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Tax treaties and elimination of double taxation

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Agenda

- Objective of DTAAs
- Why does double taxation arise
- Elimination of double taxation
- Methods of avoidance of double taxation
- Practical issues
- Judicial decisions
- Avoidance of double taxation where no treaty exists
- Provisions of the first draft of the Direct Taxes Code



Why Double Taxation Avoidance Agreements (DTAA)

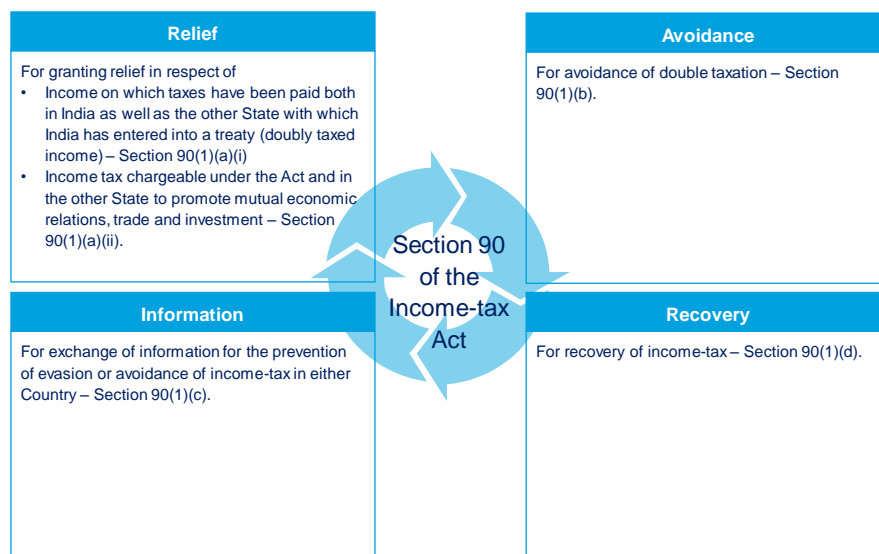
Title in most Model Conventions:

"Convention between [State A] and [State B] for the avoidance of double taxation and prevention of fiscal evasion".

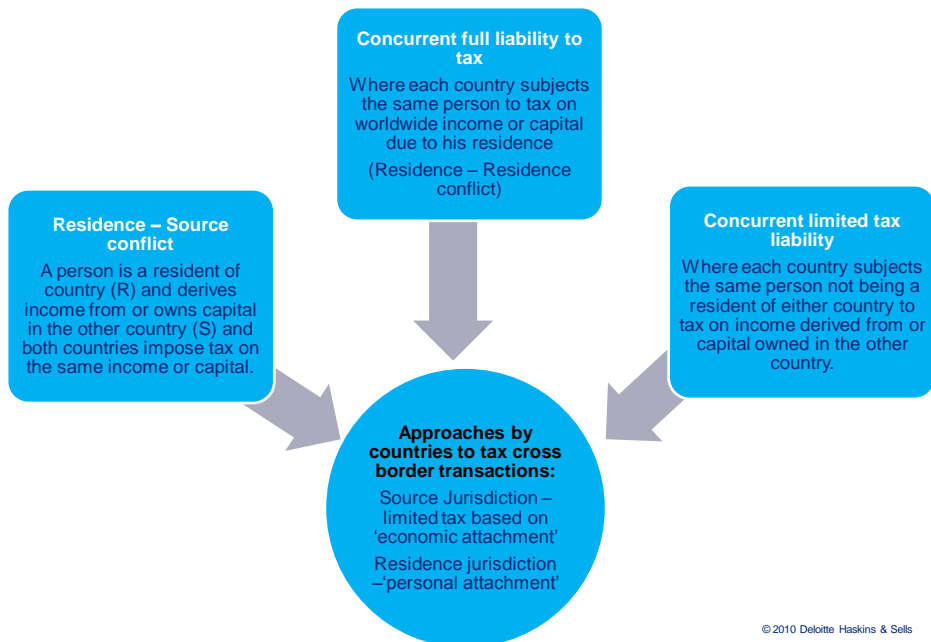
- Tax payers engaged in cross border transactions are taxed twice on same income
- Double taxation implies 'over – taxation' due to overlapping taxing rights.

- One of the primary objectives of International tax principles is avoidance of double taxation
- DTAA provides for the tax claims of two States 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 the tax is to be shared between them
- The scope of the Articles on elimination of double taxation is to deal with the "juridical double taxation" where the same income or capital is taxable in the hands of the same person by more than one State

Objectives of DTAAs as defined under Indian Laws



Why does juridical double taxation arise



Elimination of double taxation

Elimination of double taxation

- Countries often provide their residents with relief from double taxation through their domestic tax laws
- DTAA's contain articles for the elimination of double taxation.
- Relief via DTAA's may be more generous than the domestic tax laws
- Relief entrenched in the DTAA also restricts a country's ability to amend unilaterally the double tax relief provisions in its domestic law to the detriment of tax payers.



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Elimination of Juridical double taxation

Text

Elimination of Juridical double taxation

A. Defining residency of a contracting State – Article 4

- State where an individual is a Resident as determined by treaty would have wider taxing rights, would provide related reliefs where income is taxed in the source State
- Article 4 lists out criteria to determine the State which would have such right.
- Where a person is Resident of more than one State, the tie breaker clause would apply.

B. Allocation of the right to tax between the Contracting States.

- Renunciation of the right to tax either by the State of source or by the permanent establishment (E) or by the State of Residence (R) e.g.: Dependent personal services
- By sharing the right to tax between the two states. ("may be taxed" by Source State, **Resident** state to provide relief) e.g. Royalty and FTS

C. Exclusive right given to one of the Contracting States by use of the term 'shall be taxable only'

- This precludes the contracting State from taxing – exclusive right given normally to a resident of a contracting State (R)

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Methods for elimination of double taxation

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Methods to eliminate double taxation

Foreign income is taxable in the resident country, but taxes paid in the source country are allowed as an expense deduction

Deduction Method

Exemption Method

Foreign income is exempt from tax

Foreign income is taxable but the taxes paid in the source country are credited against the tax payable in the resident country

Foreign Tax Credit

Tax Sparing Method

A credit is given for certain notional taxes that are not actually payable in the source country

Foreign income is taxable but at a reduced tax rate

Reduced Rate Method

- Most jurisdictions use a mixture of deduction, exemption, foreign tax credit and tax sparing methods. The reduced rate method is generally not used

Methods of elimination of double taxation – Deduction Method

Deduction Method

The principle of expense deduction method - Deduction for foreign taxes from the assessable income in the resident country

How it works

- This method limits the relief to the foreign tax paid as multiplied by the marginal tax rate.
- The tax payer bears some element of double taxation on its foreign source income; Does not completely eliminate Residence –Source conflict
- Less desirable method except in a tax loss situation where the excess foreign credit can not be carried forward.

Example – Deduction Method

Particulars	Amount
Foreign source income (Country S)	50
Domestic income (Country R)	50
World wide income	100
Foreign tax payable on foreign source income (40% x 50)	20
World wide income	100
Less: Foreign tax paid	(20)
Taxable income in country R	80
Domestic tax payable in country R (35% X 80)	28
Total tax payable by the tax payer (20+28)	48

State S tax rate is assumed at 40%, State R tax 35%
Foreign Tax paid is 20, benefit received is 35% of 20 i.e 7

Methods of elimination of double taxation – Exemption Method

Exemption Method

The principle of exemption - The State of residence does not tax the income which according to the convention may be taxed only in State S or E

- Looks at **income** for elimination of double taxation.

Two main methods

- Full exemption
 - The income taxed in State S or E is not taken into account by State R at all ; Austria (partial)
- Exemption with progression – e.g Bulgaria
 - Income not taxed by State R, however retains right to take the income into account for determination of tax to be imposed on the rest of income – eg Greece, Bulgaria
 - 'Exemption with progression' produces a different result if the resident country has a progressive tax rate scale.
 - 'Exemption with progression' does not dilute relief from double taxation; but imposes tax at a higher rate on domestic source income.

'Full exemption' Vs 'Exemption with progression' methods

Particulars	Full exemption	Exemption with progression
Foreign source income (Country S)	50	50
Domestic income (Country R)	50	50
World wide income	100	100
Foreign tax payable on foreign source income (40% x 50)	20	20
Domestic tax payable on domestic source income only	17.5 (50 x 35%)	22.5 (50 x 45%)
Total tax payable by the tax payer on world wide income of 100	37.5	42.5

State S rate is assumed at 40%, State R 35% up to income limit of 50, 45% beyond 50
An increase in domestic tax under the second method

Exemption Method – concerns

- Reduces the tax revenues of the State of residence
- Losses of the permanent establishment may be disallowed by the residence state
- Encourages the use of low tax countries or tax havens as the source state
- Could result in double non-taxation where the source country exempts such amounts from taxation.
- Income base to be exempted
- Detailed financial statements are required if exemption is given with progression



Methods of elimination double taxation – Foreign Tax Credit

Foreign Tax Credit

The Principle of credit method - State R allows a deduction (credit) from tax for tax paid in State S

- Looks at tax for elimination of double taxation.

Steps:

- The State R calculates tax including income taxable in State S or E (except where an exclusive right to tax is with State S)
- State R allows a deduction from its own tax for tax paid in State S / E

Two main methods:

- 1) Full credit – Germany (partial), US
- 2) Ordinary tax credit

Methods of elimination of double taxation – Foreign Tax Credit

Foreign Tax Credit

Full Credit Method

- Deduction allowed of the total tax paid in State of S/E on income that may be taxed in that State
- Tax payer is liable to pay only the difference between the tax on State R and State S on the income
- If the foreign tax exceeds the home tax, the residence state refunds the excess tax payment
- The full credit method is rarely used.

(Provisions of the Indo-US Treaty)

Ordinary Tax Credit

- Limits the tax credit to the tax on the doubly taxed income, as computed under the domestic law, as if it were earned at home in the same accounting period.
- Tax payer pays the deficit as tax if the home country tax exceeds the foreign tax paid on the same income.
- Excess tax is not refunded if the foreign tax exceeds the home tax.
- Most of the countries use ordinary credit method

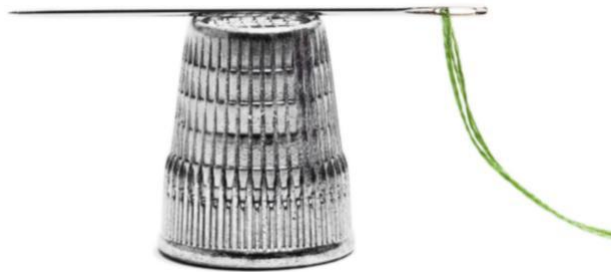
Comparison of 'Full credit' and 'Ordinary credit' methods

Particulars	Full Credit	Ordinary credit
Foreign source income (Country S)	50	50
Domestic income (Country R)	50	50
World wide income	100	100
State S tax payable on State S source income (40% x 50)	20	20
State R tax payable on world wide income (35% x 100)	35	35
Less: Tax credit for foreign tax paid on foreign source income	(20)	(17.5) (35% x 50)
Tax payable in country R	15	17.5
Total tax payable by the tax payer	35 (20+15)	37.5 (20+17.5)

State S Tax rate is assumed at 40%, State R tax 35%

Foreign tax credit method – Concerns

- Excess foreign tax credit may be unusable
- Most of the countries provide ordinary credit, full credit of the foreign taxes paid is not given
- Tax payer always pays the greater of foreign and domestic taxes
- Eliminates the tax relief and incentives given in the source state unless the residence state spares the tax



Methods of elimination of double taxation – Tax Sparing Method

Tax Sparing Credit

“Tax sparing” arises where a source country offers tax incentives to investors which result in reduced or no tax payable in the source country of the investors income, compared with the amount of tax that would otherwise have been payable in the source country.

- A notional tax credit is granted in the resident country for the tax not paid under special incentive schemes/allowances in the source country.
- Treaty prescribes exact nature of such tax free income;
e.g. Australia
- Absence of tax sparing clause in the Treaties would result in the transfer of tax revenues from Source to Resident state with no ultimate benefit to the tax payer.

[ARTICLE XXIV - Methods of elimination of double taxation ...](#)

Forms of Tax Sparing Credit

Tax Sparing Credit

State of Residence

- Allows as a deduction the amount of tax which the State of source could have imposed in accordance with the general legislation, even if the State of source has waived all or part of that tax under special provisions.
- Exempts the income which has benefited from tax incentives in the State of source;
- Agrees to allow a deduction against its own tax of an amount at a higher rate;

Tax Sparing Credit - Concerns

Tax Sparing Credit

Vulnerable to taxpayer abuse which can be costly in terms of loss of revenue to both the State of residence and source.

- Abuse difficult to detect and difficult for State of residence to reach / modify the tax sparing provisions.
- Not necessarily an effective tool to promote economic development since elimination of the benefit of tax incentive would generally be available only when profits are repatriated
- Promotes short-term investment and a disincentive to operate on long-term basis
- May be used only in regard to States the economic level of which is considerably below that of OECD member States – apply objective economic criteria to decide on States entitled to tax sparing benefit.

Underlying Tax Credit

Underlying Tax Credit

In case of US companies holding at least 10% stake in an Indian Company and from which the US company receives dividends, the US company would be able to claim a credit even in respect of the taxes paid by the Indian company on the profits out of which it has paid dividends against its US taxes [Provisions of the Indo-US Treaty](#)

- Individuals and non – corporate assesseees not covered
- Only relevant for USA under the Treaty – India does not allow underlying tax credit
- India provides underlying tax credit in respect of the Mauritius tax payable by the company in respect of the profits out of which such dividend is paid by a company resident in Mauritius to an Indian company (ownership stake of 10% required)
- In the absence of underlying tax credit - outbound investments could be affected – for instance, even if the company may have suffered dividend tax in the US, India will tax the amount

Elimination of double taxation as per DTAA's

Elimination as per DTAA

OECD Model Convention –Article 23

- Article 23 deals with the Treaty relief from double taxation where the same income or capital is taxed by more than one state under the Treaty
- As the prior taxing rights remain with the source state, the relief provisions apply to the residence state only.
- Residence state to elect from the following methods:
 - Exemption method (Article 23A) which considers 'income'
 - Credit Method (Article 23B) which considers 'tax'
 - A contracting state may also use a combination of the two methods.
- **UN Model Convention – Article 23**
 - UN Model also specifies 'Exemption Method' (Article 23A) and 'Credit Method' (Article 23B) to be adopted by residence state.
 - The UN Committee provides for investment incentives through tax sparing credits.
 - Countries, remain free to adopt these investment incentives

Elimination as per DTAA

US Model Convention – Article 23

- US MC does not include the exemption method.
- US MC provides only for the credit method.
- Direct relief to a citizen or resident of a Contracting State for the income tax paid or accrued in the other Contracting State

Elimination as per DTAA

- Either of the exemption or credit methods may have been followed in Treaties.
- Combination methods are however generally used
- The term 'May be taxable' used where specified income is taxable in source state with State of resident allowing a credit for taxes. However, the Source state is subjected to limited tax, credit is available in State R such limited tax.
- Indo – US & Australia treaty extracts reproduced for better understanding...

Provisions of the Indo-US Treaty

Relief from double taxation

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income:

- (a) the income-tax paid to India by or on behalf of such citizen or resident; [full credit] and
- (b) in the case of a United States company owning at least 10 per cent. of the voting stock of a company which is a resident of India and from which the United States company receives dividends, the income-tax paid to India by or on behalf of the distributing company with respect to the profits out of which the dividends are paid. [Underlying Tax Credit]

For the purposes of this paragraph, the taxes referred to in paragraphs 1(b) and 2 of article 2 (Taxes Covered) shall be considered as income taxes.

Indo-US Treaty – contd.

2. (a) Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States. [\[ordinary credit\]](#)
- (b) Further, where such resident is a company by which a surtax is payable in India, the deduction in respect of income-tax paid in the United States shall be allowed in the first instance from income-tax payable by the company in India and as to the balance, if any, from surtax payable by it in India.

Indo-US Treaty - contd

3. For the purposes of allowing relief from double taxation pursuant to this article, income shall be deemed to arise as follows: [\(specific source Rules\)](#)
- (a) income derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention (other than solely by reason of citizenship in accordance with paragraph 3 of article 1 (General Scope) shall be deemed to arise in that other State;
- (b) income derived by a resident of a Contracting State which may not be taxed in the other Contracting State in accordance with the Convention shall be deemed to arise in the first-mentioned State. Notwithstanding the preceding sentence, the determination of the source of income for the purposes of this article shall be subject to such source rules in the domestic laws of the Contracting States as apply for the purpose of limiting the foreign tax credit. The preceding sentence will not apply with respect to income dealt with in article 12 (Royalties and Fees for Included Services). The rules of this paragraph shall not apply in determining credits against United States tax for foreign taxes other than the taxes referred to in paragraphs 1(b) and 2 of article 2 (Taxes Covered).

ARTICLE XXIV - *Methods of elimination of double taxation*
Indo-Australia Treaty (extracts)

1. (a) Subject to the provisions of the law of Australia from time to time in force which relate to the allowance of a credit against Australian tax or tax paid in a country outside Australia (which shall not affect the general principle hereof), Indian tax paid under the law of India and in accordance with this Agreement, whether directly or by deduction, in respect of income derived by a person who is a resident of Australia from sources in India shall be allowed as a credit against Australian tax payable in respect of that income.

(b) Where a company which is a resident of India and is not a resident of Australia for the purposes of Australian tax pays a dividend to a company which is a resident of Australia and which controls directly or indirectly not less than 10 per cent of the voting power of the first-mentioned company, the credit referred to in sub-paragraph (a) shall include the Indian tax paid by that first-mentioned company in respect of that portion of its profits out of which the dividend is paid. (underlying tax credit)

ARTICLE XXIV - *Methods of elimination of double taxation*
Indo-Australia Treaty (contd.) (extracts)

2. In paragraph (1), Indian tax paid shall include :

(a) subject to sub-paragraph (b) an amount equivalent to the amount of any Indian tax foregone which, under the law of India relating to Indian tax and in accordance with this Agreement, would have been payable as Indian tax on income but for an exemption from, or reduction of, Indian tax on that income in accordance with : (tax sparing)

(i) section 10(4), 10(15)(iv), 10A, 10B, 80HHC, 80HHD or 80-I of the Income-tax Act, 1961, insofar as those provisions were in force on, and have not been modified since, the date of signature of this Agreement, or have been modified only in minor respects so as not to affect their general character; or

(ii), and

(b) in the case of interest derived by a resident of Australia which is exempted from Indian tax under the provisions referred to in sub-paragraph (a), the amount which would have been payable as Indian tax if the interest had not been so exempt and if the tax referred to in paragraph (2) of Article 11 did not exceed 10 per cent of the gross amount of the interest.

Claiming tax credit – Documentation requirements

- Overseas Tax Returns
- Overseas Tax withholding certificates
- Certificate of Residency
- Certificate from Foreign Tax authorities
- Third party certification
- Fiscal year mismatch – part year return, part year withholding certificate?

Judicial decisions

Digital Equipments India Limited (Mumbai Tribunal)

- Assessee is a public limited company engaged in the manufacture, sale, service, development of software
- Co. filed its return of income disclosing a loss
- Part of income included in the India return of income was also subjected to tax in the US
- AO did not allow credit as 'deduction of tax paid in the US had to be allowed from taxes payable in respect of the same income in India'
- CIT (A) held that the situation is absurd and not envisaged in the Treaty and that a credit is available AND a tax paid in the US is refundable even though no tax was paid in India
- Mumbai Tribunal held that a deduction on account of income tax paid in the US from income tax payable in India cannot exceed the Indian tax liability in respect of such income

Effect of DTAA

CIT Vs R.M. Muthiah – 202 ITR 508 (Kar)

- If no liability is imposed under the domestic law, the question of resorting to the agreement would not arise.
- No provision of the agreement can possibly fasten a tax liability where the liability is not imposed by the domestic law.
- If a tax liability is imposed by this Act, the agreement may be resorted to for negating or reducing it.
- In case of difference between the provisions of the Act and the agreement, the provisions of the agreement would prevail over the provisions of the Act and can be enforced by the appellate authorities.

CIT Vs C.S. Murthy – 169 ITR 686 (AP)

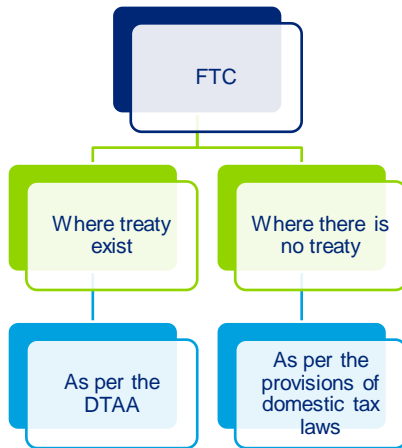
- If any particular slice of foreign income is not subject to tax in the assessment made in India, it is not possible to treat such foreign income not subjected to tax in India also as forming part of doubly taxed income for the purpose of section 91.

Circular No. 333 dated 02-04-1982 to the same effect.

- Where a double taxation avoidance agreement provides for a particular mode of computation of income, the same should be followed, irrespective, of the provisions in the Income-tax Act.

FTC – Indian Scenario

India – Foreign tax credit (FTC) provisions



Current legal position:

- Adopts a Country-by-country approach. Excess credits from high tax countries cannot be used to offset low taxes in other countries. Results in cumulative higher effective tax rate for the tax payer.
- Tax concessions allowed by a foreign country for investments made in that country do not effectively accrue to the investor.
- Tax spared by the source country accrue to the residence country.

India – Foreign tax credit (FTC) provisions

Section 91 deals with FTC in those cases where there is no DTAA.
Relief to be calculated on income country-wise and not on aggregation basis – CIT v. Bombay Burmah (126 Taxman 403)(Bom)

FTC	"Indian rate of tax"	"Rate of tax of the other country"	"Income tax"
= Lower of "Indian rate of income-tax" or "the rate of tax of the other country" , on doubly taxed income	= Amount of Indian Income Tax less <u>relief</u> under the Act / Total Income.	= Amount of income-tax and super-tax actually paid <u>less relief</u> / whole amount of income as assessed in the said country.	= In relation to the other country includes excess profit tax or business profits tax charged on the profits by the Government of any part of that country or local authority in the country.

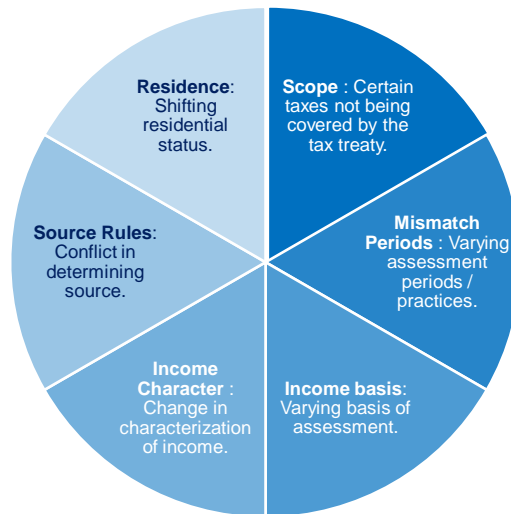
Optimal credit method for FTC

	Country S1	Country S2	Country S3	Country R	Worldwide
Income	100,000	100,000	100,000	100,000	400,000
Rate of taxation	30%	42%	20%		30%
Tax amount	30,000	42,000	20,000		120,000
Total Foreign Sourced Income	300,000				
Total Foreign Taxes Paid	92,000				
Foreign Tax Credit					
A - Country by Country Method	30,000	30,000	20,000		80,000
B - Full Credit Method					92,000
C - Aggregation or Overall Method (with limitation)					
FTC = Resident Income Tax X Foreign Source Income / Worldwide taxable income					90,000
120,000 X 300,000 / 400,000					
Carry forward / carry back ward					2,000

Full credit method with carry-forward / carry-back – equitable

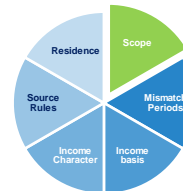
Foreign tax credit – Practical Issues

FTC Denial



Situations where FTC may be denied

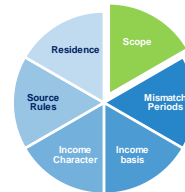
Situation 1: Taxes not covered – State taxes



Scope – Taxes not covered

- Article 2 of tax treaties specifies only those taxes it covers.
- Indo US perspective, will typically cover Federal taxes on income and capital.
- Non-federal taxes will fall outside the tax treaty. Imposition of such taxes will result in double taxation.
- When a tax is not covered by a tax treaty, the treaty cannot provide a relief mechanism for avoiding double taxation of such tax.
 - Relief from double taxation of taxes not covered by the tax treaty has to be allowed through unilateral measures in each State's domestic law.

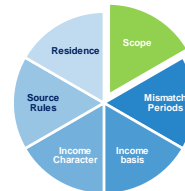
FTC for dividend distribution tax



Dividend Distribution Tax (DDT)

- **Section 115-O :**
 - Tax on distributed profits of domestic companies
 - No deduction for the company distributing the dividend
 - No deduction for the shareholder receiving the dividend
- **Creates a situation for granting FTC for underlying tax**
- **Only some tax treaties allow FTC for underlying tax**
 - India : Mauritius tax treaty expressly allow FTC for underlying tax where the beneficial ownership of a company in a company resident in the other state exceeds 10%
 - India UK treaty allows for underlying credit in UK, no specific provision for FTC in India

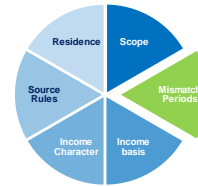
FTC for Fringe Benefit Tax



Fringe Benefit Tax(FBT)

- **Section 115WA: Charge of FBT**
 - FBT shall be charged in addition to income-tax charged under the Act
 - In respect of fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year
 - Tax on fringe benefits shall be payable by the employer
- **Circular No. 9/ 2007:**
 - Denial by India - Q7: No FTC can be claimed in India
 - Q8: FTC claim in other State possible where there is a recovery, FBT being a surrogate tax.

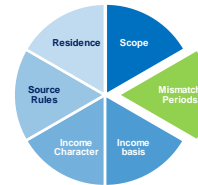
Situation 2: Different Assessment Periods



Timing mis-match

- Different assessment periods leads to:
 - Variance in timing of deductible expenses
 - Variance in timing of income
- Could result in double taxation
- Some of the common reasons for variances could be:
 - Section 43B
 - Provisions allowing deferment of income

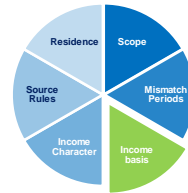
Situation 2: Different Assessment Periods



Different payment / assessment practices

- FTC often gets denied only on account of technicalities and vagaries in tax administration
- Corporate tax returns to be filed in India by 30th September
- A foreign (source) country could permit longer periods for payment of taxes and filing of tax return
- Subsequent tax assessment in the foreign (source) country could also enhance the tax liability
- Such events result in delay in quantifying the amount of FTC

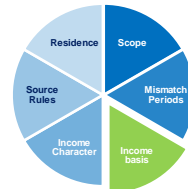
Situation 3: Different Assessment Bases



Difference while determining "income"

- Source State having more generous depreciation rules than residence State resulting in less taxable income in the residence State.
- Expenses deducted in one State may be capitalized in another.
- Gains on account of foreign exchange fluctuations.
- Indexation benefit available for capital gains in the residence State but not available in Source State.

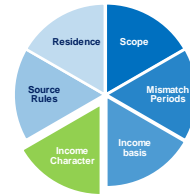
Situation 3: Conflict in source of income



Conflict in determining source

- Different States may characterize income or capital differently resulting in application of different tax treaty Articles.
- Different States may differ in the interpretation of tax treaty rules allocating the right to tax.
- E.g. Inter-company transfer pricing principles

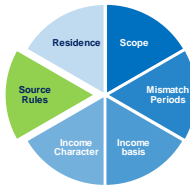
Situation 4: Characterisation of Income



Characterization

- Source State interpreting “ordinary business income” as “royalties and fees for technical service”
- Tax is levied by invoking Article 12
- Residence State may take a view that income being in the nature of business profits, the source State [in the absence of a PE] ought not have taxed such income
- FTC may be denied by the residence State

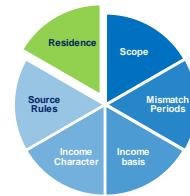
Situation 5 : Shifting residential status



Source Rules

- X an employee seeks voluntary retirement while serving for a company in State A. Compensation upon termination of employment to be paid over a five years period.
- After retirement, X settles as a tax resident in State B. Ceases to be a tax resident of State A.
- State A can claim that VRS compensation paid to X is sourced in State A as it related to a former employment in State A.
- Based on residential status, State B will tax VRS compensation. State B can also deny FTC on the ground that employment was not exercised in State A during the relevant year.
- State B can also tax the compensation as “other income”.
- **Article 15 (Dependent Personal Services) gives the source state a right to tax only when employment is exercised in that state.**

Situation 6: Situations of treaty shopping



Residence

- “Treaty shopping” refers to the use of a treaty by persons who are not themselves within the personal scope of the convention
- Resident of a State A establishing an entity within State B which is a party to the treaty with another State C in order to take advantage of the provisions of that treaty between State B and State C
- Establishing a conduit company in a Contracting State B to receive income from State A

ESOP Taxation

Issues in ESOP Taxation

Example

- Employee a US tax resident employed by a “domestic company” in India
- Employment exercised wholly in the US
- Granted options under ESOP scheme, which when exercised will result in allotment of shares in the Indian company

Tax treatment as per IT Act

- When exercised, there is no income under the head “Salaries” in India. No FBT as well.
- When shares are sold, it results in capital gains liable to tax in India as the situs of the share is in India.

Issues in ESOP taxation – example contd..

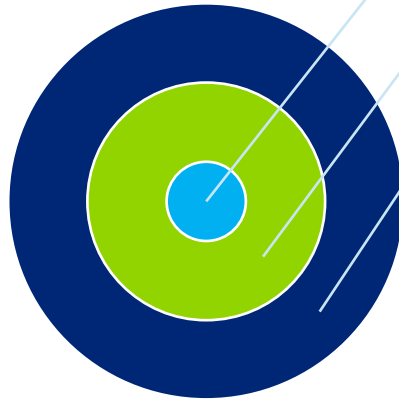
US law taxes non-qualified stock options at two levels:

- Compensation income on exercise / vesting: Equal to the fair market value of shares on such date less the exercise price paid to acquire the shares.
- Capital gains on disposition : Equal to the sale consideration less the FMV on date of exercise.

Denial of FTC in the US for the following reasons:

- Employees suffers only capital gains tax in India. US taxes income partly as compensation income & partly as gains.
- US taxes capital gains based on residential status. If alienator of shares is tax resident in the US, he is liable to tax in the US. US domestic law does not recognize, the Indian source rule.
- As Article 25 of the India- US tax treaty, source rules for the purposes of FTC are to be determined as per the domestic laws.

Issues in ESOP taxation



Both States to the tax treaty claiming that income is sourced therein both under its domestic law and under the tax treaty.

Resident State will proceed to tax the income applying its source rules.

Resident State ignores the "source" claims of the other State.

FTC under the Proposed Direct Tax Code(Draft)

No Treaty Override

- Neither a Double Taxation Avoidance Treaty (DTAA) nor the Code to have preferential status.
- The provisions of the later of DTAA and DTC provisions will prevail.

FTC included under the DTC provisions

- FTC provided for as per the DTAA could be availed since specifically included under the domestic tax law provisions
- Where no treaty has been entered into, FTC with respect to taxes paid overseas could be availed, however no FTC available where the income is India sourced.
- Requirement of Residency Certificate incorporated
- Benefits of lower rates of taxes specified in the DTAA – can be availed only if the treaty is ratified subsequently?

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