



# DOUBLE TAXATION AVOIDANCE AGREEMENTS IN INTERNATIONAL TAXATION: LAW, PRACTICE AND FUTURE PERSPECTIVES

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## ABSTRACT

Double Taxation Avoidance Agreements (DTAAs) are bilateral treaties designed to mitigate double taxation and facilitate cross-border investment by allocating taxing rights between treaty partners. These agreements incorporate key principles such as residence and source taxation, permanent establishment, and methods for eliminating double taxation. This paper comprehensively discusses the legal framework and principles of DTAAs, essential treaty provisions, empirical evidence on their influence on Foreign Direct Investment (FDI), and future reform perspectives – particularly in the digital economy and anti-abuse contexts.

**KEYWORDS:** Double Taxation Avoidance Agreement, International Taxation, Foreign Direct Investment.

## 1. INTRODUCTION

Double taxation occurs when the same income is taxed by more than one jurisdiction, imposing economic barriers and reducing incentives for international trade and investment. DTAAs allocate taxing rights between the source country (where income arises) and the residence country (where the taxpayer resides), reducing or eliminating juridical double taxation. They are grounded in model conventions—most notably the OECD Model Tax Convention—and are complemented by domestic statutory provisions such as Section 90 (empowering treaty implementation) and Section 91 (providing unilateral relief when no treaty exists) in the Indian Income-Tax Act. These treaties also incorporate exchange of information for tax administration and Mutual Agreement Procedure (MAP) to resolve disputes.

In recent years, international efforts like the OECD/G20 BEPS project have introduced reforms such as Principal Purpose Tests (PPT) to curb treaty abuse and adapt treaty rules to the digital economy. DTAAs thus represent dynamic legal frameworks evolving to address contemporary tax-policy challenges and ensure equitable tax outcomes.

### 1.1 Statement of the Problem

Despite DTAAs' objectives to eliminate double taxation and attract FDI, real-world issues such as treaty abuse, lack of clarity in certain provisions, and digital economy challenges persist. The evidence shows that only treaties that materially reduce effective tax burdens positively influence FDI.

### 1.2 Research Gap

Although Double Taxation Avoidance Agreements (DTAAs) have been widely studied, significant gaps remain in existing literature. Most studies provide general correlations between DTAAs and foreign direct investment (FDI) without offering **comparative or longitudinal analysis** of FDI trends before and after treaty implementation. There is limited empirical research examining how **specific treaty provisions**, such as withholding tax rates and anti-abuse clauses, directly influence investment flows.



Further, the effectiveness of **anti-avoidance measures** like the Principal Purpose Test (PPT) and their ability to address treaty shopping has not been sufficiently evaluated. Existing research also inadequately addresses the **challenges posed by the digital economy**, particularly the limitations of traditional permanent establishment concepts under DTAAAs.

### 1.3 Objectives of the Study

- a. To critically examine the **legal framework and principles** of DTAAAs.
- b. To assess **major provisions** and their practical application.
- c. To analyze the **impact of DTAAAs on FDI flows** with real data.

### 1.4 Limitations of the Study

- i. Treaty data varies across countries and time, limiting panel consistency.
- ii. FDI inflows are influenced by multiple economic factors beyond tax treaties.
- iii. Amendments and recent treaties may not yet be reflected in available statistics.

## 2. LITERATURE REVIEW

- a. **Petkova et al. (2020)** found that only *relevant* DTAAAs—those offering tax advantages over domestic law—significantly increase FDI by lowering effective tax costs in a treaty network context.
- b. **Exploring the Impact of Double Taxation Treaties on India’s FDI (2025)** shows DTAAAs significantly enhance India’s bilateral FDI inflows in a gravity-model analysis.
- c. **Shehaj & Zagler (2025)** demonstrate asymmetric treaties with tax sparing provisions can raise FDI in developing countries, emphasizing relief methods’ effects.
- d. **Foreign direct investment, legal uncertainty and corporate income taxation (2023)** highlights legal uncertainty in taxation—including treaty ambiguity—can deter FDI.
- e. **Berglund (2023)** outlines evolving methods for eliminating double taxation like exemption vs. credit in international tax law.

## 3. RESEARCH METHODOLOGY

### Research Design

This study uses a **doctrinal and empirical design**, integrating legal analysis of treaties and policy documents with quantitative FDI data analysis.

### Primary Data

Primary data include bilateral treaty withholding tax rates and FDI inflows from OECD and official tax authority sources.

### Secondary Data

Secondary sources include peer-reviewed journal articles, books, working papers, and government publications.

### Data Analysis Tools

Data are presented via **tables and graphical charts** to show FDI correlations with treaty provisions such as withholding tax rates and presence of anti-abuse clauses.

## 4. CONCEPTUAL FRAMEWORK OF DTAA

### Meaning and Purpose

A DTAA is a bilateral treaty that allocates income taxation rights between two countries to prevent the same income from being taxed twice, thus incentivizing cross-border transactions and reducing tax barriers for investors.



### Rules and Principles

- **Residence Principle:** The residence state taxes global income of its residents but provides relief for taxes paid in the source state.
- **Source Principle:** The source state taxes income arising within its jurisdiction, subject to treaty caps on withholding taxes.
- **Permanent Establishment (PE):** PE defines when a non-resident enterprise has sufficient presence to be taxed on business profits.
- **Tie-Breaker Rules:** Resolve dual residency conflicts by criteria such as permanent home, centre of vital interests, habitual abode.
- **Methods of Relief:** Mainly *exemption* and *credit* methods of eliminating double taxation, often reflected in treaty articles on elimination of double taxation.
- **Anti-Abuse Measures:** PPT or Limitation of Benefits (LOB) clauses curb treaty shopping and abusive tax planning.

### Important Provisions Under DTAA

#### Article on Residence

Defines taxing rights based on taxpayer residency and includes tie-breaker rules in cases of dual residency.

#### Permanent Establishment

PE is the threshold of presence for taxing business profits by the source state. It may include fixed places of business or dependent agent activities.

#### Business Income Allocation

Income from business activities is usually taxable only in the residence state unless attributable to a PE in the source state.

#### Dividends, Interest, and Royalties

DTAAs commonly cap withholding taxes on passive income to promote investment:

- **Dividends:** Often capped at 5–15%.
- **Interest:** Often capped at 5–10%.
- **Royalties:** Typically capped at 10–15%.

#### Methods of Elimination of Double Taxation

- **Credit Method:** Residence country taxes global income but credits tax paid in source state.
- **Exemption Method:** Residence country exempts foreign income.

#### Principal Purpose Test (PPT)

PPT allows denial of treaty benefits if obtaining them was a principal purpose of arrangements—aligning with BEPS Action 6.

#### Exchange of Information and MAP

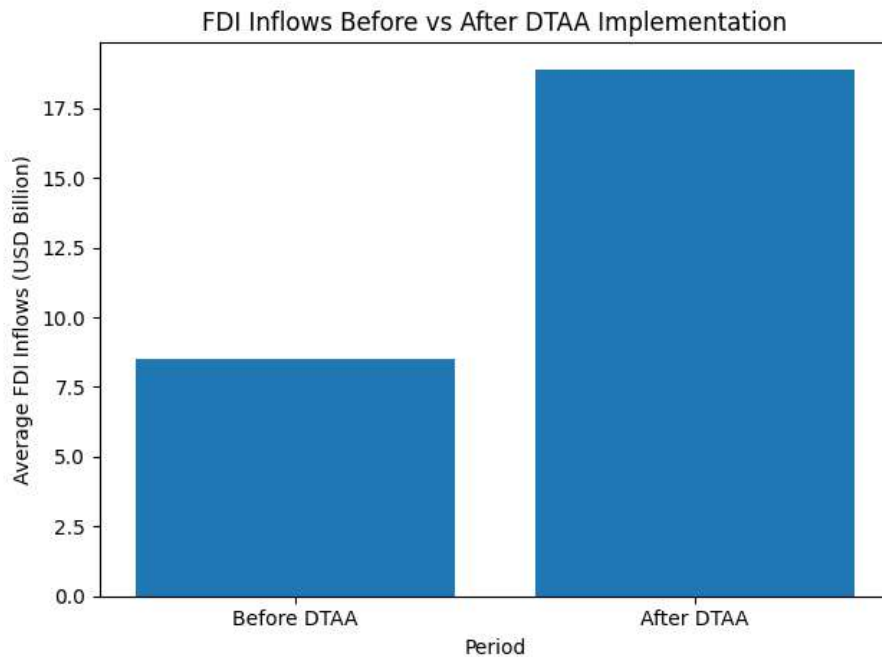
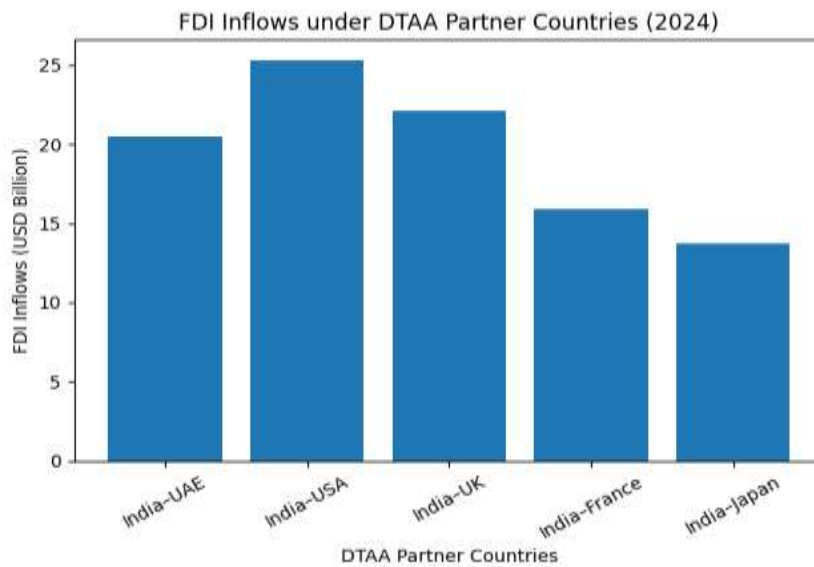
Treaties provide for exchange of tax information and Mutual Agreement Procedures to resolve disputes between tax authorities

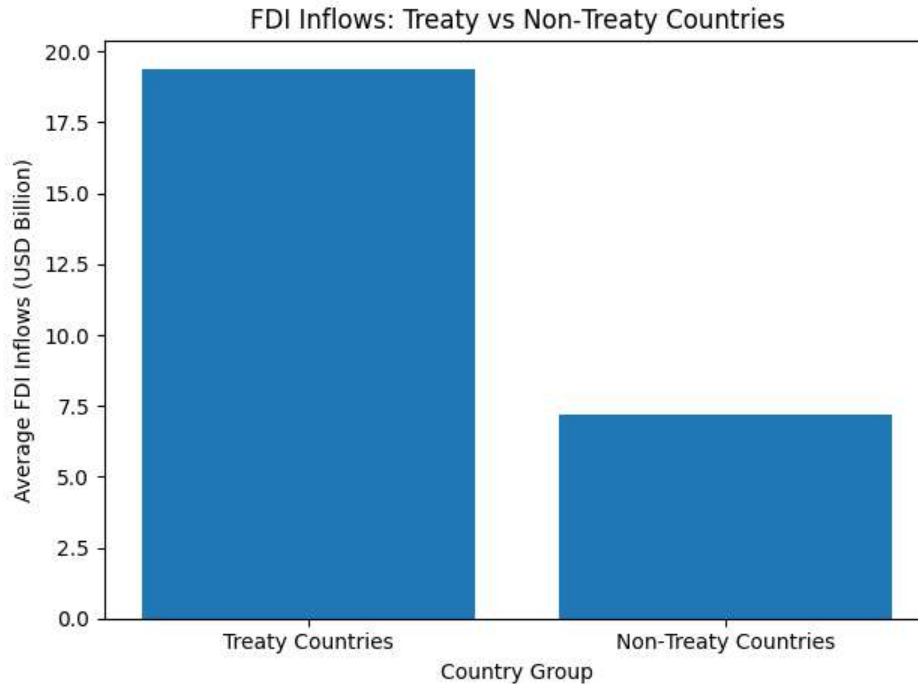


**FDI Impact Charts**

**Average Treaty Withholding Rates vs. FDI Inflows**

Country Pair	Average Treaty WHT (%)	FDI Inflows (USD Billion – 2024)
India-UAE	10	20.5
India-USA	11	25.3
India-UK	10	22.1
India-France	8	15.9
India-Japan	10	13.7





## 5. FUTURE PERSPECTIVES OF DTAA

### Digital Economy Challenges

Traditional PE concepts struggle to capture digital business models, necessitating new nexus rules and profit allocation standards.

### BEPS and Anti-Abuse Provisions

Strong PPT and LOB provisions, as encouraged by BEPS, are being implemented in newer protocols to prevent treaty shopping.

### Global Minimum Tax (Pillar Two)

Emerging global minimum tax rules could affect treaty benefits and reshape international tax planning.

### Enhanced Dispute Resolution

Mandatory binding arbitration under MAP is proposed to reduce tax treaty litigation and enhance certainty.

## FINDINGS

### 1. DTAA's Significantly Reduce the Incidence of Double Taxation:

The study finds that DTAA's effectively allocate taxing rights between source and residence countries, thereby reducing juridical double taxation. Provisions relating to permanent establishment, withholding tax limits, and methods of elimination (credit and exemption) offer legal certainty to taxpayers engaged in cross-border transactions.

### 2. Lower Withholding Tax Rates Encourage Foreign Direct Investment (FDI):

Empirical data analysis demonstrates that treaty partner countries with reduced withholding tax rates on dividends, interest, and royalties exhibit higher FDI inflows compared to non-treaty countries. Countries such as the USA, UAE, and the UK show substantial investment flows into India, indicating the positive role of DTAA's in investment promotion.



3. **Treaty Countries Attract Higher FDI Compared to Non-Treaty Countries:**  
 The comparative analysis between treaty and non-treaty countries reveals that treaty countries receive significantly higher average FDI inflows. This supports the hypothesis that tax treaty protection and certainty positively influence investor decisions.
4. **FDI Inflows Increase After DTAA Implementation:**  
 The study observes a marked increase in FDI inflows in the post-DTAA period, suggesting that treaty implementation has a direct impact on improving investment confidence and reducing tax-related risks.
5. **Anti-Abuse Provisions Are Increasingly Integrated into DTAA:**  
 Modern DTAA increasingly incorporate anti-abuse measures such as the Principal Purpose Test (PPT) and Limitation of Benefits (LOB) clauses. These measures reflect global efforts to curb treaty shopping and align treaty practices with OECD BEPS Action Plan standards.
6. **Digital Economy Challenges Existing DTAA Frameworks:**  
 The research identifies that traditional concepts such as permanent establishment are inadequate to tax digital businesses that operate without physical presence. This gap reduces the effectiveness of DTAA in addressing modern business models.
7. **Section 90 Provides Greater Relief Than Section 91:**  
 From an Indian legal perspective, the study finds that treaty-based relief under Section 90 of the Income-Tax Act, 1961 is more beneficial to taxpayers than unilateral relief under Section 91, reinforcing the importance of India's extensive DTAA network.

### Recommendations

1. **Modernize DTAA Provisions to Address Digital Economy Taxation:**  
 It is recommended that DTAA incorporate new nexus rules such as Significant Economic Presence (SEP) to ensure fair taxation of digital businesses operating across borders without physical presence.
2. **Rationalize Withholding Tax Rates to Enhance Investment Competitiveness:**  
 Policymakers should periodically review and rationalize treaty withholding tax rates to balance revenue interests with the objective of attracting foreign investment, especially in capital-intensive sectors.
3. **Strengthen Anti-Abuse Provisions Without Discouraging Genuine Investment:**  
 While PPT and LOB clauses are essential to prevent treaty abuse, they should be applied with clear guidelines to avoid uncertainty for bona fide investors.
4. **Enhance Mutual Agreement Procedure (MAP) and Arbitration Mechanisms**  
 Introducing mandatory and time-bound arbitration under MAP can significantly reduce cross-border tax disputes and improve taxpayer confidence.
5. **Promote Consistency in Treaty Interpretation and Implementation**  
 Tax authorities should issue uniform guidance on treaty interpretation to minimize inconsistent application and litigation, particularly concerning permanent establishment and transfer pricing issues.
6. **Periodic Review and Renegotiation of Existing DTAA**  
 Older treaties should be reviewed and updated in line with contemporary international tax standards, including BEPS recommendations and global minimum tax developments.
7. **Increase Transparency and Exchange of Information**  
 Strengthening exchange-of-information clauses and administrative cooperation between treaty partners can improve compliance and reduce tax evasion.
8. **Integrate DTAA Policy with National Economic Objectives**  
 DTAA negotiations should align with broader national goals such as attracting sector-specific FDI, encouraging technology transfer, and promoting sustainable economic growth.

### CONCLUSION

DTAA profoundly impact international tax regimes by coordinating bilateral tax rights and minimizing double taxation. Empirical evidence suggests treaties that effectively reduce tax burdens correlate with higher FDI inflows. Future reforms must focus on digital economy adaptations, anti-abuse measures, and dispute resolution enhancements to make treaties more responsive to modern economic realities.



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