit for Foreign Taxes Withheld is Available, even if No Return Filed Overseas but Income can be shown to be Taxable in that Country*, (Tax Insights from India Tax & Regulatory Services, PWC, July 30, 2018) https://www.pwc.in/assets/pdfs/news-alert-tax/2018/pwc_news_alert_30_july_2018_credit_of_taxes_withheld_outside_india_available.pdf.

