Avoidance of Double Taxation (DTAA) - UAE & India

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Introduction

Benjamin Franklin once said, there are two things you cannot avoid; death and taxes. In a country like the UAE, where tax is almost invisible, corporate tax is levied on oil companies and foreign banks as part of the corporate tax regime, and with the introduction of VAT, this saying could not have been truer. Despite the aforementioned taxes, UAE is still a very attractive investment hub for foreign investors.

The UAE has entered into an agreement to avoid double taxation with over 100 countries with the aim to promote their economic relations and prevent tax evasion. The taxation regime protects the interest of enterprises by making sure either country is not burdened with double the tax that they are liable to pay. Enterprises in business with either country need to, however, constantly keep updating themselves with the changing tax regimes thereto.

This article, therefore, deals with one such country that has entered into an agreement with the UAE under this taxation regime.

Double Tax Avoidance Agreement (DTAA) between UAE- India

India, unlike the UAE, has a tax regime that has a wider scope and covers a myriad of income. Tax is levied on income, wealth accompanied by a levy of VAT and surtax. In order to keep track of all these taxes, their implications and to keep a check on all the updates in any tax legislation, rules and regulations, a legal entity requires the assistance of legal practitioners.

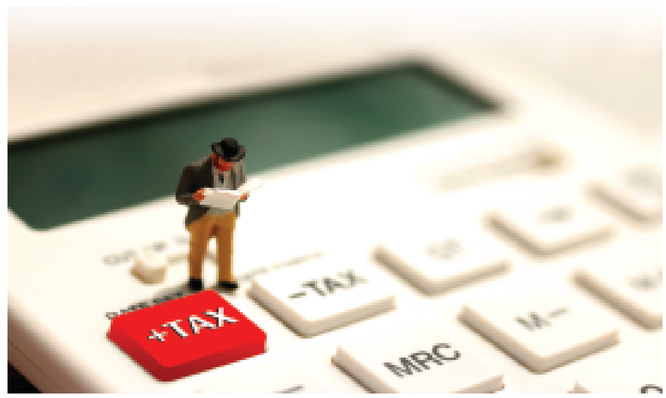
This Treaty was entered into by the two parties in the year 1993, with the aim of promoting trade relations and as a benefit, to enterprises of both countries, to avoid being taxed for the same thing twice. Protection of income is with respect to the following:

I. Revenue derived from shipping and Air transport;

II. Royalties, interest and dividends;

III. Revenue generated from immovable property or alienation thereof; and

IV. Revenue derived from providing personal services.



In order to avail this benefit, the entities of either country must have a permanent establishment in either state.

With respect to the subject of taxation, tax is to be levied on the following:

I. Profit derived out of business along with any profits derived from Air and shipping transport;

II. Revenue of each individual entity that exists in either country;

III. Directors' fees; and

IV. Employee salaries.

The Treaty lays down that a tax levied hereunder shall be on the entity wherein commercial activity was conducted. To determine the place of commercial activity, the entity must have either of the places of business in the country to the Treaty; it may be, an office, place of management, a factory or workshop or any other such place that would facilitate business activities and generate revenue or profit to the entity concerned.

continued on next page ▸

"Taxes are the lifeblood of government and no taxpayer should be permitted to escape the payment of his just share of the burden of contributing thereto."

– Arthur Vanderbilt

Case Laws

Tax, as a subject is a very complex one. Legislations of taxation though, theoretically sound, are practically complicated to implement. Therefore, many businesses either resort to experts or they stumble into lengthy litigation due to discrepancies.

As a cautionary measure, businesses must always refer to precedents to avoid making errors in the application of the tax.

Abu Dhabi Commercial Bank, Mumbai V Department Of Income Tax

For the sake of convenience let us refer to ADCB as A. A, is a party engaged in the banking business and made remittances to UAE nationals. However, by certificates issued by their CA, tax deducted on such remittance showed "nil".

As per **Article 13** of the DTAA, A argued that the tax value remained nil on such remittance because tax deductions on capital gains are payable in the country of residence.

It was observed by the court that, since there are no provisions regarding tax on capital gains in the UAE, the capital gains arising in India are taxable. Therefore, the judge held that any person responsible for making payment to a non-resident, including the resident bank (i.e. A) is responsible for deducting tax at the source.

In another case, Dr. Rajnikant Bhatt, Thane V Assessee, A, was a resident of the UAE, therefore as per the DTAA any income not falling under the ambit of **Article 22** of the Treaty, which talks about the effect of the Treaty on income other than the ones mentioned in the preceding Articles, was subject to taxation.

The learned judge herein failed to appreciate the fact that A was a resident of the UAE and held that the income was properly taxed in India, whereas it was subject to be taxed in UAE.

Therefore, this holding was erroneous and had to be amended. It was ultimately held that A was a recipient of income arising out of business carried out through a permanent establishment in the UAE; therefore the income assessed fell under the heading "other income sources" as per the Treaty and cannot be taxed in India, since A was a resident of UAE.

UoI v. Azadi Bachao Andolan reported in (2003) 263 ITR 706 (SC)

The Supreme Court of India clarified that the capital gains of any resident of the contracting state that arose from the alienation of shares in the other contracting state should be taxable in that contracting state in which the resident resides, as per their domestic laws. Any contravention to the domestic laws of the state would be averse to its constitution; further, a treaty cannot precede legislation of the state.

Important Provisions

The practical application of case laws demonstrates that there are some provisions of the DTAA, that cause the most confusion among parties governed under it. Therefore, we must concentrate on those to avoid complications;

Applicability

The scope of applicability of the Treaty governs those people who are residents of both or one of the contracting states. However, this Article is quite ambiguous in nature, considering that the domestic laws in India and the UAE with respect to taxable entities. Therefore, what takes precedence over the other is usually a subject of confusion.

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"The avoidance of taxes is the only intellectual pursuit that carries any reward."

– John Maynard Keynes

Taxes covered

The provisions of the DTAA only cover direct taxes, that is, taxes imposed on income and capital gains. It further also lays down that the agreement will be applicable to identical or similar taxes imposed on income or capital as per the state laws. A question that may arise here is whether the tax treaty will override the provisions of the domestic laws of the contracting states. Therefore, to answer that question, we may rely on the precedent of; in the affirmative, we can say that the tax treaties will, in fact, override the domestic tax laws of the concerned states.

Residents

A resident under the provisions of this Treaty is any person who is liable to pay taxes owing to his residence, domicile, place of establishment or any other such criteria imposed by the Treaty.

In the case of dual residency, the rule is that the predominant personal or economic ties of that person with respect to the contacting state is to be determined. Either by his citizenship or permanent home or by his place of establishment or place of effective management in any other case.

Most controversies arise under this Article of the Treaty (**Article 4**) since the domestic tax laws in AUE do not impose taxes on their residents. The question that arises is whether the resident of UAE will be eligible to receive tax benefits under this Treaty. In the case of *MA Rafik (213 ITR 317),* it was observed that the term resident and liable to pay, cannot be equated with the actual payment of tax. Therefore, making him eligible to tax benefits.

Dividend

The right to impose a tax on dividend lies with the country where the recipient resides. However, as per the Treaty, dividend may also be taxed based on the place of the company's establishment, subject to the domestic tax laws of the country. The point that may be disputed herein is that, if dividends arise out of the profit of the company that has already been taxed, would it not amount to double taxation, defeating the whole purpose of the Treaty? For this purpose, dividends are generally excluded from being taxed.

Interest

Interest on income is subject to the imposition of tax in the country where the resident resides. Contrarily, it can also be taxed depending on the laws of the country where such interest arises. Therefore, it becomes important to determine, accurately, which contracting state is entitled to levy such tax.

Capital Gains

Capital gains basically mean the profit that arises out of the sale of immovable property. Therefore, the DTAA provides for taxation of such capital gains in the country where such property is situated. In the case of the movable property; however, the tax will be levied by the country in which the permanent establishment of the company is situated.

Elimination of Double Taxation

Where a resident of India, derives income that is taxable in UAE, India shall allow such a deduction on tax on that income tax paid in the UAE, either directly or by deduction.

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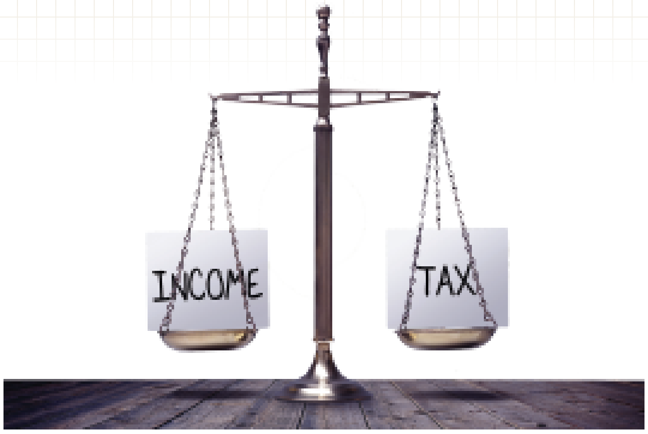

"Of all debts, men are least willing to pay their taxes; what a satire this is on government."
- Ralph Waldo Emerson

There are two aspects of elimination. One deals with exception and the other with credit. The exception is with respect to the allocation of tax and the credit aspect, includes provisions for giving tax credit against the tax paid in the country of origin of such tax.

Non- discrimination

The DTAA clearly lays down that no person should be taxed in any of the contracting states with a tax burden, that wouldn't have been imposed in normal conditions on a resident of that contracting state, under similar circumstances.

Benefits derived out of the Treaty

I. Economic growth is a result of individual growth; therefore, foreign investments play a big part in growing economies through their cross-border transactions. It makes each party to the agreement an attractive investment hub by providing relief from double taxation. Tax deductions may range from 10 to 15 percent depending on the country in case of the UAE the tax rate is about 12.5 percent. The fact that UAE charges minimal rates of tax anyway is an attractive destination for investment for many countries since taxation under this Treaty does not dent the company's capital to a great extent.

II. The DTAA solves the problem of imbalance in tax collection. Charging heavy taxes on income in the source country and the resident country results in losses in both parties to the contract. Therefore, by this agreement, the burden on businesses is also reduced.

III. It further encourages the cross-border flow of technology and investment, along with facilitating the smooth movement of goods between the two countries.

IV. International treaties such as this, facilitate the exchange of information between countries regarding ant changes in the taxation regime or otherwise, which reduces the burden on the parties to constantly keep updating themselves about changes.

V. It further provides a sense of legal certainty. With the application of this Treaty and the rules imposed according to it, contracting parties do not have to worry about keeping in mind conflicting provisions of multiple legislations.

The non-discriminative policies implemented through the agreement ensures that the same laws and regulations apply to both countries with regards to similar situations.

Conclusion

Therefore, this tax convention serves as a means to provide profit to both contracting parties. It governs all aspects of taxation and lays down benefits for the avoidance of the same. This policy was introduced to open up the economy, and it makes it more suitable and attractive to international trade. It further leads to economic integration through economic growth and the free flow of goods and services.

Further, the growth in cross border trade relations has forced countries to develop new technology to match the scale of operation and demand from all over the world.

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