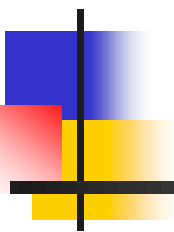


ICAI'S Committee On International Taxation

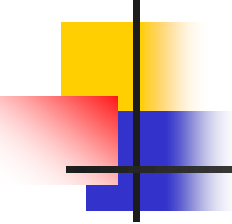
DIPLOMA IN INTERNATIONAL TAXATION

Articles 1 – 4 in the Model Conventions
keeping in view the UN convention



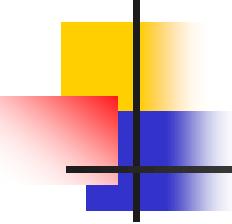
Presented by:
Mr. Paresh P. Shah

P.P. Shah & Associates
Chartered Accountants
Email: ppshahandassociates@gmail.com



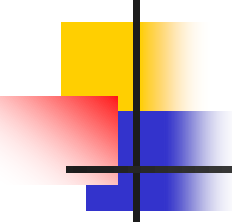
Overview of Presentation

- Treaties: Types of Double Tax Avoidance Treaties / Double Tax Convention (DTC)
- Purpose and Objective of the DTC
- Treaties – Legal Status and Model Tax Conventions
- Structure of Tax Treaties – UN Model
- Articles 1 to 4 of UN Model



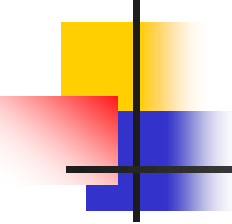
Types of Treaties

- Double Tax treaties
- Bilateral Investment treaties
- Preferential trade and investment agreements
- Shipping and Air Transport treaties
- Multilateral Tax treaties
- Multilateral directives on taxation and mergers



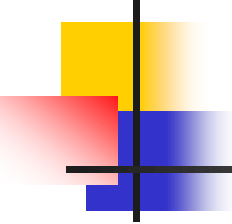
Purpose & Objective of DTC

- Elimination of Double taxation
- Certainty of tax treatment
- Prevention of Fiscal evasion
- Prevention of tax discrimination
- Resolution of tax disputes
- Lower compliance cost
- Limitation of taxation of cross border transactions / trade



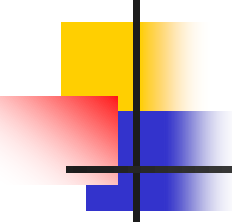
Treaties – Legal Status

- A formal agreement between two or more sovereign states
- Phases: Negotiations, Signature, ratifications and entry into force
- Country's view on these agreements and International law
 - Treaty prevails over domestic law
 - Treaty is nothing but the part of domestic law
- Restricts the national taxing powers of cross border transaction



Model Tax Conventions

- Model Tax Convention – A need
- Scope of Model Conventions & its content
- Legal standing & acceptance of Model DTC
- League of Nations models 1928 -1946
- OECD Model – 1963, 1977, 1992 and so on with latest being 2017
- UN Model – 1980, 2001 and 2011
- CIAT Model, ASEAN Model
- National Models e.g. US Model, Netherlands Model, etc.

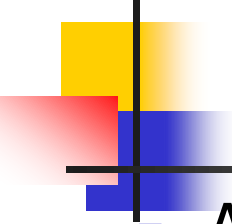


Article 1 – Persons covered

Article 1

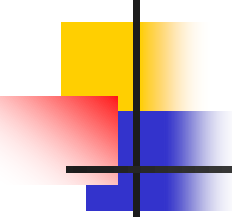
PERSONS COVERED

- This Convention shall apply to persons who are residents of one or both of the Contracting States.
 - *'Person' is defined in Article 3*
 - *'Resident' is defined in Article 4*



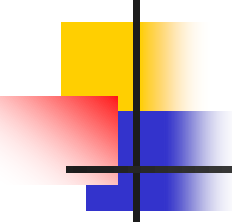
Article 1 – Persons covered

- Applicability of certain Articles of the treaty are applicable irrespective whether they are eligible persons or not
 - Article 19: Government Service (“individuals”)
 - Article 24(1): Non-discrimination (“nationals”)
 - Article 26: Exchange of Information
 - Article 27: Assistance in Collection of Taxes



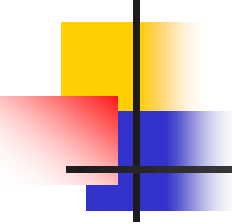
Article 1 – Persons covered

- The United Nations Model Convention (UN MC) applies to persons who are “residents of one or both of the Contracting States” like the OECD Model Convention (OECD MC).
- The personal scope of most of the earliest conventions was more restrictive, in that it encompassed “citizens” / “taxpayers” of the Contracting States.



Article 1 – Persons covered

- UN MC does not contain special provisions relating to partnerships. The Contracting States are therefore left free to examine the problems concerning partnerships in bilateral negotiations and to agree upon such special provisions as they may find necessary and appropriate.
- If the Contracting States differ in their treatments of partnerships, different articles of the Convention can apply to the same transaction in the two States, which may result in double taxation or non-taxation in both States
- OECD MC 2017 now includes fiscally transparent entities under Article 1(2) – Persons covered

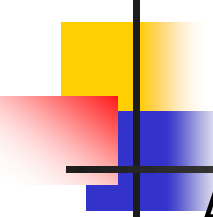


Article 1 – Persons covered

- New Article 1(2) of the OECD Model Tax Convention introduced due to the BEPS Action 2 Report “Neutralizing the Effects of Hybrid Mismatch Arrangements”

2. For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Thus, an entity or arrangement (e.g. a partnership) that is treated as a company for tax purposes qualifies as a company under the definition in subparagraph (b) of paragraph 1 of Article 3 and, to the extent that it is a resident of a Contracting State, is therefore entitled to the benefits of the treaty as available to a person

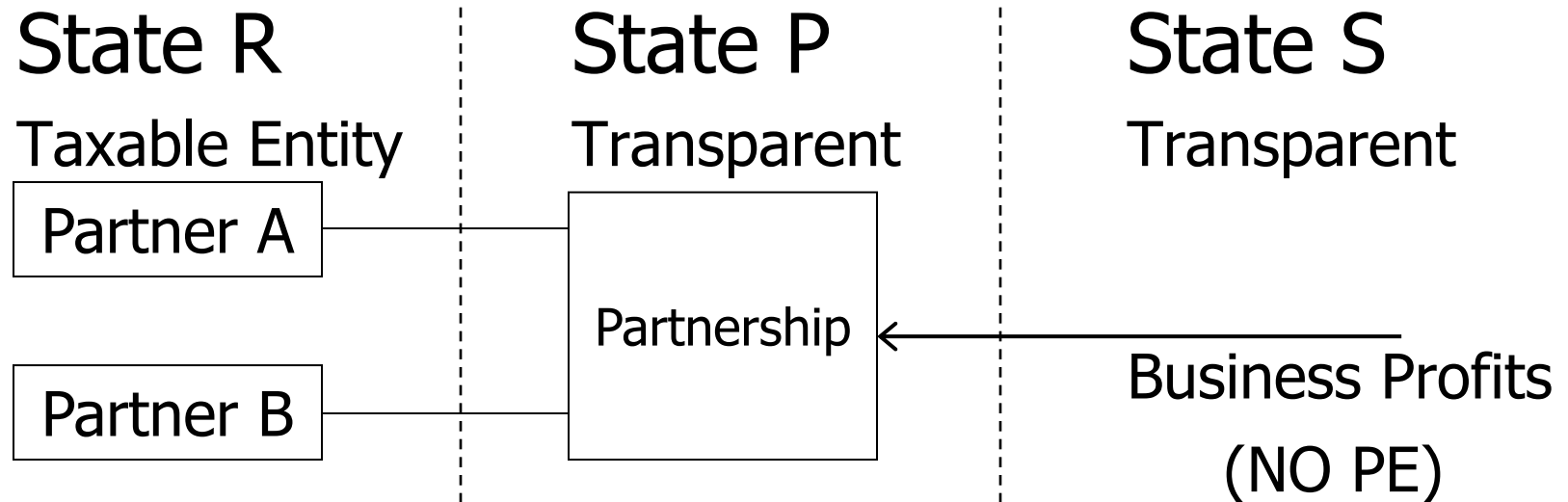


Article 1 – Persons covered

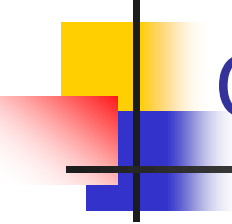
Applicability of Article 1

- As only residents are covered, question arises with respect to applicability of a treaty to following entities:
 - **Permanent Establishment**, as it does not have a legal, distinct identity separate from that of its head office. The owner of a PE qualifies for treaty protection only if he is resident of a contracting state
 - **Partnerships & other fiscally transparent entities**, as it is dependent on whether the partnership / fiscally transparent entity is subject to tax in the contracting state concerned. Difficulty arises when one of the two concerned states treats them as independently taxable entities whilst the other one attributes their profits to the individual partners / beneficiaries
 - **Collective Investment Vehicles (CIV)**, as it is dependent on whether the CIV itself or its unit-holders are subject to tax in the contracting state concerned

Taxation of Partnership under Model Convention

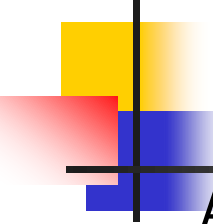


- State P & S treats P as transparent therefore treats A & B as tax payers, whereas State R allocates income to P as it treats the entity as taxable and therefore income is not liable to tax in State R.



Taxation of Partnership under OECD Model convention

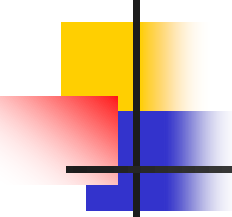
- Article 1: Paragraph (2) to (6.7)
- Article 3: Paragraph (2), (9) to (10.1)
- Article 4: Paragraph (8.8)
- Article 5: Paragraph (19.1)
- Article 10: Paragraph (11) and (27)
- Article 13: Paragraph (26) and (28.5)
- Article 15: Paragraph (6.1) and (6.2)
- Article 23: Paragraph (32.4) to (32.7), (69.1) to (69.2)
- Article 24: Paragraph (7) and (16)
- Article 26: Paragraph (19.3)



Article 1 – Persons covered

Applicability of Article 1 – Some important Case Laws

- General Electric Pension Trust [280 ITR 425]
- Linklaters LLP [2010-TII-80-ITAT-MUM-INTL]
- TD Securities (USA) LLC [2010 TCC 186]
- Schellenberg Wittmer [AAR No. 1029 of 2010]

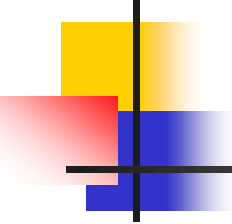


Article 1 – Persons covered

Improper use of tax treaties (UN MC Commentary on Article 1)

Approaches to prevent the improper use of tax treaties:

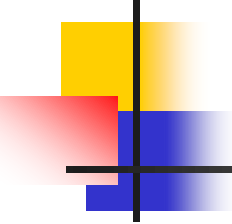
- Specific legislative anti-abuse rules found in domestic law
- General legislative anti-abuse rules found in domestic law
- Judicial doctrines that are part of domestic law
- Specific anti-abuse rules found in tax treaties
- General anti-abuse rules found in tax treaties
- The interpretation of tax treaties



Article 1 – Persons covered

Specific legislative anti-abuse rules found in domestic law
(UN MC Commentary)

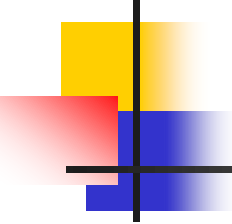
- Controlled foreign company rules (CFC)
- Thin Capitalisation Rules
- Transfer Pricing regulations
- Place of Effective Management (PoEM)



Article 1 – Persons covered

General legislative anti-abuse rules found in domestic law
(UN MC Commentary)

- Substance over form
- Economic substance



Article 1 – Persons covered

Abuse of Tax Treaty (Para 23 of UN MC Commentary)

- A guiding principle is that the benefit of a double tax convention should not be available where main purpose for entering into a transaction or arrangement was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions



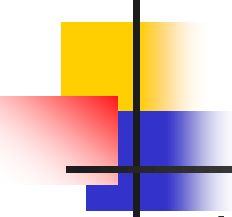
Article 1 – Persons covered

Examples of abuse of Tax Treaty

- Dual residence and transfer of residence
- Treaty shopping
- Conduit company cases
- Preferential tax regimes
- Attributing profits or income to a specific person or entity
- Transactions that seek to circumvent thresholds

Some important Jurisprudence on abuse of Tax Treaty

- Azadi Bachao Andolan [263 ITR 706] - the Supreme Court upheld the validity of the CBDT Circular No. 789 dated April 13, 2000 granting benefits of the India-Mauritius treaty.
- Vodafone International Holdings B.V. [204 Taxman 408] - the Supreme Court held that in absence of specific anti-abuse provisions in the treaty or domestic legislation, a treaty benefit cannot be denied to a company incorporated by nationals of a third State in the State of residence.
- E*Trade Mauritius Ltd [2010 324 ITR 1 (AAR)]

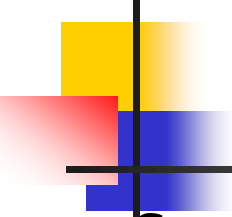


Article 1 – Persons covered

Judicial doctrines that are part of domestic law
(UN MC Commentary)

In the process of determining how domestic tax law applies to tax avoidance transactions, the courts of many countries have developed different judicial doctrines that have the effect of preventing domestic law abuses

- Business purpose
- Substance over form
- Economic substance
- Step transaction
- Abuse of law and *fraus legis*



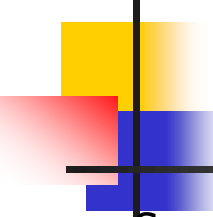
Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties

(UN MC Commentary)

- Force of attraction rule – Art. 7(1)

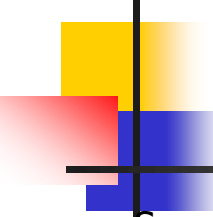
The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.



Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- **Concept of Beneficial ownership – Art. 10,11,& 12**
- The term beneficial owner is not defined under the treaty
- The condition of beneficial ownership is an anti-tax avoidance provision, which is incorporated with the objective of avoiding treaty shopping by interposing an intermediary company to access a particular DTAA.
- Commentary on Model Convention states that “the term “beneficial owner” is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance”. In other words, it should be interpreted with reference to the context of the treaty and intentions with which it is used.
- Generally, it can be understood that recipient acting purely as nominee or agent is not a beneficial owner. Beneficial owner is the principal for whose account the agent or nominee is acting. The purpose of Article 10(2), 11(2) & 12(2) is not to grant benefit of treaty to the agent or nominee or conduit entity.



Article 1 – Persons covered

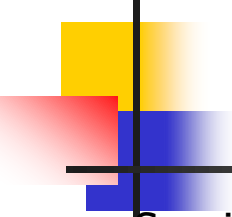
Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Concept of Beneficial ownership – Art. 10,11,& 12

Art. 10(2) - Dividends: However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- a) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;
- (b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases

Art. 10(4): The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.



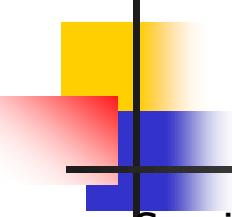
Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Concept of Beneficial ownership – Art. 10,11,& 12

Art. 11(2) - Interest: However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ____ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Art. 11(4): The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.



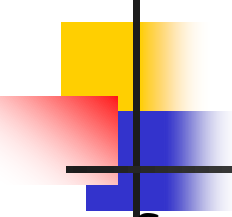
Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Concept of Beneficial ownership – Art. 10,11,& 12

Art. 12(2) - Royalty: However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ____ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Art. 12(4): The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.

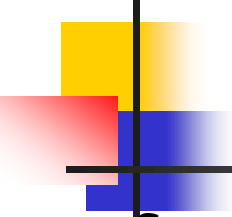


Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Special relationship rule - Art. 11(6) & Art. 12(6)

Art. 11(6) – Interest: Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

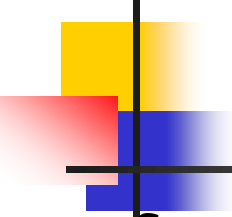


Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Special relationship rule - Art. 11(6) & Art. 12(6)

Art. 12(6) – Royalty: Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.



Article 1 – Persons covered

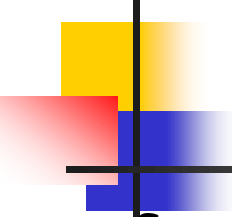
Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Alienation of shares of immovable property companies – Art. 13(4)

Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:

(a) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.

(b) For the purposes of this paragraph, “principally” in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.



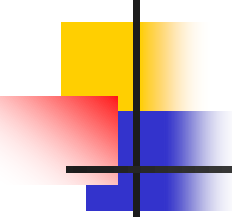
Article 1 – Persons covered

Specific anti-abuse rules found in tax treaties (UN MC Commentary) (con't)

- Star / Athlete companies – Art. 17(2)

Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Such specific treaty anti-abuse rules provide more certainty to taxpayers than broad general anti-abuse rules or doctrines

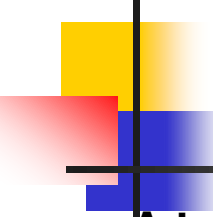


Article 1 – Persons covered

General anti-abuse rules found in tax treaties
(UN MC Commentary)

- e.g. Israel-Brazil – Tax treaty signed in 2002 – Art. 25(2)

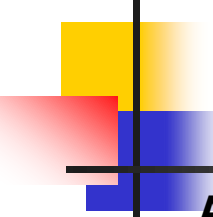
A competent authority of a Contracting State may deny the benefits of this Convention to any person, or with respect to any transaction, if in its opinion the granting of those benefits would constitute an abuse of the Convention according to its purpose. Notice of the application of this provision will be given by the competent authority of the Contracting State concerned to the competent authority of the other Contracting State.



Article 24A – Limitation of Relief – India Singapore DTAA

Art. 24A: (inserted w.e.f. 23.03.2017)

1. A resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement if its affairs were arranged with the primary purpose to take advantage of the benefits in the said paragraph 4A or paragraph 4C of Article 13 of this Agreement, as the case may be.
2. A shell or conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement. A shell or conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
3. A resident of a Contracting State is deemed to be a shell or conduit company if its annual expenditure on operations in that Contracting State is less than S\$ 200,000 in Singapore or Indian Rs. 5,000,000 in India, as the case may be:
 - (a) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12 month periods in the immediately preceding period of 24 months from the date on which the gains arise;
 - (b) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.



Article 24A – Limitation of Relief; Article 28A – GAAR in India-Singapore DTAA

Art. 24A (con't):

4. A resident of a Contracting State is deemed not to be a shell or conduit company if:
- (a) it is listed on a recognised stock exchange of the Contracting State; or
 - (b) its annual expenditure on operations in that Contracting State is equal to or more than S\$ 200,000 in Singapore or Indian Rs. 5,000,000 in India, as the case may be:
 - (i) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;
 - (ii) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.
5. For the purpose of paragraph 4(a) of this Article, a recognised stock exchange means:
- (a) in the case of Singapore, the securities market operated by the Singapore Exchange Limited, Singapore Exchange Securities Trading Limited and The Central Depository (Pte) Limited; and
 - (b) in the case of India, a stock exchange recognised by the Securities and Exchange Board of India.
- Explanation: The cases of legal entities not having bona fide business activities shall be covered by paragraph 1 of this Article.

Art. 28A – Miscellaneous: This Agreement shall not prevent a Contracting State from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.

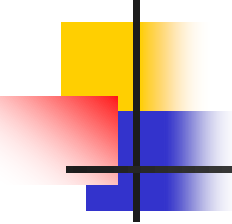


Article 27A – Limitation of Benefits – India Mauritius DTAA

Art. 27A: (inserted w.e.f. 1.04.2017)

1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.
2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
3. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian Rs.1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.
4. A resident of a Contracting State is deemed not to be a shell/conduit company if:
 - (a) it is listed on a recognized stock exchange of the Contracting State; or
 - (b) its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention

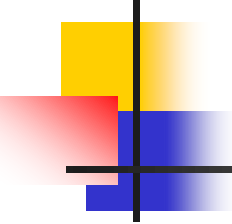


Article 2 – Taxes covered

Article 2

TAXES COVERED

- 1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
 - Applies to taxes on income and on capital, irrespective of the authority on behalf of which such taxes are imposed (e.g. the State itself or its political subdivisions or local authorities)
 - Applies irrespective of the method by which the taxes are levied (e.g. by direct assessment or by deduction at the source, in the form of surtaxes or surcharges or as additional / supplementary levies).

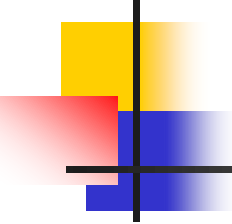


Article 2 – Taxes covered

Article 2

TAXES COVERED

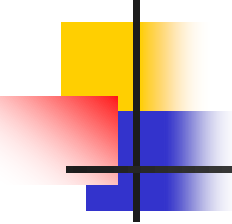
- 2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
 - The Article does not mention “ordinary taxes” or “extraordinary taxes”. As it is not intended to exclude extraordinary taxes from all conventions, ordinary taxes have not been mentioned either.
 - The Contracting States are thus free to restrict the convention’s field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions.



Article 2 – Taxes covered

Article 2 - TAXES COVERED

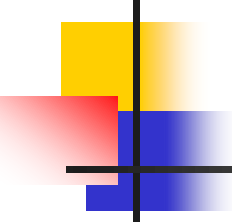
- 3. The existing taxes to which the Convention shall apply are in particular:
 - (a) (in State A):
 - (b) (in State B):
- The list is not exhaustive, for it serves to illustrate the preceding paragraphs of the Article.
- In principle, however, it is expected to be a complete list of taxes imposed in each State at the time of signature and covered by the Convention.
- All non-governmental taxes, dues, duties, etc. are not covered
- Indirect taxes such as excise duty, sales tax, VAT, etc. are not covered
- Social security charges, monetary fines & penalties, interest for late payment or non-payment of taxes, etc. are not regarded as taxes as such payments are not designed to produce revenue



Article 2 – Taxes covered

Article 2 - TAXES COVERED

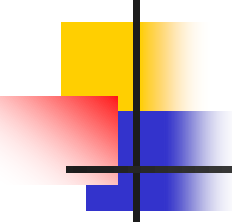
- 4. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.
- Each state to notify the other state of any changes made to their taxation laws from time to time relating to
 - New or substituted taxes
 - New regulation or judicial decisions
 - Changes in other laws that have an impact on treaty obligation of each state
- If a state fails to notify any such changes in its tax laws to the other country, the new taxes would still come under the purview of treaty. The country which failed to make such notification cannot be denied the right to apply its changed domestic law.



Article 2 – Taxes covered

Taxes in respect to DTAA with foreign countries under Income-Tax Act, 1961 ('ITA'):

- In case of DTAAs entered with foreign countries, Section 90(1) of the ITA provides for relief in respect of income on which tax has been paid under the tax laws of India and the foreign country i.e. tax credit. It also provides for avoidance of double taxation of income under the ITA and under the tax laws of the foreign country
- In case DTAA does not exist with a foreign country, Section 91 states that the tax-payer resident in India shall be entitled to unilateral credit from the Indian income-tax payable by him on such doubly taxed income of a sum calculated at the Indian rate of tax or the rate of tax of the foreign country, whichever is lower



Article 2 – Taxes covered

Taxes in respect to income may be levied at Federal, State & Municipal levels:

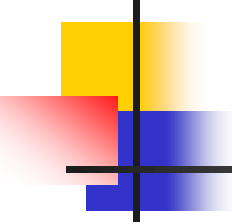
- In case of India – US Treaty, only U.S. Federal taxes on income are covered whereas U.S. State taxes on income are not covered
 - Does that mean that for State taxes, there is no DTAA and hence unilateral credit would be given in India to a resident tax-payer for state taxes paid under Section 91?
 - Or does it mean that as a DTAA exists between India-USA but state taxes are not covered, no tax credit of state taxes paid is available because Section 90 only gives relief on tax covered under the DTAA
- Imp. Case law: Tata Sons vs DCIT [ITA No. 4978/Mum/04]*
- Similar situations may arise when there is a DTAA as per Section 90 but it does not include certain income streams or certain scenarios such as triangular situations.



Article 2 – Taxes covered

Explanation 1 to Section 90 and Non-discrimination Article 24 under UN MC:

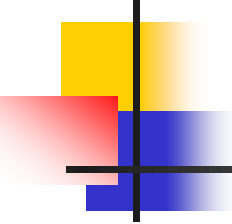
- Expln. 1: For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company
- Non-discrimination obligations under Article 24 of the MC obligate the Contracting States to provide no less favourable taxation including of a foreign national and foreign owned or controlled domestic enterprises (Paragraph 5).
- However, under the ITA, foreign companies (i.e. those which are not Indian companies and have not made arrangements for declaration & payment within India of dividends payable out of such income) are charged to tax at higher rates than domestic companies
- Discrimination based on nationality has been dealt in various Indian judgments. Discrimination with respect to nationality is prohibited however; there could be discrimination in tax provisions with respect to residence.
 - Universities Superannuation Scheme Ltd - [2005] 275 ITR 434 (AAR)
 - Transworld Garnet Co Ltd - [2011] 333 ITR 1 (AAR)
 - Standard Chartered Bank v Inspecting Asst. Commissioner - [1991] 39 ITD 57 (Bom)



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (a) The term “person” includes an individual, a company and any other body of persons;
- Term ‘person’ should be interpreted very broadly
- Treaty applies only to ‘persons’ who are ‘residents’
- It includes any body corporate or entity that, although not incorporated, is treated as a body corporate for tax purposes e.g. foundation, partnership if it falls within the definition of ‘company’ or is treated as a distinct taxable entity or any other fiscally transparent entity that is treated as a body corporate
- Body of persons covers structures that neither have independent legal capacity nor are independently taxable

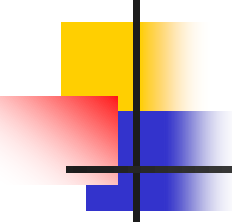


Article 3 – General definitions

Article 3

GENERAL DEFINITIONS

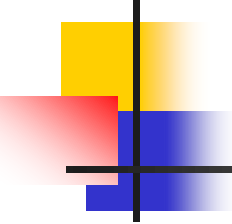
- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes;
- Includes an unincorporated entity(e.g. trust, foundation, partnership) only if the same is treated as a body corporate for tax purposes
- Practical issues arise when an entity is treated as a transparent entity for tax purposes but a body corporate for corporate purposes (.g. LLC in the US)



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (c) The terms “enterprise of a Contracting State” and enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
- The term “enterprise” per se has not been defined, because, as noted in the Commentary on the OECD Model Convention, the question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States.
- The residency of the enterprise depends on the residency of the person carrying the enterprise and not the place from which the enterprise is carried on.

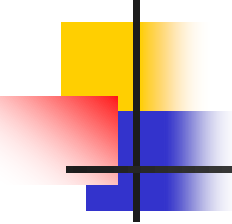


Article 3 – General definitions

Article 3

GENERAL DEFINITIONS

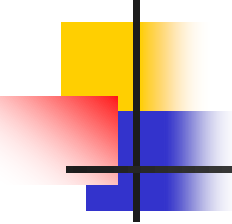
- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (d) The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;
- Means that the State in which an enterprise has its PoEM, has the right to tax its domestic traffic as well international traffic between third States, whereas the other Contracting State is permitted to tax traffic exclusively within its borders



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

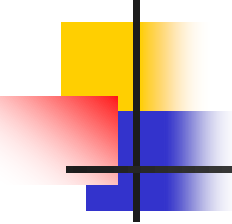
- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (e) The term “competent authority” means:
 - (i) (In State A):
 - (ii) (In State B):;
- This is left to the Contracting States, which are free to designate one or more authorities as being competent for the purpose of applying the Convention
- Usually, these are bodies of each state which are vested with the authority to determine issues relating to the convention, in particular under Mutual Agreement Procedures (Article 25) and Exchange of Information (Article 26)



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

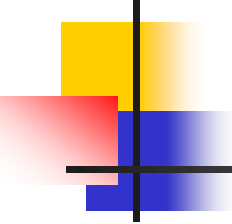
- 1. For the purposes of this Convention, unless the context otherwise requires:
 - (f) The term “national” means:
 - (i) any individual possessing the nationality of a Contracting State
 - (ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.
- Individuals as per respective State laws
- Legal persons, partnership and association – as per respective State laws in view of the legal relationship created between the entity and the State under whose laws it is constituted, which resembles the relationship of nationality for individuals
- This definition is primarily relevant to Article 24 dealing with non-discrimination.



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

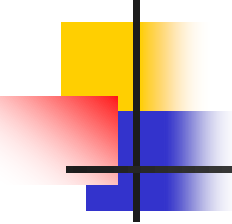
- 2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.
- Negative consequences arise when both countries to a treaty attach different meaning to the terms for applying provision of treaty which may result into double taxation or double non-taxation.
- Terms not defined in the treaty – As per domestic tax laws only if it is in the right context



Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

- 2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall...(con't)
- When a conflict arises between the law in force when the Convention was signed and that in force when the Convention is applied (i.e. when tax is imposed), the latter law should prevail (also called ambulatory approach)
- Section 90(3) of ITA provides that any term not defined under the ITA or the tax treaty will have the meaning as assigned to it in a notification issued by the Govt.
- Explanation 3 to Section 90 with retrospective effect from 01.10.2009 states that the meaning in the notification will be deemed to have effect from date of coming into force of the tax treaty (also called static approach)
- Important Case laws: on the issue to determine meaning of terms not defined in the Treaty; whether to use legislation in use when the Treaty was signed or that in force when the Treaty is being applied, it appears that ambulatory approach is generally preferred by Indian Courts;
 - Cairn UK Holdings Ltd. [2017] 185 TTJ 593 (Delhi ITAT)
 - Siemens Aktiengesellschaft [(2009) 310 ITR 320 (Bom.)]
 - Skycell Communications Ltd [(2001) 251 ITR 54 (Mad.)]

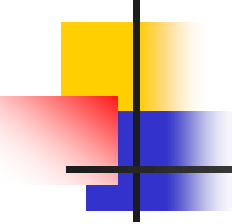


Article 3 – General definitions

Article 3 - GENERAL DEFINITIONS

- 2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall...(con't)

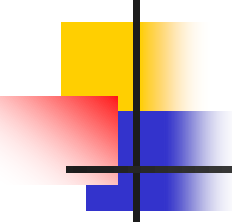
- Notification u/s 90(3) – “May be taxed”
“.....provides that any income of a resident of India “may be taxed” in the other country, such income shall be included in his total income chargeable to tax in India” in accordance with the Act and relief for double taxation may be provided
Notification no. S.O. 2123 (E) dated 28-8-2008



Article 4 – Resident

Article 4 - RESIDENT

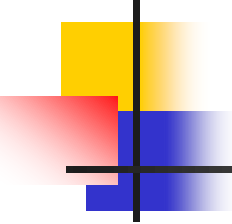
- 1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.



Article 4 – Resident

Article 4 - RESIDENT

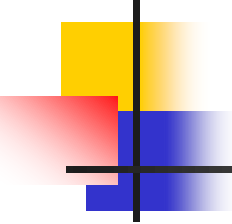
- Relevance of concept of Resident
 - Residence of a State establishes tax liability
 - Assists in determining a convention's scope of application
 - Solving issues where double taxation arises in consequence of double residence
 - Solving issues where double taxation arises as a consequence of taxation in the State of residence and in the State of source or situs
 - DTAAs rely entirely on the domestic laws for determining the residency.
 - Conflicts between two residences must be resolved by special provisions in the treaty.



Article 4 – Resident

Article 4 - RESIDENT

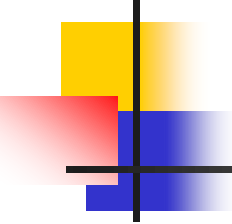
- Criteria for taxation as resident
 - Domicile
 - Residence
 - Place of incorporation
 - Place of management
 - Or any criterion of similar nature
 - Any political sub-division or local authority are treated as residents



Article 4 – Resident

Article 4 - RESIDENT

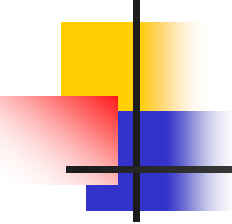
- 1. “.....This term however does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein”
- If a tax-payer is a non-resident of a state, he may be yet be liable to tax on source basis in that state. Therefore, the above clarifies that liability to tax *per se* does not make a person resident in that state if such liability is in respect of only income from sources in that State.
- But for this clarification, every person whose income is chargeable to tax in two jurisdictions would have been resident of both the jurisdictions.
- Thus it avoid dual residency identifying source state income separately



Article 4 – Resident

Article 4 - RESIDENT

- 1. “..... the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein.....”
 - To be *liable to tax*, the person must be *subject to* the laws of that jurisdiction
 - If a person is not *subject to* the laws, he would also not be *liable to tax*
 - However, even if he is *subject to* the laws, he may yet not be *subject to tax* (i.e. he is *liable to tax* but may not be required *to pay tax* e.g. in case of exempt income). Resident status cannot be denied in such cases
- **Important Jurisprudence on ‘liable to pay tax’**
 - Mohsinally Alimohammed Rafik [(1995) 213 ITR 317 (AAR)]
 - Cyril Eugene Pereira [(1999)) 239 ITR 650(AAR)]
 - Green Emirate Shipping & Travels [(2006) 100 ITD 203 (Mum.)]
 - Resource Connections FZE [(2010) 42 SOT 23 (Mum.)]
 - Mahavirchand Mehta [(2011) 45 SOT 137 (Mum.)]

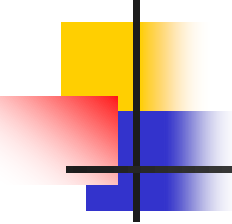


Article 4 – Resident

Article 4 - RESIDENT

➤ **Important Jurisprudence: Azadi Bachao Andolan (2003) 263 ITR 706 (SC)**

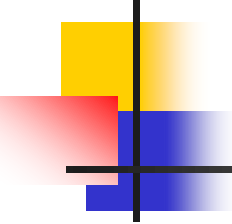
- The Supreme Court, in the case of Azadi Bachao Andolan, held that 'liability for taxation' is not to be determined on the basis of an exemption granted in respect of any particular source of income, but by taking into consideration the totality of the provisions of the income-tax law that prevails in either of the Contracting States. Merely because, at a given time, there may be an exemption from income-tax in respect of any particular head of income, it cannot be contended that the taxable entity is not liable to taxation in that Contracting State.
- Liability to taxation is a legal situation; payment of tax is a fiscal fact. For the purpose of application of Article 4 of the Tax Treaty, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax. If this were not so, the Tax Treaty would not have used the words 'liable to taxation', but would have used some appropriate words like 'pays tax'.



Article 4 – Resident

Article 4 - RESIDENT

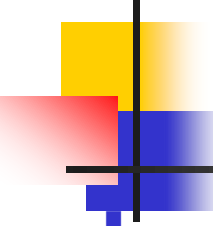
- **2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:**
 - (a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);**
 - (b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;**
 - (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;**
 - (d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.**



Article 4 – Resident

Article 4 - RESIDENT

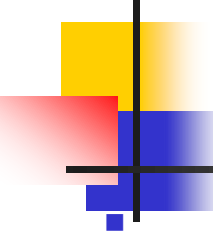
- An individual may be resident of a state for part of the year and resident of other state for the other part of the year
- Hence, tie-breaker test in case of individual's dual residency
- An individual's personal attachment is recognized to determine residency and following criteria are specified:
 - Permanent home
 - Personal and economic relations (centre of vital interests)
 - Habitual abode
 - Nationality
 - Competent authorities to decide



Article 4 – Resident

Tie-breaker test – Where an individual is a resident of both contracting states, then his status shall be determined as follows:

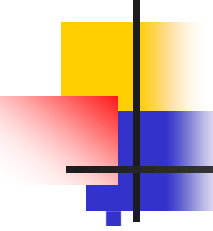
- Deemed to be a resident only of the State in which he has a Permanent Home available to him (should be available continuously at all times; may be rented for a prolonged period)
- In case a Permanent Home is available in both States, deemed to be a resident only of the State with which his personal and economic relations are closer (Centre of Vital Interests:- personal & economic relations, family and social relations, occupations, political, cultural and other activities)
- If Centre of Vital Interests cannot be determined, or a Permanent Home not available to him in either State, deemed to be a resident only of the State in which he has an Habitual abode (at any place like hotel where he stays for sufficient length of time; concept of habitual abode involves notions of frequency, duration, regularity of stays of a quality which are more than transient.)
- If Habitual abode is in both / neither States, deemed to be a resident only of the State of which he is a National
- If National of both / neither States, Competent Authorities shall settle by mutual agreement



Article 4 – Resident

Jurisprudence – Where test of permanent home is not sufficient to determine the residential status centre of vital interest in the country is to be examined

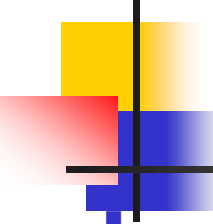
- Shalini Seekond (ITA No. 3877/Mum/2012)
- Dr. Rajnikant R. Bhatt vs. CIT {1996} 222 ITR 562/89 Taxman 82 (AAR–New Delhi)
- P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC)



Article 4 – Resident

Implications of Tie-breaker test

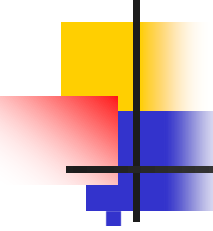
- When a person is resident of two countries, the tie-breaker test determines the taxing right of one of the contracting states to the DTAA i.e. the state in whose favour the tie breaks gets the right to tax the individual as a 'resident of that contracting state'. From a treaty perspective, the other state would become a source state.
- The residential status determined under tie-break is for the purpose of treaty only. For domestic law purposes, the person continues to be resident. For example, assume that an Indian company is held to be resident of another State in terms of treaty between India and that State. At the time of filing return in India, the residential status of the company should be resident. Only for the purpose of availing treaty benefits, its status would be non-resident.
- However, if a foreign company is held to have a place of effective management in India, it would be regarded as resident in India both for the purpose of the Act as well as treaty. All the provisions applicable to resident may be applicable to it. However, this company would not be regarded as an Indian company. Therefore, the provisions applicable to foreign company would continue to apply to it e.g., the payment to such company would be subject to withholding tax under section 195.



Article 4 – Resident

Implications of Tie-breaker test in case of income in third state

- Question arises as to whether the convention applies to the Income earned only from the sources in the other state to the treaty or also to that sourced in third state
- For example, if a person (say Mr. X) is resident under domestic laws of two countries (say State R and State R1) and receives income from a third country (State S). This will give rise to a triangular situation. State S would like to tax this income under source criteria under its domestic law. State R and State R1 would like to tax this income under residence criteria under their respective domestic laws
- Which DTAA to apply as Mr. X is resident of two states and both states would like to tax?
 - Alternative I: between State R and State S, or
between State R1 and State S
 - Alternative II: between State R and R1.
On tie-break, if State R prevails, then Mr.X will not be entitled to benefit under treaty between State R1 & State S; treaty between State R & State S would apply



Article 4 – Resident

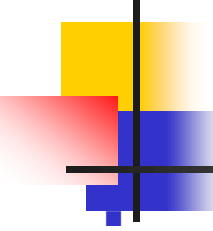
Implications of Tie-breaker test in case of income in third state (con't)

- The assignment of one state as state of residence is quintessential to ascertain as to which state will get the taxing rights as provided for from Article 6 to Article 20 of the DTAA and MC.
- Therefore one needs to look at each and every article from 6 to 20 to find out whether sources in third state is also included for the purposes of the tax treaty and if affirmative, the result of the tie breaker test will also apply to income sourced in the third state or any other state other than the treaty partners.
- Normally, DTAA does not apply to third state sources however if treaty partners so decide, it is provided in the Article on 'Other Income'. Such exceptions exist in the India-USA DTAA in Article 23 (Article 21 of the UN MC) which is reproduced below:

“1. Subject to the provisions of paragraph 2, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing Articles of this Convention shall be taxable only in that Contracting State.

2.

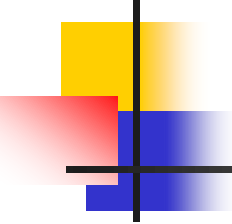
3.....” (Emphasis supplied)



Article 4 – Resident

Implications of Tie-breaker test in case of income in third state (con't)

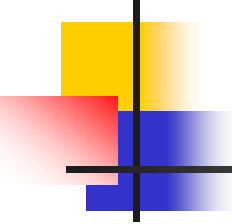
- Thus, Article 23(1) will prevent the other State from taxing the person on income arising in third states even if the person is resident of this other State for domestic law purposes
- This may also find support from paragraph 2 of OECD commentary on Article 21 which States that in cases of conflict between two residences, Article 4 will also allocate the taxation right in respect of the third State income.
- Also of importance is the following extract of para 3 of OECD Commentary on Article 21:
"Likewise, when income arises in a third State and the recipient of this income is considered as a resident by both Contracting States under their domestic law, the application of Article 4 will result in the recipient being treated as a resident of one Contracting State only and being liable to comprehensive taxation ("full tax liability") in that State only. In this case, the other Contracting State may not impose tax on the income arising from the third State, even if the recipient is not taxed by the State of which he is considered a resident under Article 4. In order to avoid non-taxation, Contracting States may agree to limit the scope of the Article to income which is taxed in the Contracting State of which the recipient is a resident and may modify the provisions of the paragraph accordingly".



Article 4 – Resident

Article 4 - RESIDENT

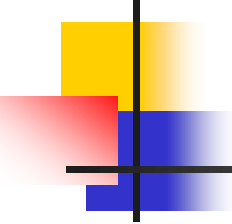
- 3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.
- Importance is attached to the place of effective management rather than the place of incorporation or registration
- A company may be subject to tax as a resident in more than one State, if, for instance, one State attaches importance to the registration and the other State to the place of effective management
- There may be more than one place of management but only one POEM at any one time
- US MC differs from the UN MC in-as-much as it provides that a company which is resident of both states is deemed to be the resident of the state under whose laws it is created



Article 4 – Resident

Article 4 - RESIDENT

- 3.person other than an individual.....State in which its place of effective management is situated.
- Model DTAA does not define the term 'effective management'
- Circumstances which may, inter alia, be taken into account while determining effective management are:
 - The place where a company is actually managed and controlled;
 - The place where the decision-making at the highest level on the important policies essential for the management of the company takes place;
 - The place that plays a leading part in the management of a company from an economic and functional point of view; and
 - The place where the most important accounting books are kept



Article 4 – Resident

- Earlier, section 6(3)(ii) of ITA laid down test of 'control and management' to determine the residence of a company under the Act. From April 1, 2017, this test is replaced with 'Place of effective management (PoEM)'
- PoEM as per Explanation to Section 6(3) of ITA
*"(3) A company is said to be a resident in India in any previous year, if -
(i) it is an Indian company; or
(ii) its place of effective management, in that year, is in India."*

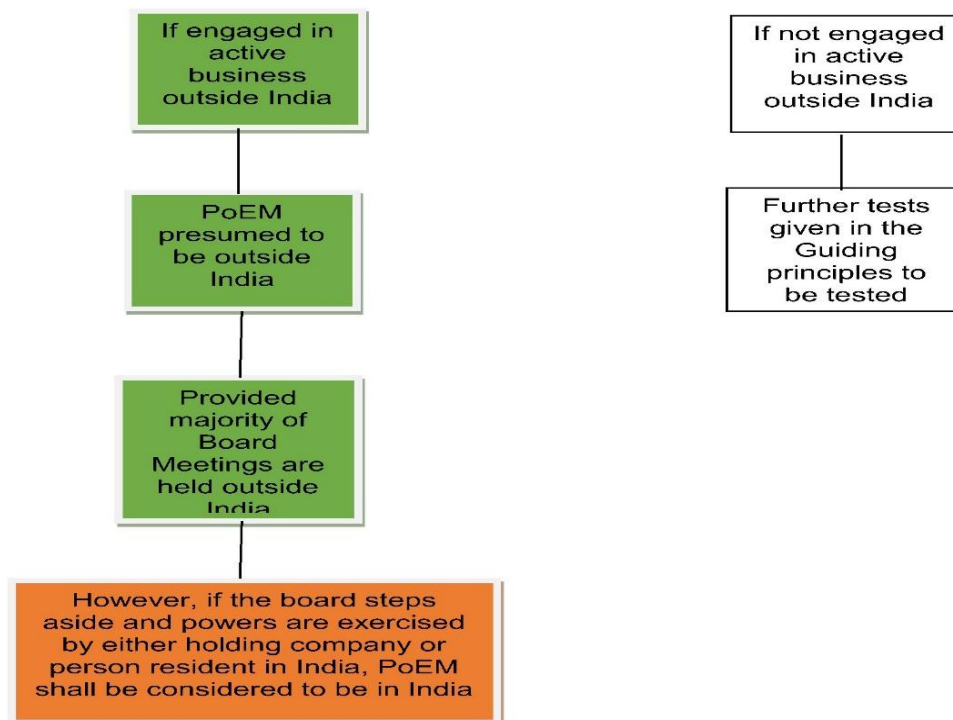
Explanation.—For the purposes of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made."

PoEM as per ITA

Guiding Principles for determination of PoEM as per CBDT

Key ingredients are active business, passive business and meetings of Board of Directors

The process of determining PoEM would depend on whether it is engaged in 'active business' outside India and the place of conduct of the board meetings of the entity:

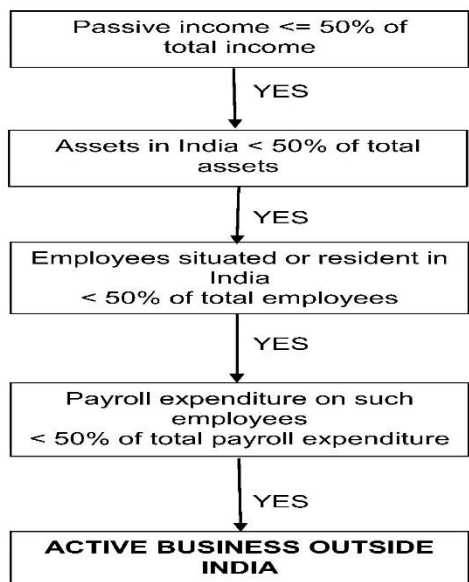


PoEM as per ITA

Determination of Active Business outside India

Key ingredients are Assets, Employees, Employees remuneration and passive income (unearned and trading with UAE)

A company shall be said to be engaged in "active business outside India if all the following conditions are met:

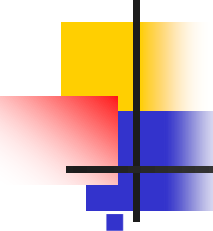


What is Passive income?

- income from transactions where both purchase and sale of goods is from / to its associated enterprises; and
- income by way of royalty, dividend, capital gains, interest or rental income.

Press Release dt. 24.01.2017 of CBDT

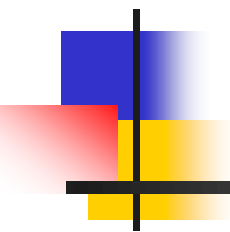
It has been further decided that the POEM guidelines shall not apply to companies having turnover or gross receipts of Rs. Fifty crore or less in a financial year



Article 4 – Resident

Jurisprudence – Control & Management test

- Integrated Container Feeder Service [(2005) 278 ITR 182 (AT) (Mumbai)]
- DLJMB Mauritius Investment Co. [(1997) 228 ITR 268 (AAR) – on place of management]
- Radha Rani Holdings (Pvt.) Ltd. [2007] 16 SOT 495 (Del.) – on control and management]
- Saraswati Holding Corporation Ltd. 16 SOT 535 (Del.) – on control and management]
- Nandlal Gandadal 1960 AIR 1147 – on control and management of HUF



Thank You
