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Taxation of Income from Immovable Property: Analysis of Judgements of Indian Courts on Article 6 of the OECD and UN MC

ORIGINAL ARTICLE

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Abstract

Taxation of income from immovable property situated outside India requires the application of Article 6 of the Organisation for Economic Co-operation and Development Model Convention (OECD MC) and United Nations Model Convention (UN MC) as well as section 90 of the Income-tax Act, 1961, India. This article seeks to analyse the viewpoint of Indian judicial system on Article 6 of the OCED MC and UN MC and concludes that the Indian judicial system has taken the favourable view for the assessee's by providing them the benefit under sub-section (2) of section 90 of the Income-tax Act, 1961, India where the assessee's have been allowed to apply the provisions of the Income-tax Act, 1961, India or the Double Taxation Avoidance Agreement (DTAAs), whichever is beneficial to them. The case analyses in this article covers the discussion on cases where income from immovable property situated in Australia and UK earned solely by Indian tax residents were allowed to be included in India or the source country depending upon the choice of the assessee. It also covers the discussion on a case where rental income from immovable property situated in India was earned by a Netherlands tax resident but was not treated as being covered under Article 6 of the India-Netherlands DTAAs and thus, not taxable in India.

Key Words

Taxation, Judgement, Court, Article, United Nations, Convention.

Introduction

Taxation of income from immovable property situated in another country requires the application of international taxation. Article 6[1] of the Organisation for Economic Co-operation and Development Model Convention (OECD MC) 2017 as well as United Nations Model Convention (UN MC) 2021 deals with "Taxation of Income from Immovable Property". As per Paragraph I of Article 6 of both the Model Conventions, "income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State". Section 90(2)[2] of the ITA 1961 (IND)[3] is a beneficial provision for the assessees who are earning income outside India. This section allows the assessees to apply the provisions of the ITA 1961 (IND)[4]or the provisions of Double Taxation Avoidance Agreement (DTAA) whichever are beneficial to them.

This article analyses the viewpoint of Indian judicial system on the income from immovable property earned outside India solely by Indian tax residents. The countries covered in the judgements are Australia and the UK.

Analysis of Judgements delivered by Indian Courts/ Tribunals related to Article 6

A. Natasha Chopra vs. DCIT (2022) – Countries involved are Australia and the UK

Natasha Chopra vs. DCIT[5]*(2022)* case, heard by the Income Tax Appellate Tribunal (ITAT) Delhi, concerns an Indian tax resident (the assessee) who had earned rental income from properties situated in Australia and the UK.

The Assessing Officer (AO) had included such rental incomes to tax in India in the hands of the assessee, and the decision of the AO was upheld by the CIT (Appeals)[6].The AO relied upon the provisions of Article 6(1)[7] of the DTAA between India and the UK, section 90(3)[8] of the ITA 1961 (IND) and the Notification No. 91/2008[9] dated 28 August 2008 issued by the Government of India to include such rental incomes as taxable in India in the hands of the assessee. Section 90(3)[10] of the ITA 1961 (IND) allows the Central Government to define terms not explicitly defined in the ITA 1961 (IND) or relevant DTAA. The AO argued that since the rental income was not taxed in Australia and the UK, it should be taxed in India. Further, the AO construed the words 'may be taxed' in Article 6(1)[11] of the India-UK DTAA as 'shall be taxed' based on Notification No. 91/2008[12]. Based on the above arguments, the AO treated the rental incomes from properties situated outside India as taxed in India in the hands of the assessee.

Some of the relevant grounds of the assessee in favour of not including such rental incomes in her hands were:

1. The assessee had declared such rental incomes in the income tax returns she filed in Australia and the UK.
2. The provisions of section 90(2)[13] of the ITA 1961 (IND) and DTAA were not applied by the AO by stating that the facts of the case were not covered under section 90(1)(*a*)(*i*), 90(1)(*a*)(*ii*) and 90(1)(*b*) of the ITA 1961 (IND).
3. The provisions of section 90(3)[14] of the ITA 1961 (IND) were wrongly invoked.

The Tribunal relied upon the provisions of section 90(1)[15] and section 90(3)[16] of the ITA 1961 (IND), the notifications issued by the Central Board of Direct Taxes (CBDT) and the impact of Multilateral Instruments (MLIs). It was also necessary here to go through the provisions of section 90(2)[17] of the ITA 1961 (IND).

The assessee appealed before the ITAT against the order of the CIT (Appeals)[18]and the ITAT concluded that the phrase 'may be taxed' from the relevant DTAA does not mean 'shall be taxed only in the resident State', unless it is expressly stated. Simply put, the assessee, having declared her rental income in her returns for Australia and the UK could not be denied the applicability of section 90(1)*(a)(i)*[19]of the ITA 1961 (IND) which clearly applies to the facts of this case. This case went in favour of the assessee.

In this case, the author is of the opinion that the ITAT treated the facts of the case as covered under section 90(1)*(a)(i)*[20] of the ITA 1961 (IND) and because of this, the assessee availed himself of the benefit as per section 90(2)[21] of the ITA 1961 (IND) which states that the provisions of the ITA 1961 (IND) are applicable to the extent these are more beneficial to the assessee. The ITAT ruled that since such rental incomes were not taxable in Australia and the UK, though the assessee had declared the income in her income tax returns and applied Article 6(1)[22] of the DTAA, such income will not be included in the resident country, India. However, the author disagrees with the viewpoint of the ITAT that the facts of the case are covered under section 90(1)*(a)(i)*[23]of the ITA 1961 (IND) because to make this section applicable, income-tax should be paid on an income in India as well as outside India but in the present case, tax was not at all paid in the source country, though the rental incomes were shown in the income tax return filed by the assessee in the

source country. The author is of the opinion that the Income Tax Department should appeal this judgement of Hon'ble ITAT (Delhi) in the Hon'ble Delhi High Court.

B. Sumit Aggarwal vs. DCIT (2014) – Country involved is Australia

Sumit Aggarwal vs. DCIT[24](2014) case, heard by the ITAT Chandigarh, concerns an Indian tax resident (the assessee) whohad incurred a loss from rental property in Australia. Such loss had arisen because the payment of interest on loan taken from a bank in Australia to purchase the house property in Australia was higher than the rental income from the said house property.

The AO relied upon the provisions of section 25[25] of the ITA 1961 (IND) in disallowing the interest payment of the loan as the assessee has not deducted the tax while making the interest payment. However, the CIT (Appeals)[26]disagreed with the viewpoint of the AO and ruled that as per the provisions of section 9[27] of the ITA 1961 (IND), interest received by the bank shall not be deemed to accrue in India and thus, not chargeable to tax in India. Since it was not chargeable to tax in India, there was no liability to deduct any tax at source on such interest payment, and thus, as per the CIT (Appeals), the income under the head House Property of the assessee was to be computed after deducting the interest payment from rental income.

However, the CIT (Appeals)[28] also held that the income under the head House Property of the assessee was to be included in Australia only and not in India by referring to the decision of *CIT vs. PVAL Kulandagan Chettiar*[29] *(2004)* case in which the Hon'ble Supreme Court held that the income arising from immovable property from the property situated in another Contracting State is taxable only in that other Contracting State.

Some of the relevant grounds of the assessee in favour of including negative income under the head House Property from Australia in India were :

1. The assessee had an option to include the income under the head House Property from Australia in India as per the provisions of section 90(2)[30] of the ITA 1961 (IND).
2. The decision of the Hon'ble Supreme Court in *CIT vs. PVAL Kulandagan Chettiar(supra)* could not be applied in the present case because in that case "the assessee was A resident of Malaysia as well as India, and income had been derived from Rubber plantations in Malaysia, where the Hon'ble Supreme Court had observed that the assessee's fiscal connection was more with and Malaysian territory." In the present case, however the assessee was a resident of India only and not of Australia.

The Tribunal relied upon the provisions of section 5[31] and section 90(2)[32] of the ITA 1961 (IND) and Article 6(1)[33] Para 1 of Article 6 of the India-Australia DTAA.

The assessee appealed before the ITAT against the order of the CIT (Appeals)[34] and the ITAT concluded that as per section 5[35] of the ITA 1961 (IND), in the case of a resident, income accruing or arising outside India must be assessed in India. On this basis, the ITAT ruled in favour of the assessee in including income under the head House Property from Australia in India. The ITAT also referred to section 90(2)[36] of the ITA 1961 (IND) and held that section 90(2)[37] of the ITA 1961 (IND) allows an assessee to choose between applying the provisions of the ITA 1961 (IND) or the provisions of the DTAA, whichever is more beneficial to him. On this basis, the ITAT accepted the assessee's right of exercising the option of filing an income tax return under Indian laws. This case went in favour of the assessee.

C. DIT vs. KLM Royal Dutch Airlines (2008) – Country involved is Netherlands

DIT vs. KLM Royal Dutch Airlines[38] (2008) case, heard by the Hon'ble High Court of Delhi concerns a Netherlands tax resident company that had its business of operating aircrafts in international traffic both for the transport of passengers and the handling of cargo. In the present case, the company had obtained the licence from the Airport Authority of India (AAI) to use certain premises in Bombay on payment of rent and engaged another company,'CSC India P. Ltd.' on a payment basis to handle the cargo in India on its behalf.

For this purpose, the assessee company had paid the agreed amount to CSC India P. Ltd. after deducting the same amount of rent that it had paid to the AAI for using the AAI's premises.

The AO treated the amount deducted by the assessee company while making payment to CSC India P. Ltd. as the assessee company's income chargeable to tax in India under Article 6(1)[39] of the India-Netherlands DTAA. The CIT (Appeals)[40] confirmed the view of the AO.

Some of the relevant grounds of the assessee company in favour of not taxing the amount received by it from CSC India P. Ltd. were:

1. The amount received by the assessee company from CSC India P. Ltd. was the same amount that the assessee company had to pay to the AAI for using the AAI's premises. The AAI had never raised any objection to having used the premises other than that for which the licence was granted, and the licence was renewed too from time to time.
2. The business of the assessee company was only the operation of aircraft in international traffic, i.e., the transport of passengers and cargo and all activities connected therewith. Thus, profits from such connected activities could not be taxed in India as per Article 8(1)[41] of the India-Netherlands DTAA as the place of effective management of the assessee company was in the Netherlands and not in India.
3. Even if the amount recovered by the assessee company from CSC India P. Ltd. was treated as income from other sources, the same amount paid by the assessee company to the AAI as a fee for using the AAI's premises would be allowed as a deduction under section 57(iii)[42] of the ITA 1961 (IND), effectively making the net taxable income as nil.

On appeal by the assessee company before the Delhi ITAT, the Tribunal held that the provisions of Article 6(1)[43] of the India-Netherlands DTAA were not applicable in this case as the amount paid by CSC India P. Ltd. to the assessee company (the amount paid was through deduction by the assessee company from the amount paid to CSC India P. Ltd.) was not in the course of a separate business of renting out the properties by the assessee company. The Tribunal concluded that such adjustment of deducting the amount to be paid by the assessee company to the AAI as rent for using the AAI's premises from the amount payable by the assessee company to the CSC India P. Ltd. for receiving management, supervision, document handling, and tracking and tracing export and import cargo services from CSC India P. Ltd. only reduces the ultimate amount payable by the assessee company to CSC India P. Ltd. and not in the course of a separate business of renting out the premises. The Tribunal also noted that it was never alleged by the AAI that the premises were used for any purpose other than for which the licence to the assessee company was granted by the AAI. The Tribunal also held that the assessee company did not carry on any business operations from letting out the premises and thus concluded that the provisions of Article 6(1)[44] of the India-Netherlands DTAA were not at all applicable to the assessee company. The Tribunal further held that even if the recovery of rent by the assessee company from CSC India P. Ltd. was to be treated as income from other sources at the hands of the assessee company, the same amount paid by the assessee company to the AAI would be allowed as a deduction under section 57(iii)[45] of the ITA 1961 (IND) which makes the net income of the assessee company from other sources as nil.

The Hon'ble High Court of Delhi held that the Tribunal had correctly appreciated the law on the issue and had also determined the facts and thus dismissed the appeal filed by the Income Tax Department. This case went in favour of the assessee.

Conclusion

The above decisions of Indian courts related to the application of Article 6 of the OECD MC and UN MC,i.e., Income from Immovable Property,reaffirm the importance of understanding the relationship between domestic tax legislation [ITA 1961 (IND)] and DTAAs when calculating taxable income for residents with rental income from properties situated in a foreign country. Based on analysis of the above cases, the author

is of the opinion that when it comes to issues covered under Article 6 of the OECD MC and UN MC, the Income Tax Department of India should issue notices to the assessees cautiously after carefully applying the provisions of section 90(2)[46] of the ITA 1961 (IND) and Article 6(1) of the respective DTAAs. Moreover, the above case analyses also show that every rental income earned by a foreign tax resident from the premises given on rent in India cannot be covered under Article 6(1) of the respective DTAAs.

References

1. Available at https://www.oecd.org/en/publications/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en.html and https://financing.desa.un.org/sites/default/files/2023-05/UN%20Model_2021.pdf, Accessed on 30/06/2024.
2. The Income-tax Act, 1961, No. 43 of 1961 (IND), s. 90:
   "**Agreement with foreign countries or specified territories.**
   90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—
   (a) for the granting of relief in respect of—
   (*i*) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
   (*ii*) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, 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, as the case may be, 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
   (c) …….
   (d) …….
   and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
   (2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, 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.
   (3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf." available at: https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx, Accessed on 23/06/2024.
3. The Income-tax Act, 1961, No. 43 of 1961 (IND).
4. ITA 1961 (IND), above fn. 3.
5. [2022] 196 ITD 185 (Delhi - Trib.)[30-06-2022]
6. Commissioner of Income-tax (Appeals) appointed under s. 117(1) of the ITA 1961 (IND), above fn. 3.
7. Para 1 of Article 6 of the India-UK DTAA states:

"1. Income from immovable property may be taxed in the Contracting State in which such property is situated." available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx, Accessed on 20/06/2024.

8. ITA 1961 (IND), above fn.3, s. 90(3), above fn. 2.
9. Notification No.91/2008, dated 28-8-2008 states that:
" ……. where an agreement entered into by the Central Government with the Government of any country outside India for granting relief of tax or as the case may be, avoidance of double taxation, provides that any income of a resident of India "may be taxed" in the other country, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961 (43 of 1961), and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement." available at:https://incometaxindia.gov.in/Pages/communications/notifications.aspx, Accessed on 31/05/2024.
10. ITA 1961 (IND), above fn. 3. s. 90(3), above fn. 2.
11. Para 1 of Article 6 of the India-UK DTAA, above fn. 7.
12. Notification No.91/2008, dated 28-8-2008, above fn. 9.
13. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
14. ITA 1961 (IND), above fn. 3. s. 90(3), above fn. 2.
15. ITA 1961 (IND), above fn. 3. s. 90(1), above fn. 2.
16. ITA 1961 (IND), above fn. 3. s. 90(3), above fn. 2.
17. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
18. CIT (Appeals), above fn. 6.
19. ITA 1961 (IND), above fn. 3. s. 90(1), above fn. 2.
20. ITA 1961 (IND), above fn. 3. s. 90(1), above fn. 2.
21. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
22. Para 1 of Article 6 of the India-UK DTAA, above fn. 7.
23. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
24. [2014] 163 TTJ 509 (Chandigarh - Trib.)[20-05-2014]
25. ITA 1961 (IND), above fn. 3, s. 25:
" **Amounts not deductible from income from house property.**
25. …….. interest chargeable under this Act which is payable outside India (not being interest on a loan issued for public subscription before the 1st day of April, 1938), on which tax has not been paid or deducted under Chapter XVII-B and in respect of which there is no person in India who may be treated as an agent under section 163 shall not be deducted in computing the income chargeable under the head Income from house property". available at: https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx, Accessed on 01/05/2024.
26. CIT (Appeals), above fn. 6.

27. ITA 1961 (IND), above fn. 3, s. 9:
"Income deemed to accrue or arise in India.
9. (1) The following incomes shall be deemed to accrue or arise in India:— ….(v) income by way of interest payable by—
(a) the Government; or
(b) a person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or
(c) a person who is a non-resident, where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India. ……"
28. CIT (Appeals), above fn. 6.
29. CIT v. PVAL Kulandagan Chettiar [2004] 267 ITR 645
30. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
31. ITA 1961 (IND), above fn. 3, s. 5:
"Scope of total income
5. (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which –
(a) ……..
(b) ……..
(c) accrues or arises to him outside India during such year: ……."
32. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
33. Para 1 of Article 6 of the India-Australia DTAA states:
"1. Income from real property may be taxed in the Contracting State in which that property is situated." available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx, Accessed on 19/05/2024.
34. CIT (Appeals), above fn. 6.
35. ITA 1961 (IND), above fn. 3, s. 5, above fn. 31.
36. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
37. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.
38. [2008] 220 CTR 268 (Delhi) [22-10-2008] & [2008] 307 ITR(T) 142 (Delhi - Trib.) [31-03-2008]
39. Para 1 of Article 6 of the India-Netherlands DTAA states:
"*1.* Income derived by a resident of one of the States from immovable property (including income from agriculture or forestry) situated in the other State may be taxed in that other State." available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx, Accessed on 19/05/2024.
40. CIT (Appeals), above fn. 6.
41. Para 1 of Article 8 of the India-Netherlands DTAA states:
"*1.* Profits from the operation of aircraft in international traffic shall be taxable only in the State in which the place of effective management of the enterprise is situated.", available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx, Accessed on 19/05/2024.

42. ITA 1961 (IND), above fn. 3, s. 57:
"Deductions
57. The income chargeable under the head "Income from other sources" shall be computed after making the following deductions, namely:—
(i) ……..
(ia) ……
(ii) …….
(iii) any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income;
(iv) ……]" available at: https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx, Accessed on 14/05/2024.

43. Para 1 of Article 6 of the India-Netherlands DTAA, above fn. 39.

44. Para 1 of Article 6 of the India-Netherlands DTAA, above fn. 39.

45. ITA 1961 (IND), above fn. 3, s. 57(iii), above fn. 42.

46. ITA 1961 (IND), above fn. 3. s. 90(2), above fn. 2.

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