CHAPTER 22

DOUBLE TAXATION RELIEF



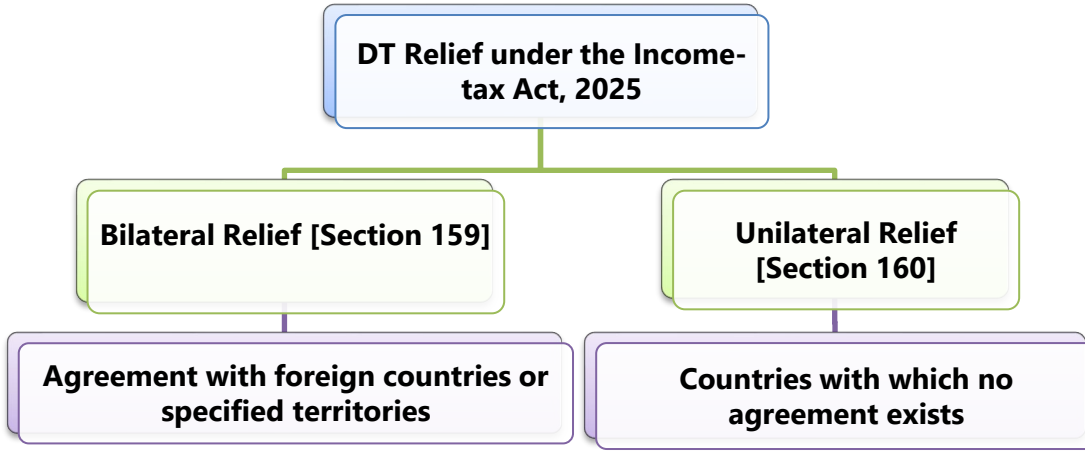
LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the need for double taxation relief.
- **appreciate** the types of double taxation reliefs available.
- **comprehend and apply** the provisions relating to double taxation relief contained in the Income-tax Act, 2025 and Income-tax Rules, 2026 in problem solving and addressing related issues;
- **comprehend** the procedure for claiming deduction where there is no double taxation avoidance agreement between India and the other country where the income has been taxed and **compute** the amount of deduction.
- **appreciate** the concept of Permanent Establishment under double taxation avoidance agreements and its relevance.

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CHAPTER OVERVIEW



22.1 CONCEPT OF DOUBLE TAXATION RELIEF

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country's domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule.

Source rule of taxation

The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident.

Residence rule of taxation

The residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides.

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If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAAs) become very significant.

DTAAs lay down the allocation rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAAs.

Meaning of Double Taxation

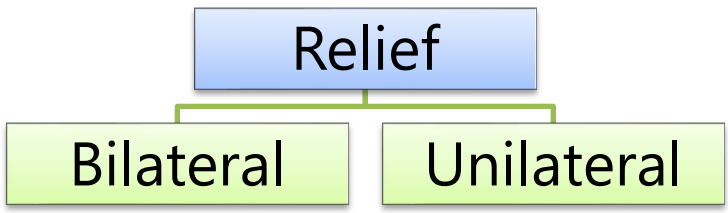
Double taxation means taxing the same income twice in the hands of an assessee. A particular income may be taxed in India in the hands of a person based on his/its residence. However, the same income may be taxed in his/its hands in the Source Country also, as per the domestic laws of that country.

This gives rise to double taxation. It is a widely accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 2025 has provided for double taxation relief.

Further, modern DTAAs increasingly incorporate anti-abuse provisions such as the Principal Purpose Test (PPT). The CBDT has issued guidance on the application of the PPT in India's tax treaties *vide Circular No. 1/2025 dated 21 January 2025*, and therefore the availability of DTAA benefits is subject to satisfying such anti-abuse conditions.

22.2 TYPES OF RELIEF

Relief from double taxation can be provided in mainly two ways:



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(1) Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or avoidance of double taxation with almost 90+ countries which include Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief

Bilateral Relief may be granted in either one of the following methods:

Exemption Method	• A particular income is taxed in only one of the two countries.
Tax Credit Method	• Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement. • The country of residence of the tax payer, however, allows him credit for the tax charged thereon in the country of source.

India follows credit method in majority of its DTAAs.

(2) **Unilateral Relief**

This method provides for double taxation relief unilaterally by a country to its resident for the taxes paid in the other country, even where no DTAA has been entered into with that country. India grants unilateral relief through credit method under section 160 to its residents for taxes paid in a country, with which India has not signed DTAA.

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22.3 AGREEMENT WITH FOREIGN COUNTRY OR SPECIFIED TERRITORY [SECTION 159]

Central Government or Specified association may enter into an agreement with other Country

Section 159 provides for bilateral relief of double taxation. Section 159 empowers the Central Government to enter into an agreement with the Government of

- any other country or
- specified territory

for the purposes as stated in section 159(3) below and may by notification make such provisions as necessary for implementing the agreement.

Further, any specified association in India may also enter into an agreement with any specified association in the specified territory outside India for the purposes for the purposes as stated in section 159(3) below.

Purposes for which agreement with other country may be entered

The following are the purposes stated in section 159(3) -

(a) **for the granting of relief** in respect of -

- income on which income-tax has been paid both in India and in that country or specified territory; or
- income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) **for the avoidance of double taxation of income** under this Act and under the corresponding law in force in that country or specified territory, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory); or

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(c) **for exchange of information** for

- the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or
- for investigation of cases of such evasion or avoidance; or

(d) **for recovery of income-tax** under this Act and under the corresponding law in force in that country or specified territory.

Provisions of the Act applicable to the extent more beneficial

Where the agreement has been entered into under section 159 for granting of relief of tax or avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

However, the provisions of General Anti-Avoidance Rule (GAAR) contained under Chapter XI, shall apply to the assessee even if such provisions are not beneficial to him.



Notification No.90/2008 dated 28.8.2008 and Notification No.91/2008 dated 28.8.2008

The Central Government has, vide these notifications, notified that where an agreement under section 159 for granting of relief of tax or avoidance of double taxation **provides that any income of a resident in India may be taxed in the other country,** then such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 2025, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

Charge of Tax

The charge of tax in respect of a foreign company or a company incorporated in the specified territory outside India at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such company.

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Meaning of terms used in agreement

S. No.	Particulars	Meaning of the term
Term defined in the agreement itself		
(1)	Term used in any agreement which is defined in the agreement itself.	The term shall have the same meaning assigned to it in the agreement.
Term not defined in agreement, but defined in the Income-tax Act, 2025		
(2)	Term used in any agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 2025.	The term shall have the meaning assigned to it in the Income-tax Act, 2025 **including any explanation given** by the Central Government.
Not defined in the agreement or the Act but assigned meaning in the notification issued by the Central Government		
(3)	Term used in any agreement under section 159 and not defined in the agreement or the Act but assigned a meaning in the notification issued by the Central Government, which is still in force.	It shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which the agreement came into force.
Not defined in the agreement or the Act or in the notification issued by the Central Government		
(4)	Term used in any agreement under section 159 and not defined in the agreement or the Act or in any notification issued but assigned a meaning in the notification issued by the Central Government, which is still in force.	It shall have the meaning assigned to it - - in any Act of the Central Government related to taxes and - in any other case, in any other law of the Central Government and shall be deemed to have effect from the date on which the agreement came into force.

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Circular No. 333 dated 2.4.1982

The CBDT has, vide this circular provides that the specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 2025. However, where there is no specific provision in the treaty, then the Income-tax Act will apply.

Generally, DTAA only provides for distribution of taxing rights between the residence and the source State. The computation mechanism is usually not provided under DTAA and the same is governed by the domestic tax law of each country.

Furnish certificate of residence for claiming treaty benefit

The agreement under section 159 is intended to provide relief to the taxpayer, who is resident of one of the Contracting States to the agreement. Such taxpayer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a Contracting State also claimed the benefits under the agreement. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 159(8)(a) provides that an assessee, not being a resident can be allowed to claim the relief under such agreements if-

- a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory outside India and
- he provides such other prescribed documents and information.

Accordingly, Rule 75 specifies the following for claiming double taxation relief:

- For the purposes of claiming any double taxation relief under an agreement, the other documents and information to be provided by an assessee (not being a resident) under section 159(8)(b) shall be as per Form No. 41.
- The assessee shall keep and maintain such documents as are necessary to substantiate the information provided in Form No. 41 and the income-tax authority may call for the said documents to verify the claim of relief.
- An assessee, being a resident in India, for obtaining a certificate of residence for the purposes of an agreement shall make an application in Form No. 42 to the Assessing Officer.

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- The Assessing Officer, on receipt of the application and on being satisfied in this behalf, shall issue a certificate of residence in Form No. 43.

Information to be provided for claiming double taxation relief

As per Form No. 41, the following information, to be furnished by the assessee for claiming treaty benefits:

(i) Tax Year

(ii) Status (individual, company, firm, HUF etc.) of the assessee;

(iii) Country of residence (in the case of an individual) or Country/Region of incorporation/ registration (in the case of others).

(iv) Tax Identification Number of the applicant in the country or region of his residence and in case no such number is available, then a unique number on the basis of which the applicant is identified by the Government of that country or the region of which he claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 159(8) is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

(vii) Copy of certificate to be uploaded as annexure with Form 41.

Meaning of Specified Associations and Specified Territory [Section 159(9)]

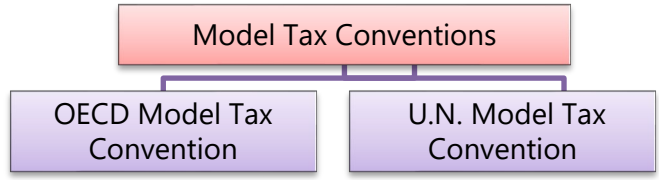
'Specified association' means any institution, association or body, whether incorporated or not,

- functioning under any law for the time being in force in India or the laws of the specified territory and
- which may be notified as such by the Central Government.

"Specified territory" means any area outside India which may be notified as such by the Central Government.

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It may be noted that Tax treaties are generally based on certain model tax conventions. The most common ones are:



These model tax conventions will be discussed in detail in Chapter 27 "Overview of Model Tax Conventions".

ILLUSTRATION 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 2025.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION

The statement is correct.

Section 159(4) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 2025 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 2025, the provisions of the DTAA would prevail over the Act in view of the provisions of section 159(4), to the extent they are more beneficial to the assessee [*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)*].

22.4 DOUBLE TAXATION UNILATERAL RELIEF [SECTION 160]

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under section 160 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India in any tax year in respect of which the income is taxable.

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(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the tax year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

Meaning of important terms

Term	Meaning
Indian Income-tax	It means income-tax charged as per this Act.
Income-tax	Income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.
Indian rate of tax	It means the rate determined by dividing the Indian income-tax after deduction of any relief due under this Act but before deduction of any double taxation relief due to the assessee by the total income.
Rate of tax of the said country	It means income-tax and super-tax actually paid in that country as per the corresponding laws in force in the said country after deduction of all relief due, but before deduction of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country.

ILLUSTRATION 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under

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section 159 of the Income-tax Act, 2025, with that country. Her income in India amounted to ₹ 6,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the tax year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her mother, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the tax year 2026-27, assuming that she opted out of the default tax regime.

SOLUTION

Computation of tax liability of Nandita for the Tax Year 2026-27 under normal provisions of the Act

Particulars	₹	₹
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**
Less: **Deduction under section 123 read with Schedule XV**		
- Deposit in PPF	1,50,000	
- Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
The aggregate deduction under section 123 be restricted to ₹ 1,50,000	1,50,000	
Under section 126		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 126, since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000.	28,000	
Medical insurance premium of ₹ 26,000 paid for mother aged 84 years. Since the mother is a non-resident in India, she will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,03,000
Total Income		**5,17,000**

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Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
		13,936
Average rate of tax in India (i.e. ₹ 13,936/ ₹ 5,17,000 × 100)	2.70%	
Average rate of tax in foreign country (i.e. ₹ 11,000/ ₹ 1,10,000 × 100)	10%	
Deduction under section 160 on ₹ 1,10,000 @ 2.70% (lower of average Indian-tax rate or average foreign tax rate)		2,970
Tax payable in India (₹ 13,936 – ₹ 2,966)		**10,966**
Tax payable in India (rounded off)		**10,970**

Note:

An assessee shall be allowed deduction under section 160 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant tax year.

(b) The income accrues or arises to him outside India during that tax year.

(c) Such income is not deemed to accrue or arise in India during the tax year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 159 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction under section 160.

Foreign Tax Credit [Rule 76]

Year of availability of credit for foreign tax paid

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of

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deduction or otherwise, in the tax year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this Rule [Rule 76(1)].

However, in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India. [Rule 76(2)]

Meaning of "Foreign tax" [Rule 76(3)]

	Country/Specified Territory	Foreign Tax
(a)	in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms section 159.	the tax covered under the said agreement
(b)	in respect of any other country or specified territory outside India	the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 160(3)(a). For this purpose, income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

Components of income-tax in respect of which FTC is available

Foreign Tax Credit (FTC) is available against the amount of tax, surcharge and cess payable under the Income-tax Act, 2025. However, it is not available in respect of any sum payable **by way of interest, fee or penalty [**Rule 76(4)].

No tax credit would be allowed in respect of foreign tax credit or tax paid in foreign country if such tax is disputed in any manner in that foreign State. [Rule 76(5)].

However, if the dispute is settled later and the assessee has paid any amount by way of tax after the settlement of such dispute then he is eligible for tax credit as per rule 76 by making a claim within 6 months from the end of the month in

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which the dispute was settled. The claim is to be supported by furnishing evidence of the payment of tax by the assessee. [Rule 76(6)].

Manner of computing FTC [Rule 76(7)]

The credit of foreign tax would be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:

(a) the credit would be the lower of the tax payable under Act on such income and the foreign tax paid on such income.

However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess has to be ignored.

(b) the credit would be determined by conversion of the currency of payment of foreign tax **at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.**

Rate of exchange for conversion into rupees of income expressed in foreign currency [Rule 206]

As per rule 206(1), the rate of exchange for the calculation of the value in rupees of any income, accruing or arising or deemed to accrue or arise to the assessee in foreign currency, or received or deemed to be received by him or on his behalf in foreign currency, shall be the telegraphic transfer buying rate (TTBR) of such currency as on the specified date.

Rule 206(2)(b)(i) provides that the "specified date" in respect of the nature of income referred in column B of the following Table shall be as given in column C:

Sl. No.	Types of Income	Specified Date
A	B	C
1.	Income chargeable under the head "Salaries"	Last day of the month, immediately preceding the month in which salary is due, or is paid in advance, or arrears.
2.	Income by way of interest on securities.	Last day of the month, immediately preceding the month in which the income is due.

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3.	Income chargeable under the heads "Income from house property", "Profits and gains of business or profession (not being income referred to in Sl. No. 4)", and "Income from other sources (excluding dividends and interest on securities)".	Last day of the tax year of the assessee.
4.	Income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships.	Last day of the month immediately preceding the month in which the income is deemed to arise in India.
5.	Income by way of dividends.	Last day of the month, immediately preceding the month in which dividend is declared, distributed, or paid by the company.
6.	Income chargeable under the head "Capital gains"	Last day of the month, immediately preceding the month of in which the capital asset in the table is transferred;

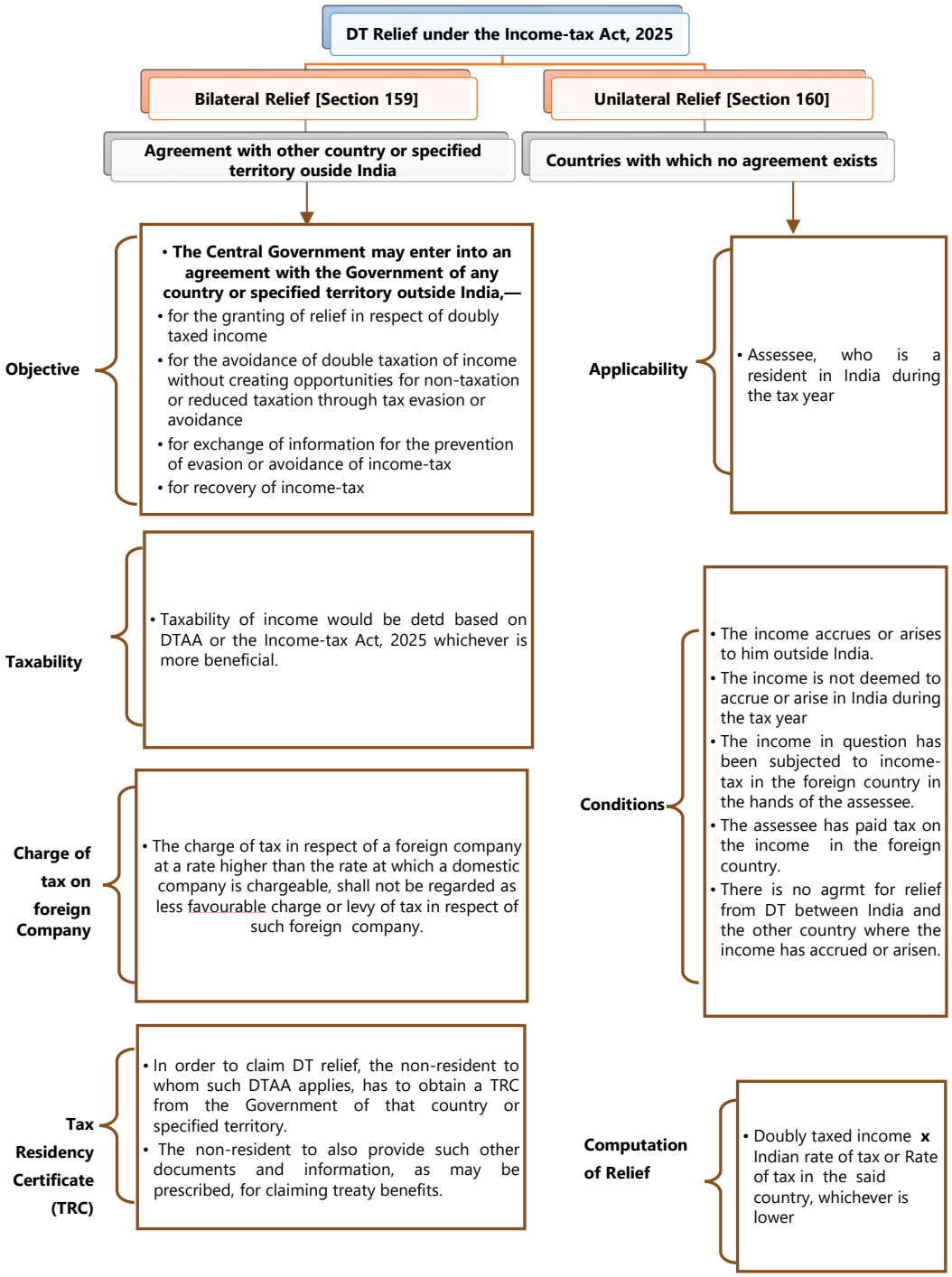
The specified date, in respect of above incomes, payable in foreign currency and from which tax has been deducted at source under rule 207, shall be the date on which the tax was required to be deducted under the provisions of the Chapter XIX-B [Rule 206(2)(b)(ii)].

Nothing contained in sub-rule (1) shall apply in respect of income referred to in sub-rule (2)(b) [Table: Sl. No. 3], where such income is received in, or brought into India by the assessee or on his behalf before the specified date, in accordance with the provisions of the Foreign Exchange Regulation Act, 1973.

Note *– Students should note that the rate of exchange for converting foreign tax along with manner of computing Foreign Tax credit is prescribed under Rule 76, whereas Rule 206 provides for the conversion of foreign income on the specified dates. Students are advised to refer detailed Rule 76 of the Income-tax Rules, 2026, given as Annexure 1 at the end of this Module.*

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Summary

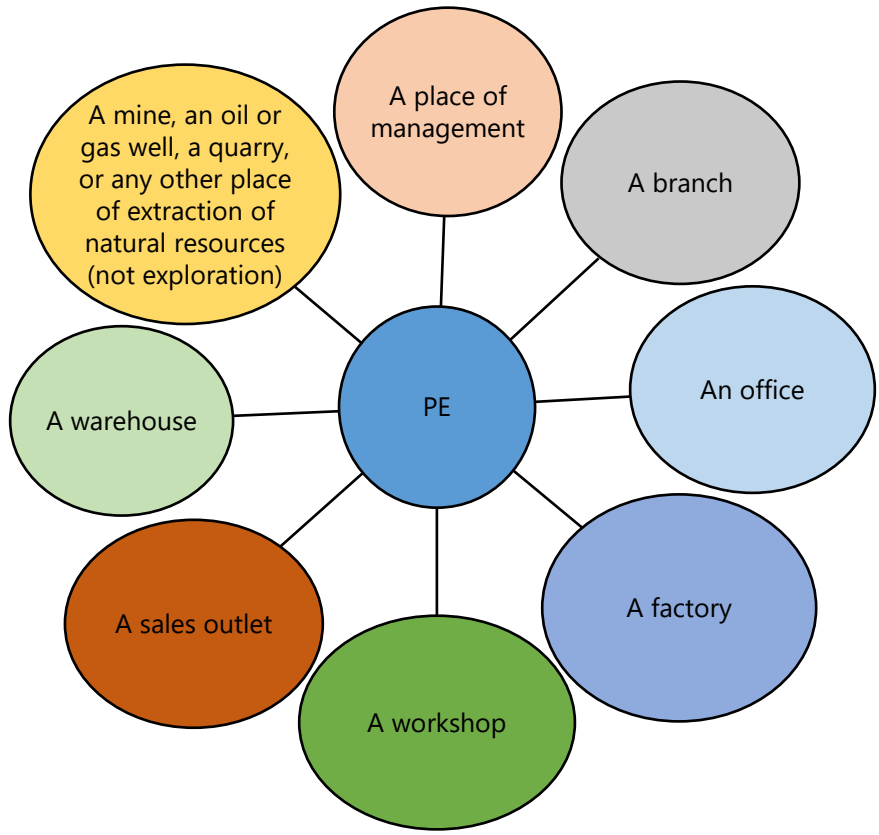


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22.5 CONCEPT OF PERMANENT ESTABLISHMENT

Under the Income-tax Act, 2025, the taxability of business profits is determined by existence of business connection in India under section 9(2) Under the DTAA, taxability of business profits is determined by existence of a Permanent Establishment (PE) in India. It may be noted that the scope of business connection under section 9(2) is wider than that of a PE. Article 5(1) of the DTAA usually provides that for the purpose of this convention, the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term PE is also defined under section 173(c) to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

According to Article 5(2), the term PE includes-



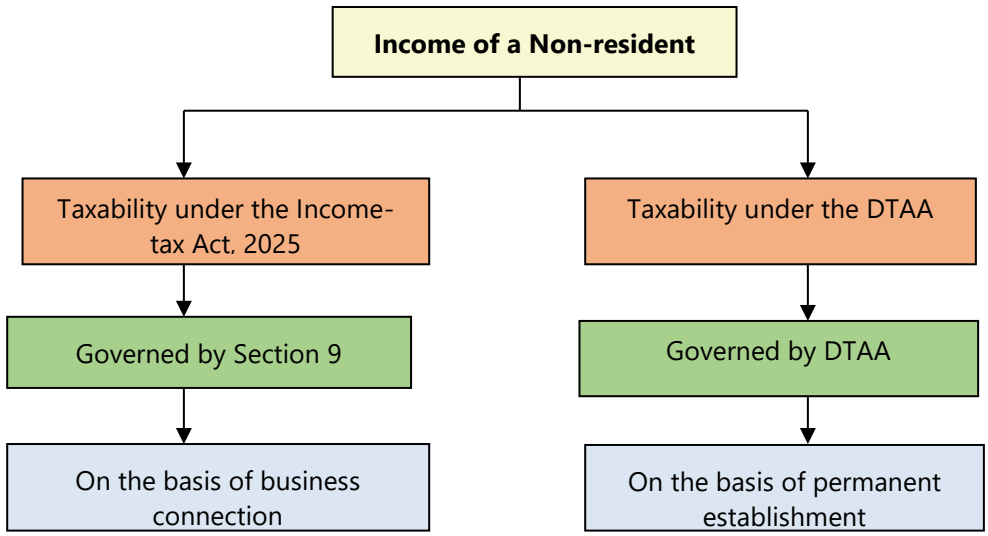
(1) Permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

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(2) Every DTAA has a specific clause dealing with an explanation of permanent establishment for the purpose of such DTAA.

(3) Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.

(4) Taxability of income under a business connection and permanent establishment is explained below:



(5) **Liaison Office – Does it constitute a PE?**

(i) **Liaison Office engaged in remittance services** - In *Union of India v. UAE Exchange Center (2020) 425 ITR 30*, the Supreme Court held that an Indian liaison office of a foreign enterprise engaged in remittance services would **not** constitute a PE. In this case, no permission was given by RBI to the assessee to engage in primary business activity **or undertake core business operations in India**. The liaison office downloads information (such as names and addresses of beneficiaries, amount to be remitted, etc.) by accessing the main servers of assessee in UAE, prints cheques/draft and dispatches them to the addresses of beneficiaries through courier. The Supreme Court held that even if the activities of LO are regarded as business activities, they were of preparatory or auxiliary character.

(ii) **Liaison Office as Communication Channel** - In *DIT (International Taxation) v. Samsung Heavy Industries Ltd. (2020) 426 ITR 1 (SC)*, the

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project office was set up solely as an auxiliary office meant to act as liaison office between ONGC and the assessee. No expenditure relating to execution of contract was incurred by the project office. Only two persons were working in the project office and they were not qualified to perform any core activity of the assessee. Therefore, the Supreme Court held that the project office is not a fixed place of business through which core business of assessee is carried on, and hence, the same would **not** constitute a PE.

Identifying new customers, marketing activities, price negotiation, discussion of commercial issues, securing and processing orders may lead to the liaison office forming a PE.

22.6 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 2025 but are given in *Circular No.5/2004 dated 28.9.2004* issued by CBDT. The provisions are briefed hereunder –

(a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity would not be regarded as a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 2025.

(b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.

(c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

(d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through a

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dependent agent who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment become taxable in India.

(e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.

(f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

(g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

(h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 2025.

(i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length principle".

(j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of "arm's length principle".

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TEST YOUR KNOWLEDGE

Questions

1. *Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2026. The Indian branch has filed return of income for Tax Year 2026-27 disclosing income of ₹ 50 lakhs. It paid tax at the rate applicable to domestic company i.e. 30% plus Health and Education Cess @4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:*

   "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

   However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 35% plus Health and Education cess@4%.

   Is the action of the Assessing Officer in accordance with law?

2. *Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 30,00,000.*

   Compute net tax liability of Kalpesh Kumar for the tax year 2026-27 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 52,000. He is paying tax as per the default tax regime.

3. *The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the tax year 2026-27:*

	(₹ In lakhs)
Income from playing snooker matches in country L	*12.00*
Tax paid in country L	*1.80*

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Income from playing snooker tournaments in India	*19.20*
Life Insurance Premium paid	*1.10*
Medical Insurance Premium paid for her father (resident Indian) aged 62 years (paid through credit card)	*0.54*

Compute her total income and net tax liability for the tax year 2026-27. Assume she is paying tax as per default tax regime. There is no Double Taxation Avoidance Agreement between India and country L.

4. *The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).*

5. *An individual resident in India, having income earned outside India in a country with which no agreement under section 159 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.*

6. *The Income-tax Act, 2025 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.*

7. *Arif is a resident of both India and another foreign country in the tax year 2026-27. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lakhs from rubber estates in the foreign country during the financial year 2026-27. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lakhs during the year. Arif has no permanent establishment of business carried on in India. However, he has derived rental income of ₹ 6 lakhs from property let out in India and he has a house in Lucknow where he stays during his visit to India.*

   Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

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You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

8. *Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the tax year 2026-27. India has not entered into double taxation avoidance agreement with these two countries.*

Particulars	₹
Income from profession carried on in India	*7,50,000*
Agricultural income in Country "X" (gross)	*50,000*
Dividend from a company incorporated in Country "Y" (gross)	*1,50,000*
Royalty income from a literary book from Country "X" (gross)	*6,00,000*
Expenses incurred for earning royalty	*50,000*
Business loss in Country "Y" (Proprietary business)	*65,000*
Rent from a house situated in Country "Y" (gross)	*2,40,000*
Municipal tax paid in respect of the above house in Country "Y" (not allowed as deduction in country "Y")	*10,000*

Note: *Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.*

The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and net tax liability of Mr. Kamesh in India for Tax Year 2026-27, assuming that he opted out of the default tax regime.

9. *Mr. Anil, aged 49 years, a resident individual furnishes the following particulars of income earned by him in India and Country N for the tax year 2026-27. India does not have a double taxation avoidance agreement (DTAA) with Country N.*

Particulars	Amount (₹)
Income from profession carried on in Mumbai	*8,50,000*
Agricultural Income in Country N	*1,30,000*
Dividend from a company incorporated in Country N (gross)	*85,000*
Royalty income from a literary book from Country N (gross)	*6,25,000*

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Expenses incurred for earning royalty	*75,000*
Business loss in Country N	*1,10,000*

The domestic tax laws of Country N do not permit set-off of business loss against any other income. The rate of income-tax in Country N is 18%. Compute total income and net tax liability of Mr. Anil in India for T.Y. 2026-27, assuming that he satisfies all conditions for the purpose of section 160 and he opted out of the default tax regime.

10. *Mr. Ravi, an individual resident in India aged 45 years, furnishes you the following particulars of income earned in India, Foreign Countries "S" and "T" for the tax year 2026-27.*

Particulars	₹
Indian Income:	
Income from business carried on in Mumbai	*4,40,000*
Interest on savings bank with ICICI Bank	*42,000*
Income earned in Foreign Country "S" [Rate of tax – 16%]	
Agricultural income in Country "S"	*94,000*
Royalty income from a book on art from Country "S" (Gross)	*7,80,000*
Expenses incurred for earning royalty	*50,000*
Income earned in Foreign Country "T" [Rate of tax – 20%]	
Dividend from a company incorporated in Country "T" (Gross)	*2,65,000*
Rent from a house situated in Country "T" (Gross)	*3,30,000*
Municipal tax paid in respect of the above house (not allowed as deduction in Country "T")	*10,000*

Compute the total income and net tax liability of Mr. Ravi in India for T.Y. 2026-27 assuming that India has not entered into double taxation avoidance agreement with Countries S & T. He is paying tax as per the default tax regime.

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Answers

1. Under section 159, where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country or a specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 2025 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (35%).

However, section 159(5) provides that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this provision, the action of the Assessing Officer in levying tax@35% on the Indian branch of Cosmos Ltd. is in accordance with law.

2. **Computation of net tax liability of Mr. Kalpesh for T.Y.2026-27 under the default tax regime under section 202**

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under VIII [Not available under default tax regime]**		Nil
Total Income		**37,50,000**
Tax on total income		7,05,000
Add: Health and Education cess @4%		28,200
		7,33,200
Average rate of tax in India [i.e., ₹ 7,33,200 / ₹ 37,50,000 x 100]	19.552%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.333%	

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Doubly taxed income	7,50,000	
Deduction under section 160 on ₹ 7,50,000 @13.333% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Net tax liability in India [₹ 7,33,200 – ₹ 1,00,000]		**6,33,200**

3. Computation of total income and net tax liability as per the default tax regime of Miss Vivitha for the T.Y. 2026-27

Particulars	₹	₹
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIII		Nil
Total Income		**31,20,000**
Tax on Total Income		
Income-tax		5,16,000
Add: Health and education cess @4%		20,640
		5,36,640
Average rate of tax in India (i.e. ₹ 5,36,640/₹ 31,20,000 × 100)	17.20%	
Average rate of tax in foreign country (i.e. ₹ 1,80,000/ ₹12,00,000 ×100)	15.00%	
Deduction under section 160 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Net tax liability in India (₹ 5,36,640 – ₹ 1,80,000)		**3,56,640**

4. Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

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As per section 173(c), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(2) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India. As per section 159(4), the provisions of the Income-tax Act, 2025 or the DTAA, whichever is beneficial, shall apply. The PE concept is narrower than the business connection concept. Therefore, in a case where the Indian Government has entered into DTAA with a country, unless and until the PE test is satisfied, the business income would not be taxable in the source country.

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

5. The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 160 specifies that if a person resident in India has paid tax in any country with which no agreement under section 159 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal. Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country but shall be allowed a deduction from the Indian income-tax payable by him as per section 160 read with Rule 76 on Foreign Tax Credit.

6. Section 159(4) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where the DTAA has been entered, the assessee can opt to be governed by the provisions of DTAA if the provisions are beneficial in comparison to provisions of Act.

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However, as per section 159(8), the assessee, in order to claim relief under the agreement, has to furnish a certificate [Tax Residence Certificate (TRC)] obtained from the Government of that country, declaring the residence of the country outside India and to provide the following information in Form No. 41:

(i) Tax Year;

(ii) Status (individual, company, firm etc.) of the assessee;

(iii) Country of residence (in the case of an individual) or Country/Region of incorporation/ registration (in the case of others);

(iv) Tax Identification Number of the applicant in the country or region of his residence and in case no such number is available, then a unique number on the basis of which the applicant is identified by the Government of that country or the region of which he claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 159(8) is applicable;

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable and

(vii) Copy of certificate to be uploaded as annexure with Form 41.

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 2025, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 2025.

Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country and provides the above information in Form No. 41.

7. Section 159(4) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 2025 shall apply to the extent they are more beneficial to that assessee.

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In this case, Arif is resident of both India and the foreign country. Therefore, the DTAA provides for a tie-breaker rule wherein if a person is resident of two countries, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore, his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for T.Y. 2026-27.

The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a Contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5. Accordingly, only the income accruing or arising or deemed to accrue or arise in India shall be taxable in India in the hands of Arif.

However, as per section 159(8), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for tax year 2026-27 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

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8. Computation of total income of Mr. Kamesh for T.Y.2026-27 under normal provisions of the Act

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 22 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	
	13,00,000	
Less: Business loss in country Y set-off[2]	65,000	
		12,35,000
Income from Other Sources		
Agricultural income in country X	50,000	
Dividend from a company in country Y	1,50,000	2,00,000
Gross Total Income		**15,96,000**
***Less:* Deduction under Chapter VIII**		
Under section 151 – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Note – Since adjusted total income (i.e., ₹ 15,96,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.

[1] *Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.*

[2] *As per section 108(1), inter-source set-off of income is permitted.*

[3] *It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the tax year.*

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Computation of net tax liability of Mr. Kamesh for T.Y.2026-27

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]	2,01,300
Add: Health and Education cess@4%	8,052
	2,09,352
Less: Deduction under section 160 **(See Working Note below)**	69,729
Net tax liability	**1,39,623**
Net tax liability (rounded off)	1,39,620

Working Note: Calculation of Deduction under section 160

	₹	₹
Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]	**16.15%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 151)][4]	2,50,000	
	3,00,000	
Deduction under section 160 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.15%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**20%**	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	

[4] *Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIII is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

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Deduction u/s 160 on ₹ 2,46,000 @16.15% (being the lower of average Indian tax rate (16.15%) and foreign tax rate (20%)]		39,729
Total deduction under section 160 (Country X + Country Y)		**69,729**

9. Computation of total income of Mr. Anil for T.Y.2026-27 under normal provisions of the Act

Particulars	₹	₹
Profits and Gains of Business or Profession		
Income from profession carried on in India	8,50,000	
Royalty income from a literary book in Country N (after deducting expenses of ₹ 75,000)	5,50,000	
	14,00,000	
Less: Business loss in Country N	1,10,000	12,90,000
Income from Other Sources		
Agricultural income in Country N [Not exempt u/s 11 read with Schedule II (Table Sl. No. 1]	1,30,000	
Dividend received from a company incorporated in Country N	85,000	
		2,15,000
Gross Total Income		**15,05,000**
***Less:* Deduction under Chapter VIII**		3,00,000
Under section 151 – Royalty income of a resident from a literary book[5]		
Total Income		**12,05,000**

Note – Since adjusted total income (i.e., ₹ 15,05,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.

[5] *It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the tax year.*

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Computation of net tax liability of Mr. Anil for T.Y.2026-27

Particulars		₹
Tax on total income [30% of ₹ 2,05,000 plus ₹ 1,12,500]		1,74,000
Add: Health and education cess @4%		6,960
Tax Liability		1,80,960
Calculation of Deduction under section 160:		
Average rate of tax in India [i.e., ₹ 1,80,960 / ₹ 12,05,000 x 100]	**15.02%**	
Average rate of tax in Country N	**18%**	
Doubly taxed income pertaining to Country N	**₹**	
Agricultural Income	1,30,000	
Royalty Income [₹ 6,25,000 – ₹ 75,000 (Expenses) – ₹ 3,00,000 (deduction under section 151)][6]	2,50,000	
Dividend income	85,000	
	4,65,000	
Less: Business Loss set off	1,10,000	
	3,55,000	
Deduction under section 160 on ₹ 3,55,000 @ 15.02% [being the lower of average Indian tax rate (15.02%) and foreign tax rate (18%)]		53,321
Net tax liability		**1,27,639**
Net tax liability (rounded off)		**1,27,640**

[6] *Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIII is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

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10. Computation of total income of Mr. Ravi for T.Y.2026-27 under the default tax regime

Particulars	₹	₹
Income from House Property [House situated in Country T]		
Gross Annual Value[7]	3,30,000	
Less: Municipal taxes paid in Country T	10,000	
Net Annual Value	3,20,000	
Less: Deduction under section 22 – 30% of NAV	96,000	
		2,24,000
Profits and Gains of Business or Profession		
Income from business carried on in India	4,40,000	
Royalty income from a book on art in Country S (after deducting expenses of ₹ 50,000)	7,30,000	11,70,000
Income from Other Sources		
Interest on savings bank with ICICI Bank	42,000	
Agricultural income in Country S [Not exempt]	94,000	
Dividend from a company in Country T	2,65,000	4,01,000
Gross Total Income		**17,95,000**
Less: Deduction under Chapter VIII [Not available under default tax regime]		Nil
Total Income		**17,95,000**

Computation of tax liability of Mr. Ravi for T.Y.2026-27 under the default tax regime

Particulars		₹
Tax on total income		1,59,000
Add: Health and education cess @4%		6,360
		1,65,360

[7] *Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.*

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Less: Deduction under section 160 **(See Working Note below)**		1,20,927
Net tax liability		**44,433**
Net tax liability (Rounded off)		**44,430**
Calculation of Deduction under section 160:		
Average rate of tax in India [i.e., ₹ 1,65,360 / ₹ 17,95,000 x 100]	**9.21%**	
Average rate of tax in Country S	**16%**	
Doubly taxed income pertaining to Country S	**₹**	
Agricultural Income	94,000	
Royalty Income [₹ 7,80,000 – ₹ 50,000 (Expenses)]	7,30,000	
	8,24,000	
Deduction under section 160 on ₹ 8,24,000 @ 9.21% [being the lower of average Indian tax rate (9.21%) and Country S tax rate (16%)]		75,890
Average rate of tax in Country T	**20%**	
Doubly taxed income pertaining to Country T		
Income from house property	2,24,000	
Dividend	2,65,000	
	4,89,000	
Deduction under section 160 on ₹ 4,89,000 @9.21% [being the lower of average Indian tax rate (9.21%) and Country T tax rate (20%)]		45,037
Total Deduction under section 160 (Country S + Country T)		**1,20,927**

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