Overview of Double Tax Avoidance Agreements Provisions

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Double Taxation can be defined as imposition of taxes in two or more states on the same / different tax payer in respect of the same subject matter in identical periods of time.

**Juridical Double Taxation**
Same person taxed on same income in different jurisdictions
- Worldwide income taxable in more than one state

**Economic Double Taxation**
Different persons taxed on same income in different jurisdictions
- Partnership entity as separate taxable entity in COS, Partners of such partnership taxable on pass through principles in COR

Concept of Double Taxation
Types of Double Taxation - Juridical double taxation

US Company

Pays taxes in USA
(Residence Country Tax)

USA

Juridical Double Taxation

Indian Company

Pays royalty after TDS @ 10%

TDS deemed as tax payment of US Co in India
(Source Country Tax)

INDIA

US Co (same person) getting taxed in US and India (different jurisdictions)
Types of Double Taxation - Economic double taxation

100 is taxable

I Co

USA

Pays Commission of 100

20 taxed in both the countries

Economic Double Taxation

INDIA

I Inc

• Arm’s length price is 80 as per transfer pricing provisions
• Excess commission paid of 20 will be disallowed

I Co and I Inc (different persons) taxed in US and India (different jurisdictions) for same income
Double Taxation Avoidance Agreements
Relief in India from Double Taxation

**Indian tax laws**

- **Section 90** - Empowers Government of India (‘GOI’) to enter into a Tax Treaty (‘DTAA’) for avoidance of double taxation
- **Section 90A** - GOI can adopt agreement entered into between specified association in India and specified association in specified territory outside India

**Statutory objective of Section 90(1) and 90A(1)**

- Avoidance of Double Taxation
- Promotion of mutual economic relations, trade & investment
- Relief on doubly taxed income
- Exchange of information to combat tax avoidance and tax evasion
- Recovery of tax

**DTAA vis a vis Domestic Tax Law**

- **Section 90 of the Income-tax Act, 1961**: Domestic tax law will apply to the extent it is more beneficial than the DTAA
- Tax treaties override the domestic tax law
Types of DTAA

**COMPREHENSIVE**
Contains rules which allocate tax jurisdiction for all or almost all types of incomes

**LIMITED**
Contains rules for only certain types of incomes like Inheritance, Gift, Shipping & Air transport, Estates

**BILATERAL**
- Between 2 countries only.
- Majority of treaties are bilateral

**MULTILATERAL**
- Between more than 2 or a group of countries
### Models of Tax Treaties

<table>
<thead>
<tr>
<th>OECD Model</th>
<th>UN Model</th>
<th>US Model</th>
<th>Andean Model</th>
</tr>
</thead>
</table>
| • Emphasis on residence based taxation  
  • Developed countries adopted this model in case of treaties with other developed countries  
  • Started from 1963 draft convention, followed by Regularly updated / amended  
  • OECD Model convention has been used as a main reference document | • Emphasis on source based taxation  
  • Developed countries adopted this model in case of treaties with developing countries or between two developing nations  
  • OECD Model convention has been used as a main reference document | • Used by USA for all treaty negotiations.  
  • This model had influence on existing Treaty between India & US  
  • OECD Model convention has been used as a main reference document | • Adopted by Latin American countries  
  • Not a very popular model |
Steps in effecting a DTAA

Negotiation
(By MoF, Dept of Revenue)

Drafting of Articles
(By MoF, Dept of Revenue)

Signing
(Typically by Chairman, CBDT)

Ratification
(By MoF, Dept of Revenue)

Notification
(By Chairman, CBDT)

Treaty becomes a law in India without any further legislation having to be enacted.

Unlike other countries, in India, treaties do not need to be placed before the parliament. S. 90 of ITA enables and empowers the Central Government to issue a notification for implementation of DTAA.
## Relevant Dates - DTAA

### Entry into Force of the Convention (Article 30)

<table>
<thead>
<tr>
<th>Date of Convention</th>
<th>Date on which Convention is signed</th>
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<tr>
<td>Date of Ratification</td>
<td>Ratification of treaty by legislative/ executive consent in each contracting state in accordance with domestic laws</td>
</tr>
<tr>
<td>Date of Exchange of Notes</td>
<td>Notes are exchanged between contracting states confirming ratification of treaty in each state</td>
</tr>
<tr>
<td>Date of Entry into Force</td>
<td>Treaty enters into force either upon the date of exchange of notes or a period thereafter as specified in treaty</td>
</tr>
<tr>
<td>Effective Date</td>
<td>Treaty provisions become effective in respective contracting states on the dates specified in relevant treaty</td>
</tr>
</tbody>
</table>

**Date of Entry into Force and Effective date of application may not be the same dates**

### Termination of Convention (Article 31)

- Treaty remains in force until terminated
- Some treaties provide for a period during which treaty cannot be terminated (eg India-US Treaty)
- Requires notice through Diplomatic Channels
- Some treaties provide for period of notice and some not
Interpretation of Terms - Relevant Material

Sources of Interpretation

Protocol / Exchange of Notes
- Clarifies/elaborates Treaty text
- Binding force – equal to Treaty
- No limit to no. of protocols
- May be entered into even after treaty is concluded

Commentary on Model Convention
- OECD
- UN
- US Technical Explanation

Public International Law
Vienna Convention on Law of Treaties
- Ordinary meaning of words
- Expressed intention of parties
- Object & Purpose of Treaty

Other Sources
- Mutual Agreement Procedure
- Judicial decisions
- Advance Rulings
- Eminent jurists such as Prof. Klaus Vogel, Philip Baker, Arvid Skaar
Structure and Provisions of a DTAA
# Articles of a DTAA (OECD)

## Scope Provisions
1. Article 1 – Persons Covered
2. Article 2 - Taxes covered
3. Article 31 - Entry into force
4. Article 32 - Termination

## Definition Provisions
1. Article 3 - General definitions
2. Article 4 - Resident
3. Article 5 – Permanent Establishment

## Elimination of Double
1. Article 23 - Elimination of double taxation
2. Article 25 - Mutual Agreement Procedure

## Anti-Avoidance
1. Article 9 - Associated Enterprise
2. Article 26 - Exchange of Information

## Substantive Provisions
1. Article 6 – Income from Immovable property
2. Article 7 - Business Profits
3. Article 8 - Shipping, etc
4. Article 10 - Dividends
5. Article 11 - Interest
6. Article 12 - Royalties & FTS
7. Article 13 - Capital gains
8. Article 14 - Independent Personal Services
9. Article 15 - Dependent Personal Services
10. Article 16 – Directors fees
11. Article 17 – Entertainers & Sports persons
12. Article 18 - Pensions
13. Article 19 - Government service
14. Article 20 - Students
15. Article 21 - Other income
16. Article 22 - Capital

## Miscellaneous Provisions
1. Article 24 - Non-discrimination
2. Article 27 – Assistance in collection of taxes
3. Article 28 – Diplomats
4. Article 29 – Entitlement to benefits
5. Article 30 - Territorial Extension

### Integral part of DTAA
- Exchange of Notes / Protocol
- Memorandum of Understanding (‘MoU’)

### Distributive Rules
Interplay between DTAA and Domestic Law

- Provision of DTAA will operate even when they are inconsistent with provisions of the Act and would override the provisions of the Act.
- DTAA provision cannot be thrust upon a taxpayer even if AO perceives that taxpayer may claim DTAA benefit in a subsequent year.
- DTAA provision cannot be thrust upon a taxpayer even if the taxpayer has applied the treaty provisions at the assessment stage and raises a claim only at appellate stage that he does not wish to be governed by them.
- DTAA cannot create more onerous obligations or liabilities than that provided under the Act.
- If the Act exempts certain income, DTAA would be inapplicable since there is no double taxation.
- Taxpayer can ask for application of the beneficial provision of the domestic tax law, even when he has opted for being governed by the provisions of the DTAA.
- DTAA benefits will generally be available subject to anti-abuse provisions under the domestic law.
- Under the Act, every year is an independent unit, and it is for the taxpayer to decide whether to opt for the provisions of the Act or DTAA irrespective of the earlier position adopted.
Access to DTAA
- Article 1 to 4
Article 1 - Person Covered

To whom does DTAA apply

- DTAA applies to ‘persons who are residents of one or both of the Contracting States’

Exceptions

- Article 24(1) (Non-discrimination) - Applies to Residents of third states
- Article 19 (Government service) – Applicable to nationals of third state
- Article 25 (MAP) - Applies to Residents of third states
- Article 1 of OECD MC allows exchange of information in respect of Residents/ nationals of third state

Example of Non-Discrimination

- A citizen of America and a non-resident, exported software from Permanent Establishment (‘PE’) in India and claimed deduction under section 80-HHE in respect of profits from export of software by invoking non-discrimination clause under India–USA DTAA.
- Sec. 80-HHE is only applicable to domestic companies and residents. However as per India–USA DTAA taxation of a PE of a USA resident shall not be less favorable than taxation of resident enterprise carrying on same activities. Accordingly, deduction u/s 80HHE can be claimed.
Triangular cases: DTAA applicability

- Netherlands Company has branch in Philippines
- Philippines branch enters into contract for rendering technical services to ICo
- Services are rendered from Philippines

Issue
- Is benefit of India-Netherlands DTAA available?
- AAR in case of Shell Technology India Pvt. Ltd.
**Article 2 - Taxes Covered**

**ARTICLE 2**

**Taxes Covered**

- Taxes on income and capital
- Wealth tax is included in certain DTAAAs
- Treaty also includes list of taxes in respect of which treaty applies
  - Indian ‘taxes covered’ include income-tax and surtax
  - Foreign treaties ‘taxes covered’ vary from treaty to treaty
  - Treaties 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

**Exceptions**

- Indirect taxes, social security charges, monetary fines and penalties, interest for late payment are not regarded as taxes

**Examples**

- Foreign State and Local levies may vary for each DTAA (India-USA DTAA does not cover State level income taxes)
Article 3 - General Definitions

ARTICLE 3
Definitions

- Provides general definitions and rules of interpretation applicable throughout the convention

Terms generally defined in DTAA

- Person, Company, Enterprise, Enterprise of a Contracting State and the Enterprise of the other Contracting State, International traffic, Competent Authority, National and Business
  - “Person” includes an individual, a company and any other body of persons
  - “Company” means any body corporate or any entity that is treated as a body corporate for tax purposes
    - Limited Liability Partnership?
  - National – Individual possessing nationality or citizenship – Any legal person, partnership or association deriving its status as such from the laws in force
  - Definition of country very important
    - Northern Ireland is covered in India – UK DTAA and not under India – Ireland DTAA
    - India – China DTAA does not cover Hong Kong
Article 3 - General Definitions

Undefined terms in DTAA

Meaning under Income-tax Act, 1961

Notified definition in Official Gazette

Domestic meaning as per Tax Law or Non Tax Law

Competent Authority

Yes

No

Yes

No

Yes

No

Yes

Meaning under Income-tax Act, 1961, unless the context requires other interpretation

Notified definition in Official Gazette, unless the context requires other interpretation

Domestic meaning as per Tax Law or non tax law, unless the context requires other interpretation
**Article 4 - Residence**

**ARTICLE 4**

- Lays down criteria for determining residence of person
- "Resident of one of the States" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature

**Objective**

- The concept of 'resident of a Contracting State' is required
  - in solving cases where double taxation arises in consequence of double residence
  - in solving cases where double taxation arises as a consequence of taxation in the State of residence and in the State of source or situs
- The following articles of a treaty can be brought into operation even if a person is not a resident of either of the contracting states:
  - Article 24: Non-Discrimination: The application of this article is based on nationality rather than residence
  - Article 26: Exchange of Information: The contracting states can exchange information in respect of persons who are not resident of either of the contracting states
Article 4
What if person is a resident in both States?

Tie-breaker applies if a person is resident in both States under Art. 4(1)

FOR INDIVIDUALS

RULE 1
Permanent Home / Centre of vital interests

RULE 2
Habitual Abode

RULE 3
National

RULE 4
Mutual Agreement by Competent Authorities

OTHER THAN INDIVIDUALS

Person is resident of State where Place of Effective Management (‘POEM’) is situated. OECD Commentary says:

- Place where key management and commercial decisions that are necessary for conduct of business are in substance made
- An entity may have more than one place of management, but it can have only one POEM

BEPS Action Plan proposes tie breaking to be resolved by mutual consideration by competent authorities
**CASE STUDY # 1:**

**Facts & Assumptions:**

- Mr. X is a citizen of UK. He travels to India on business and spent 200 days in India in 2018.
- Resident of both countries under respective domestic tax laws.
- He has a home in the UK and lives in a hotel in India.
- How is residency determined under the Treaty?
International accepted standards on POEM

OECD Commentary

- POEM of an entity shall be determined by competent authorities of two countries by way of mutual agreement
- POEM determination is based on factors such as:
  - where the meetings of BOD are held;
  - where CEO and other senior executives usually carry on their activities;
  - where the company's headquarters are located; and
  - where its accounting records are kept.
- An entity may have more than one place of management, but it can have only one place of effective management at any one point of time

UN Commentary

- The place where the 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
- The place where the most important accounting books are kept
**CASE STUDY # 2:**

**Facts & Assumptions:**
- XYZ is a company incorporated in Netherlands and is a tax resident of the Netherlands
- Its CEO and the Board of Directors meet in India and exercise control over its activities
- How will residence be determined under the India-Netherlands treaty?
Article 5 - Permanent Establishment
Article 5 - Permanent Establishment

Concept of PE
- Entities increasingly engage in economic activities across several tax jurisdictions
- PE test determines the right of source state to tax business profits
- Defined concept under DTAA

Concept of PE – under Article 5 of the OECD Model Convention (MC)

Source Country’s right to tax Residents of Other Contracting State under DTAA:
- Taxation of passive income such as dividends, interest, royalties and fees for technical services on gross basis – income not effectively connected to PE
- Taxation of business income (including passive income) attributable to PE on net basis
Article 5 – Permanent Establishment

PE definition under tax treaties

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<th>Particulars</th>
<th>Type of PE</th>
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<td>Basic rule</td>
<td>Fixed base PE</td>
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<td>Article 5(2)</td>
<td>Illustrative list of PE</td>
<td>Inclusions to fixed base PE</td>
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<td>Article 5(3)</td>
<td>PE in relation to projects</td>
<td>Construction / Installation PE</td>
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<td>List of exclusions</td>
<td>Exclusion from fixed base PE</td>
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<td>Article 5(5) &amp; (6)</td>
<td>Dependent / Independent agent</td>
<td>Agency PE</td>
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<td>Article 5(7)</td>
<td>Associated enterprise</td>
<td>Subsidiary PE</td>
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</table>
Article 5 - Fixed Base PE

- Article 5(1) of the OECD MC governs basic rule for Fixed base PE:

  "For the purpose of this Convention, the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on"

Identical definition under UN and US Model

Elements of Fixed base PE:
- Existence of ‘place of business’ and place should be at the disposal of FCo – disposal test
- Place of business must be ‘fixed’ – permanence test
- Business is carried on wholly or partly through fixed place of business – business activity test

Above conditions need to be cumulatively satisfied
Article 5 - Inclusions to PE

- Article 5(2) of the OECD MC provides an inclusive definition of PE which reads as under:
  a) “The term ‘permanent establishment’ includes especially:
  b) a place of management;
  c) a branch;
  d) an office;
  e) a factory;
  f) a workshop, and
  g) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources”

- The list is indicative and not exhaustive

Whether Article 5(1) & 5(2) are Independent?
Article 5 - Service PE

- Furnishing of “services” within India
- Through employees or other personnel
- Residential status of recipient of service is an irrelevant factor
- Activities continue for a period exceeding 90 days (30 days or one day where services are rendered by associated enterprises)
- No service PE clause in some Treaties – Netherlands, Denmark, France & Mauritius
- Services categorized as FTS / Royalty not covered

Secondment of employees
Article 5 - Construction/Installation PE

- **Article 5(3) of OECD Model Convention**
  
  “A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months”

- **Includes:**
  - Construction of roads, bridges, canals, including substantial renovation
  - Laying of pipelines, excavating and dredging
  - “Installation Project” includes installation of ‘new equipment’ (complex machine)
  - Includes assembly and supervisory activities

Some of India’s DTAA prescribe a 9 month period while the DTAA with US prescribes a threshold of 120 days
Article 5 - Agency PE

**AGENTS**

**Independent Agent**

- Agent acts in the ordinary course of his business;
- **Agent’s activities are not dependent wholly or almost wholly** on foreign enterprise or on other enterprises subject to common control of the foreign enterprise

**Dependent Agent**

Dependent agent becomes PE when he:
- **habitually conclude contracts** for foreign enterprise;
- **habitually plays principal role leading to conclusion of contracts** that are routinely concluded without material modification by foreign enterprise

**Agency PE**

Definition to change post implementation of BEPS measures

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1 United Nations Model Convention
Article 5 - Agency PE

Person acting on behalf of an enterprise?  
Yes → Authority to conclude contract exercised habitually?  
Yes → Legally and economically independent?  
Yes → Ordinary course of business?  
Yes → PE  
No → No PE

No → No
Article 5 - Subsidiaries and PE

Article 5(7) of OECD MC reads as under:

“\text{The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a PE or otherwise), shall not of itself constitute either company a PE of the other}.”

- Definition is identical under UN MC and US Model
- Existence of a subsidiary by itself does not constitute PE
  - Legal independence of the subsidiary respected
- Test of fixed base PE / service PE / agency PE need to be satisfied
Article 5 - Activities that do not result in PE

Exceptions in Article 5(4)

- Use of facilities for storage or display of goods
- Maintenance of stock of goods for storage or display
- Maintenance of stock for processing of goods
- Purchasing goods or merchandise or for collecting information for the enterprise
- Carrying on, for the enterprise, any other activity of a preparatory or auxiliary character

Impact of BEPS on Article 5(4)?
Article 5 - Quiz

- Whether an LLP in which a foreign company is a partner be construed as a PE?
- Whether Project Office is a PE?
- Is duration important for analysis of Installation PE?
- Whether a dependent agent securing orders in India constitute a PE?
- Whether a Liaison office conducting preparatory activities constitute a PE?
- Whether purchasing activity by Liaison office of FCo constitutes PE
Article 7 - Business Profits
Article 7 - Business Profits

**ARTICLE 7**

**Business Profits**

- Existence of PE must for attribution
- Only profits attributable to such PE is taxable in the source country
- PE test for each source of income
- Principle of "force of attraction" present in UN Model

**Force of Attraction**

- Primarily concerned with taxation of business profits in Source Country
- Prevents tax evasion / avoidance through artificial contracts / business arrangement
- Identification of business transactions – source based taxation

**Types of Force of Attraction**

- **General** Force of Attraction
- **Restricted** Force of Attraction
Article 9 - Associated Enterprise
**Article 9 - Associated Enterprise**

**Applicability:**
(a) Direct or indirect participation by one entity into capital, management or control of other entity; OR  
(b) Same person participates directly or indirectly into capital, management or control of both enterprises

Transactions are not commensurate with a transaction as would have been carried out between independent enterprise (Arms’ Length Price (‘ALP’))

**Impact**
Profits which, but for those conditions would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly

**Article 9(2)**
- Where the transactions between two entities is not at ALP and  
- Profits of one entity are re-determined on account of transfer pricing adjustments then  
- Enhanced income shall be chargeable to tax in one country and the other country shall provide a tax relief to the extent of enhancement  
- Corresponding adjustment available to eliminate economic double taxation
Article 6 - Income from Immovable Property
Article 6 - Income from Immovable Property

Para 1 of Article 6 – Applicability – Charging provision

- A resident of Contracting State (State of Residence) derives income;
- Such income is derived from immovable property or agriculture or forestry; and
- Such immovable property is situated in other Contracting State (State of Source)
Article 6 - Income from Immovable Property

Para 2 of Article 6 – Meaning of Immovable property

Para 2 of Article 6 – Inclusions and Exclusions

- **Inclusions as per DTAA**
  - property accessory to immovable property (e.g. Buildings)
  - livestock and equipment used in agriculture and forestry (e.g. Machinery used in Saw mill)
  - rights to which the provisions of general law respecting landed property apply (e.g. Rights covered under Transfer of Property Act)
  - usufruct of immovable property (i.e. income without ownership of the asset)
  - rights to variable or fixed payments as consideration relating to working of, or the right to work, mineral deposits, sources and other natural resources

- **Exclusions as per Treaty**
  - Ships, boats and aircrafts

General Rule – Whatever is affixed or attached to land becomes a part of the land

- **Income Tax Act, 1961-Section 269UA**
- **Illustrative list under DTAA**
- **Specific exclusions under DTAA**
- **Domestic law irrelevant if items specifically included or excluded in DTAA**
Article 6 - Income from Immovable Property

Para 3 of Article 6 – Meaning of ‘use’

• Forms of Exploitation
  - Direct use
  - Letting Out
  - Use in any other form

Para 4 of Article 6 – Additional scope

• Extends scope of situs based taxation
  - Income earned by an enterprise (PE of non resident in source country) from immovable property
  - E.g. relinquishment of property for use by a third party
Article 8 - Shipping and Air Transport
Article 8 - Shipping And Air Transport

Article 8(1)

**Profits from operation of ships or aircraft in international traffic** taxable in contracting state in which **place of effective management** situated

**KEY CONDITIONS**
- Profits
- Operation of ships or aircraft
- International traffic
- Place of Effective Management (POEM)
Article 8 - Shipping And Air Transport

Article 8(1) - Meaning of ‘profits’...

**Profits - directly connected with operation**

- Enterprise engaged in international traffic that would have some of its passengers or cargo transported internationally by ships or aircraft operated by other enterprises eg. under code-sharing or slot-chartering arrangements or take advantage of an earlier sailing
- Lease of containers by shipping lines or airlines

**Profits – ancillary to operation**

- Make minor contribution relative to operation of ships
- So closely related that it cannot be regarded as separate business or source of income
- Eg. Advertisement in magazines aboard ships, on board sale of products, etc.
Article 8 - Shipping And Air Transport

‘operation of ships or aircraft’…

- Generally, not defined under DTAA
  - Expressions not defined in DTAA - meaning to be ascertained as per domestic laws [Article 3(2)]
- ‘Operation of ships’ - defined u/s 115VB of IT Act
  - Company regarded as operating, if it operates any ship (owned or chartered) and includes arrangement such as slot charter (i.e. a slot for a container on a ship)

**Bareboat charter hire**
- Payment to owner for hire of bare vessel
- Not considered as ‘operation of ship’ by lessor - (crew of) lessee operating the ship
- Considered as ‘Royalty’ for use of equipment
- West Asia Maritime Ltd. v. ITO (109 TTJ 617)(ITAT, Chennai)
- Poompuhar Shipping Corporation Ltd. v. ITO (108 TTJ 970)(ITAT, Chennai)
  - Payment was for ‘use and hire of vessel’, not for services

**Time charter hire**
- Payment to owner for hire of vessel with crew and equipment - viz. provision of services
- Considered as ‘operation of ship’ by lessor - Article 8 benefit available to lessor
- OECD and Klaus Vogel clearly recognise time charter as operation of ships by lessor

**Slot Charter**
- Payment to owner for hire of slots (space), aboard a container ship
- Considered as ‘operation of ship’ by lessor - Article 8 benefit available to lessor - Balaji Shipping (UK) Ltd.
Article 8 - Shipping And Air Transport

Meaning of ‘international traffic’

- Defined under Article 3(1)(e) of DTAA
  - Transport by ship or aircraft operated by enterprise which has its POEM in a contracting state (prevailing assumption that operations shall be between both contracting states)
  - Coastal traffic - operation solely between places in other contracting state not covered
  - Illustration

International traffic

- Ships / aircraft plying:
  - Colombo (Sri Lanka) - Chennai (India)
  - Colombo (Sri Lanka) - Chennai (India) - Mumbai (India)
  - Colombo (Sri Lanka) - Chennai (India) - Dubai (UAE)

Not international traffic

- Ships / aircraft plying:
  - Chennai (India) - Colombo (Sri Lanka) (not stopping) – Mumbai (India)
  - Chennai (India) - Mumbai (India)
Article 10 - Dividend
Article 11 - Interest
ARTICLE 10

Dividend

- Source-based taxation
- Dividend – Income from shares, participating in profits rights, other rights not being debt claims, etc.
- Tax Treaty imposes a limitation on the maximum rate to be charged by the source country
- Generally, the condition of “beneficial owner” exists
- Dividends earned if “effectively connected” with PE taxed under Article 7

ARTICLE 11

Interest

- Source-based taxation
- Interest – income from debt claims of every kind, income from government securities, income from bonds and debentures
- Tax Treaty imposes a limitation on the maximum rate to be charged by the source country
- Generally, the condition of “beneficial owner” exists
- Interest earned if “effectively connected” with PE taxed under Article 7
Article 12 - Royalty / Fees for Technical Services
Article 12 - Royalty

ARTICLE 12
Payments of any kind received as a consideration for:

- Use of or right to use:
  - any copyright of literary, artistic or scientific work including cinematograph films;
  - any patent, trademark, design or model, plan, secret formula or process
  - information concerning industrial, commercial or scientific experience

Apart from the above, notable inclusions are use of or right to use:
- films or tapes used for radio or television broadcasting
- Industrial, commercial or scientific equipment
Article 12 - Royalty

**Article 12(1)**
Royalty of source country may be taxed in other country of which the recipient is a resident

Royalty may also be charged in the source country, but if beneficial owner of royalty is a resident of other country the tax charged shall not exceed specified percent of gross amount of royalties

**Article 12(2)**
Deals with the meaning of “Royalties”

**Article 12(3)**
Para (1) to not apply if the
- royalty is effectively connected with PE; or
- the recipient has a fixed Base in the State of Source
# Article 12 – Fees for Technical Services

There is no specific article on FTS in either OECD / UN / US MC - it treats it on par with Business Income (Article on FTS at draft stage in UN MC)

## Fees for Technical Services

Payments to any person in consideration of managerial, consultancy and technical services including provision of services of technical or other personnel

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<th>Managerial Services</th>
<th>Essentially involves controlling, directing or administering the business</th>
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<tr>
<td>Technical Services</td>
<td>Provision of services which require special skills or knowledge related to a technical field</td>
</tr>
<tr>
<td>Consulting Services</td>
<td>Provision of advice by someone, such as a professional, who has special qualifications allowing him to do so</td>
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</table>

**Article 12 - Fees for Technical Services**

**Fees for Included Services**

- Payments of any kind to any person in consideration for the rendering of any technical or consultancy services if such services:
  - Are ancillary and subsidiary to application and enjoyment of right; or
  - Make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design

Managerial Services are excluded under the definition of FIS

Excludes services ancillary to sale of property, rental of ships, aircraft, containers or other equipment’s, teaching in or by educational institutions, for personal use and to an employee of person making the payment

**Article 12 Make Available**

- Person acquiring the service is enabled to apply the technology
- Mere requirement of technical input by a person providing services does not necessarily mean that technical knowledge is “made available”
Article 13 - Capital Gains
### Article 13 - Capital Gains

<table>
<thead>
<tr>
<th>Article 13</th>
<th>Type of Capital Asset</th>
<th>OECD Model</th>
<th>UN Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Para 1</td>
<td>Alienation of immovable property</td>
<td>Taxable in COS</td>
<td>Taxable in COS</td>
</tr>
<tr>
<td>Para 2</td>
<td>Movable property forming part of business property of a PE, including gains from alienation of PE itself either alone or along with the entire enterprise</td>
<td>Taxable in COS</td>
<td>Taxable in COS</td>
</tr>
<tr>
<td>Para 3</td>
<td>Gains from alienation of ships, aircrafts, or boats or movable property relating to operations in international traffic</td>
<td>Taxable in country of POEM</td>
<td>Taxable in country of POEM</td>
</tr>
<tr>
<td>Para 4</td>
<td>Gains from alienation of shares of company resident in source country, deriving their value mainly from immovable property in source country</td>
<td>Taxable in COS</td>
<td>Taxable in COS</td>
</tr>
<tr>
<td>Para 5 (Para 6 in UN Model)</td>
<td>Gains from alienation of any other property not included in the Article</td>
<td>Taxable in COR</td>
<td>Taxable in COR</td>
</tr>
<tr>
<td>Para 5 in UN Model</td>
<td>Gains from sale of shares of a company resident in source country, other than discussion in para 4 above</td>
<td>Not found in OECD Model, taxable in COR</td>
<td>Found in UN Model, taxable in COS, subject to negotiation</td>
</tr>
</tbody>
</table>
Article 14 - Independent Personal Services
Article 14 - Independent Personal Services

Deals with taxation of income in respect of professional services or other activities of independent character

Taxable in source state if

- Regular fixed base available in that state or;
- Stay exceeds threshold period mentioned

Amount taxable – only amount attributable to fixed base or activities carried out in source state

Professional services includes especially independent scientific, literary, artistic, educational or teaching activities as well as independent activities of physicians, lawyers, engineers, architects, dentists and accountants

OECD deleted this article w.e.f. the year 2000
Article 15 - Dependent Personal Services
Article 15 - Dependent personal services

Remuneration derived by a resident of a Contracting State in respect of an employment exercised in other Contracting State is taxable in the State of Residence

Taxable in source state if any one of the following conditions satisfied:

- Presence in source state for period or periods exceeding specified threshold
- Remuneration is paid by or on behalf of resident of source state
- Remuneration is borne by PE which the employer has in the source state

Short stay exemption under the Income-tax Act, 1961
Section 10(6)(vi)

- Employee of foreign enterprise renders service in India
- Foreign enterprise is not engaged in any trade/ business in India
- Stay in India does not exceed 90 days
- Remuneration is not deductible from income of the employer
Article 16 - Directors' Fees
Article 17 - Entertainers & sportspersons
Article 18 - Pensions
Article 19 - Government Service
Article 20 - Student
**Article 16, 17, 18 - Directors’ Fees / Entertainers & Sportspersons / Pension**

<table>
<thead>
<tr>
<th>ARTICLE 16</th>
<th>Directors’ Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments include Director’s Fees, payments in cash or kind received in capacity as a Director; severance pay, annuity, etc. in connection with directorship</td>
<td></td>
</tr>
<tr>
<td>Taxable in country of residence of company</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ARTICLE 17</th>
<th>Entertainers &amp; Sportspersons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overrides Article 7, 14 and 15 of the MC</td>
<td></td>
</tr>
<tr>
<td>Income is taxable in the country in which activities are performed</td>
<td></td>
</tr>
<tr>
<td>Deals with situations where their income accrues to another person (taxable in country in which activities are performed)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ARTICLE 18</th>
<th>Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applies to individuals only</td>
<td></td>
</tr>
<tr>
<td>Covers private pension and other similar payments (annuity) in consideration of past employment</td>
<td></td>
</tr>
<tr>
<td>Taxable in country of residency</td>
<td></td>
</tr>
</tbody>
</table>
ARTICLE 19
Government Service

- Applies to Individuals only
- Covers salaries, wages and similar remuneration paid by Contracting Country, Political sub division or a local authority
- Pensions from Government
- Primary right to tax is of the Country that makes the payment
- Other contracting state has right to tax if recipient is national or resident of other state

ARTICLE 20
Student

- Period of stay to be in accordance with the education / training
- Payments not to exceed expenses likely to be incurred to ensure student’s maintenance, education or training
Article 21 - Other Income
Article 21 - Other Income

- Residuary Article
- ‘Element of Income’ to be present
- Any income not dealt with in earlier articles covered here
- Other Income connected with PE will be covered under Article 7 or Article 14 respectively
- Shared taxation rights between Source Country and Residence Country
Article 23 - Elimination of Double Taxation
Article 23 - Elimination of Double Taxation

Two contracting states in DTAAs can agree to follow different methods for eliminating double taxation.
## Article 23 - Elimination of Double Taxation

### Exemption Method

#### Full Exemption
- In this method income taxed in source country is totally excluded in resident country for tax purposes.

#### Exemption with progression method
- Rate of tax is calculated by COR by including income taxed in COS. Then such rate is applied on income excluding income taxed in COS.

- **In the following treaties with India, exemption method has been followed:**
  - By both the states:
    - Bulgaria, Poland and Egypt
  - By the other states (i.e. the other states adopts exemption method and India adopts Tax Credit method):
    - Austria, Belgium, Turkey
Article 23 - Elimination of Double Taxation

Credit Method

**Full Credit method**
- Under this method COR allows foreign taxes from total tax liability irrespective of different tax rates in COR and COS.

**Ordinary Credit method**
- COR allows tax credit by restricting it to the rate of tax in COR against income taxed in COS.

**Underlying Credit method**
- Credit for corporate tax is available when dividends are paid by resident of one state to another. This is in addition to tax paid on dividends.

Dividend and Interest always follow tax credit method

Tax credit method – Resident state retains the right to tax
Article 23 - Elimination of Double Taxation

Full credit method

A Ltd, a resident of State R, has earned a total income of Rs 1 Lac. Of its total income, Rs. 20000/- is derived from State S. State R imposes tax of 35%. State S imposes tax of 40%. In this case the credit would be computed as follows

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Credit Mechanism does not exist</th>
<th>Credit Mechanism exists</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of income earned</td>
<td>1,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>State R Tax</td>
<td>35,000</td>
<td>35,000</td>
</tr>
<tr>
<td>State S Tax</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Tax credit available</td>
<td>-</td>
<td>8,000</td>
</tr>
<tr>
<td>Taxes due in State R</td>
<td>35,000</td>
<td>(35,000-8,000) 27,000</td>
</tr>
<tr>
<td>Total tax cost</td>
<td>43,000</td>
<td>35,000</td>
</tr>
</tbody>
</table>
Article 23 - Elimination of Double Taxation

Ordinary credit method

A Ltd, a resident of State R, has earned a total income of Rs 1 Lac. Of its total income, Rs 20,000 is derived from State S. State R imposes tax of 35%. State S imposes tax of 40%. In this case the credit would be computed as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Credit Mechanism does not exist</th>
<th>Credit Mechanism exists</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of income earned</td>
<td>1,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>State R Tax</td>
<td>35,000</td>
<td>35,000</td>
</tr>
<tr>
<td>State S Tax</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Tax credit available</td>
<td></td>
<td>(20,000*35%)</td>
</tr>
<tr>
<td>Taxes due in State R</td>
<td>43,000</td>
<td>28,000</td>
</tr>
<tr>
<td>Total tax cost</td>
<td>43,000</td>
<td>36,000</td>
</tr>
</tbody>
</table>

*Maximum credit restricted to 7000 (35% which is tax rate in State R on the income earned in State S)
Underlying Tax Credits (UTC)

Certain DTAAAs offer UTC as a method for providing relief to Doubly Taxed Income.

<table>
<thead>
<tr>
<th>Company in State S</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>PBT</td>
<td>300,000</td>
</tr>
<tr>
<td>Tax @ 30%</td>
<td>90,000</td>
</tr>
<tr>
<td>PAT</td>
<td>210,000</td>
</tr>
<tr>
<td>Dividend Distribution</td>
<td>210,000</td>
</tr>
</tbody>
</table>

- Company in State R holds 80% stake in Company in State S and receives dividend of 1,68,000 (210000 @ 80%) from Company in State S
- TDS by State S – 33,600 (168,000 @ 20%); Net dividend received by Company in State R – 134,400
- Tax rate in State R – 35%
- **Assumption:** Dividend Income is the only income of Company in State R and it has no deductible expenses
### Article 23 - Elimination of Double Taxation

#### Underlying Tax Credits (UTC)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Dividend Income received in State R</td>
<td>134,400</td>
</tr>
<tr>
<td>Add: Taxes Withheld</td>
<td>33,600</td>
</tr>
<tr>
<td>Gross Dividend Income</td>
<td>168,000</td>
</tr>
<tr>
<td>Underlying tax credit = Gross Dividend / Distributable profits x Actual tax paid on those profits (1,68,000 / 2,10,000 * 90,000)</td>
<td>72,000</td>
</tr>
</tbody>
</table>
Article 23 - Elimination of Double Taxation

Tax Sparing

Need

• Source State may provide tax incentives on certain income

• State of Residence may tax that income

• Result – Country of residence may collect taxes foregone by Source Country

What does Tax Sparing mean?

State of residence –

• grants credit for deemed tax paid on income otherwise exempt in Source State

• considers tax payable; not tax paid
## Article 23 - Unilateral Tax relief illustration

### Section 91 of the Income-tax Act, 1961:
- Applicable to cases where there is no DTAA with foreign country in which tax is paid / liability incurred
- Quantum of Relief - Proportionate method *i.e.* lower of ‘Indian Tax Rate’ or ‘Foreign Tax Rate’ (Ordinary Credit method and not full method)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Case I</th>
<th>Case II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income in India</td>
<td>150,000</td>
<td>150,000</td>
</tr>
<tr>
<td>Income in foreign country</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Total income</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Tax rate in India</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Tax rate in foreign state</td>
<td>25%</td>
<td>35%</td>
</tr>
</tbody>
</table>

### Workings

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Case I</th>
<th>Case II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax on total income</td>
<td>(A) 75,000</td>
<td>75,000</td>
</tr>
<tr>
<td>Indian tax on foreign income</td>
<td>(B) 30,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Foreign tax on foreign income</td>
<td>(C) 25,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Unilateral tax relief as per the Act – Lower of (B) or (C)</td>
<td>(D) 25,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Tax payable in India (A) – (D)</td>
<td>(E) 50,000</td>
<td>45,000</td>
</tr>
<tr>
<td>Total tax outflow (B) + (E)</td>
<td>75,000</td>
<td>80,000</td>
</tr>
</tbody>
</table>

**Effective tax rate**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30%</td>
<td>32%</td>
</tr>
</tbody>
</table>
Article 24 - Non-discrimination
Article 24 - Non-discrimination

- Prevention of discrimination under tax laws of the host country on account of the following four criteria:
  - Nationality of the taxpayer [Art 24(1)] and [Art 24(2)] – tax deductions?
  - PE in the host country [Art 24(3)]
  - Deduction - Payment of interest, royalties, other consideration, etc. to a recipient abroad [Art 24(4)]
  - Holding of shares in a resident enterprise by non-residents [Art 24(5)] – section 79?

- Other provisions:
  - Stateless Persons [Art 24(2)]
  - Inclusion of other taxes [Art 24(6)]
Article 25 - Mutual Agreement Procedures (‘MAP’)
Article 25 - MAP

- MAP is an alternative available to taxpayers for resolving disputes giving rise to double taxation – juridical or economic

- Taxpayer of the country having to bear the incidence of double taxation can apply for assistance of competent authorities (‘CA’) under MAP to resolve the issue of such double taxation

- Agreement of CAs of both the states

- No obligation of CAs to reach mutual agreement

- Notwithstanding remedy under domestic tax law of source state

- Time limit for filing of MAP – generally 2 / 3 years from the date of original assessment giving rise to double taxation

- Generally in case of:
  - Specific Provisions where taxation is not in accordance with the DTAA
  - General Interpretation issues such as those under Article 4 – Resident
  - Issues not covered under DTAA such as economic double taxation, including TP adjustments of their resident countries
Steps for applying tax treaties
Steps for applying tax treaties

Step 1 – What is the nature of the income?

Step 2 – Does the treaty apply?

Step 3 – Determine which article applies?

Step 4 – How are taxing rights assigned?

Step 5 – How is the income calculated?
Limitation of Benefits
Limitation of Benefits (LOB)

• Intention is to prevent misuse of tax treaties by third countries

• Generally, a LOB clause in a DTAA is designed to test the substance of a claimant to the DTAA

• Condition is satisfied where certain objective criteria’s are met – residential status of shareholders, listing, active trade / business activity, minimum expenditure, etc.

• LOB articles in treaties vary between each treaty in terms of conditions and complexity

• India – US DTAA is India’s first DTAA with LOB clause

• BEPS Action Plan 6 – Treaty abuse recommends LOB article to be included in DTAA, objective rule plus subjective Principal Purpose Test
## Limitation of Benefits (LOB)

<table>
<thead>
<tr>
<th>Form of LOB</th>
<th>Examples of Indian treaties with LOB Clause:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Place of Effective Management</td>
<td>• India USA DTAA</td>
</tr>
<tr>
<td>• Beneficial owner</td>
<td>• India Singapore DTAA</td>
</tr>
<tr>
<td>• Subject-to-tax or liable-to-tax approach</td>
<td>• India Kuwait DTAA</td>
</tr>
<tr>
<td>• Specific article on LOB</td>
<td></td>
</tr>
</tbody>
</table>

- In the India – US DTAA (Article 24) is as follows:
  - Beneficial ownership test i.e. who are actual owners holding more than 50% of the company’s shares
  - Base erosion test i.e. income is not used directly or indirectly to meet liabilities outside the contracting states of a DTAA

- Protocol to India-Singapore DTAA
  - Shell or conduit company set-up or where the affairs are arranged with a primary purpose to take the benefit of favorable capital gains clause
Beneficial Owner
Beneficial Owner

- Critical condition for availing benefit of DTAA in case of interest, dividend, royalty and FTS income
- BO not defined in tax treaties
- Conduit companies are classic case of non-beneficial ownership
- OECD recognized that in many situations person to whom income was paid might be the bare legal owner (e.g. a nominee – such as custodians use – or an agent) with no rights to the income
- 2010 OECD Commentary indicates that term “beneficial owner” should not be used in a narrow technical sense but should be in its context and light of the objectives of OECD MC - avoiding double taxation and preventing fiscal evasion and avoidance
- As per 2017 OECD update, recipient of said income is BO when:
  - He has right to use and enjoy such income;
  - Unconstrained by a contractual / legal obligation to pass on the income to another person
- CBDT Circular No. 789 dated 13 Apr 2000 states that Tax Residency Certificate issued by the Mauritian authorities is sufficient evidence of BO (followed by SC – Azadi Bachao)
Most Favored Nation Clause
Most Favored Nation Clause (MFN Clause)

- MFN clause usually found in Protocols and Exchange of notes
- Benefit generally restricted to specific group countries like OECD countries or developing countries
- Benefit could be either lower rate or narrowing of scope
- Attempts to avoid discrimination between residents of different countries
- Ensures equal treatment between a subset of countries
- Extends similar benefits to one country as extended to certain other countries
MFN CLAUSE IN THE PROTOCOL:

“In respect of Dividends, Interest, Royalties, FTS and payment for use of equipment, if under any Convention, Agreement or Protocol signed after 1st Sept 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention ...”
### MFN Clause

#### Applying the MFN Clause

Example: In a MFN situation, generally, one of the contracting states (say India) to the DTAA grants the residents of the other contracting state (say Netherlands), the same beneficial treatment made available by it (that is, by India) to the resident of a third country (say Sweden) with whom it has entered into a Tax Treaty.

Due to MFN clause, scope and rate as provided in India – Sweden Tax Treaty shall apply to India - Netherlands Tax Treaty.

- **Netherlands**: Treaty with MFN clause Eff. AY 1990-1991
- **Sweden**: Treaty Eff. From AY 1999-2000
- **India**: Treaty signed later on with more beneficial clause relating to Royalties and FTS
Key causes of BEPS

- MNEs use wide range of cross border tax planning techniques that results in little or no tax liability – such results are referred to as “base erosion and profit shifting”
- OECD and G20 jointly established BEPS project to address global concerns
- This effort is supported by the G7 and G20 countries, the European Union (EU) has been working in parallel, and developing countries are involved as well
- In October 2013, the UN Committee of Experts on International Co-operation of tax matters established a sub-committee on BEPS issues for developing countries
- The sub-committee is mandated to work with relevant bodies and OECD with a view to highlight issues on BEPS with officials in developing countries.
- On 5 October 2015, the OECD issued its ‘final’ reports on the 15 Action points identified in its Action Plan on BEPS. The reports have been the subject of consultation and the content of the reports is largely in line with expectations.
Key Take Aways
**Key Take Aways**

- Significant increase in Cross border transactions – not restricted only to big cos. but even SMEs - this leads to increase in International Tax Issues
- Need to look at arrangement holistically
- Need for corporates to respond proactively to evolving PE-related concepts
- Indian law also incorporating amendments in laws to align with tax treaties
- Importance of International Tax is gaining with every day

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As of 2019, the BEPS treaty changes could be included in many of the existing 3000 bilateral treaties.</td>
</tr>
<tr>
<td></td>
<td>Review tax treaty positions. Potential impact for dividend, interest and royalty transactions and for capital gains.</td>
</tr>
<tr>
<td></td>
<td>Monitor implementation of the MLI per jurisdiction, including implementation of the minimum standards.</td>
</tr>
<tr>
<td></td>
<td>Interpretation of tax treaties is expected to change. New title and Preamble are minimum standards.</td>
</tr>
<tr>
<td></td>
<td>Access to Treaty benefits would be more difficult as a result of the Introduction of a PPT/LOB or a mixture of the two.</td>
</tr>
</tbody>
</table>
Thank You!