International Tax Treaty Law and DTAA

Senior Advocate Porus F. Kaka
Trustee - IBFD, Hon. President, IFA

Barrister, Field Court Tax Chambers - UK

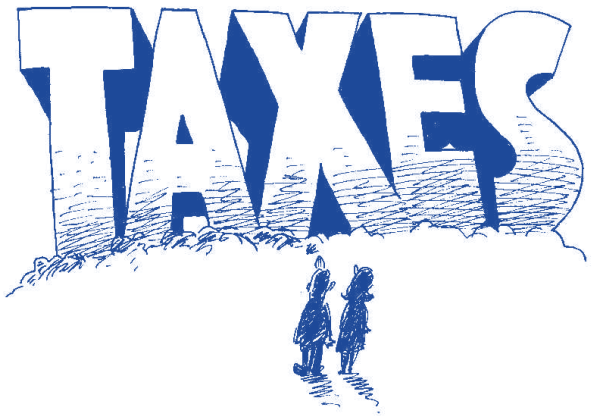
History of Tax Treaty

- Earliest Treaty was adopted by Prussia around the start of the Twentieth Century
- First Treaty was with Austria signed in 1899
- In 1920 League of Nations began to play a leadership role
- 1928 published the first internationally important Model Tax Conventions

- After World War I, Germany signed a treaty with Czechoslovakia in 1921 and with Austria in 1922
- The League of Nations began publication on tax treaties in 1923
- The OECD became the Organization for Economic Cooperation and Development

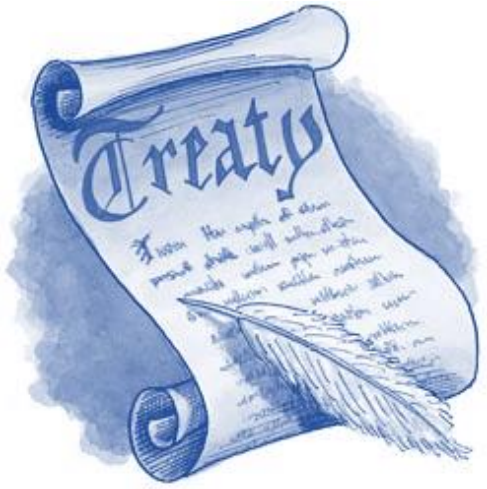
History of Tax Treaty (cont.)

- OECD first draft model treaty in 1963
- United Nations published a manual for the negotiations of bilateral tax treaties between Developed and Developing Countries in 1979
- In 1980 United Nations published a manual for the negotiations of Bilateral Tax Treaties between Developed and Developing Countries
- OECD made some amendments published in loose lease form in 1990’s
- UN Model Tax Convention 2001
- OECD started amending the publication every 2 to 3 years
- New UN Model on Tax Convention 2011
- OCED Model and Commentary 2017
- UN Model on Tax Convention 2017



Object of Tax Treaties

- Treaties cannot levy tax but can give relief- Azadi Bacho Andolan 263 ITR 706 (SC)
- The Andhra Pradesh High Court in Sanofi's 354 ITR 316 (AP) made some key observations about the importance of DTAA's and their relevance in the global scenario
- In recognition of the pejorative effect of double taxation on exchange of goods and services and movement of capital, technology and persons, agreements/treaties/conventions/protocols were entered into for removing obstacles that double-taxation presents to development of economic relations between nations
- Treaties or Conventions are thus instruments signaling sovereign political choices negotiated between States to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected, or at least theoretically possible



Changing objects - Title and preamble of OECD Model before MLI

- **1963/1977 OECD MC**
  - Title: reference to elimination of double taxation
  - Preamble: no reference to object and purpose ("*The preamble of the Convention shall be drafted in accordance with the constitutional procedure of both CS*")
  - Comm.: "The purpose of double taxation conventions is to promote, by eliminating double taxation, exchanges of goods and services, and the movement of capital and persons"
- **1992 OECD MC**
  - Title: reference to elimination of double taxation removed because of other objectives of OECD MC ("*Convention between A and B with respect to taxes on income and capital*")
  - Comm.: widespread practice of States to include reference to avoidance of double taxation or to both avoidance of double taxation and prevention of fiscal evasion in title and preamble
- **2003 Comm.**: "The principal purpose of double taxation conventions [OECD MC 1977]. It is also a purpose of tax conventions to prevent tax avoidance and evasion"

Title and preamble of OECD Model after MLI (BEPS)

- **Amendment of Title and Preamble = minimum standard under MLI**
  - **Title**: Convention between A & B for the elimination of double taxation with respect to taxes on income and on capital and **the prevention of fiscal evasion and avoidance**
  - **Preamble**: "*Desiring to further develop their economic relationship and to enhance their cooperation in tax matters. Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital* ***without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Convention for the indirect benefit of residents of 3rd States)***"
  - Comm. Intro 16/1 and 2: "*Since the title and the preamble form* ***part of the context*** *of the Convention and constitute* ***general statements of the object & purpose of the Convention****, they* ***should play an important role in the interpretation of the provisions of the Convention*** *[quote Art. 31 VCLT]"*
  - Further references to preamble/object and purpose in Comm. Art. 1/61, Art. 29/1, 173 and examples in 182

Leading International Tax models and commentary

- OECD Model Tax Convention on Income and on Capital
- United Nations Model Double Taxation Convention between Developed and Developing Countries
- United States Model conventions
- Klaus Vogel on Double Taxation Convention
- A Commentary to the OECD, UN and US Model Conventions
- Philip Baker on Double Taxation Convention

Adjudicating Forums in India

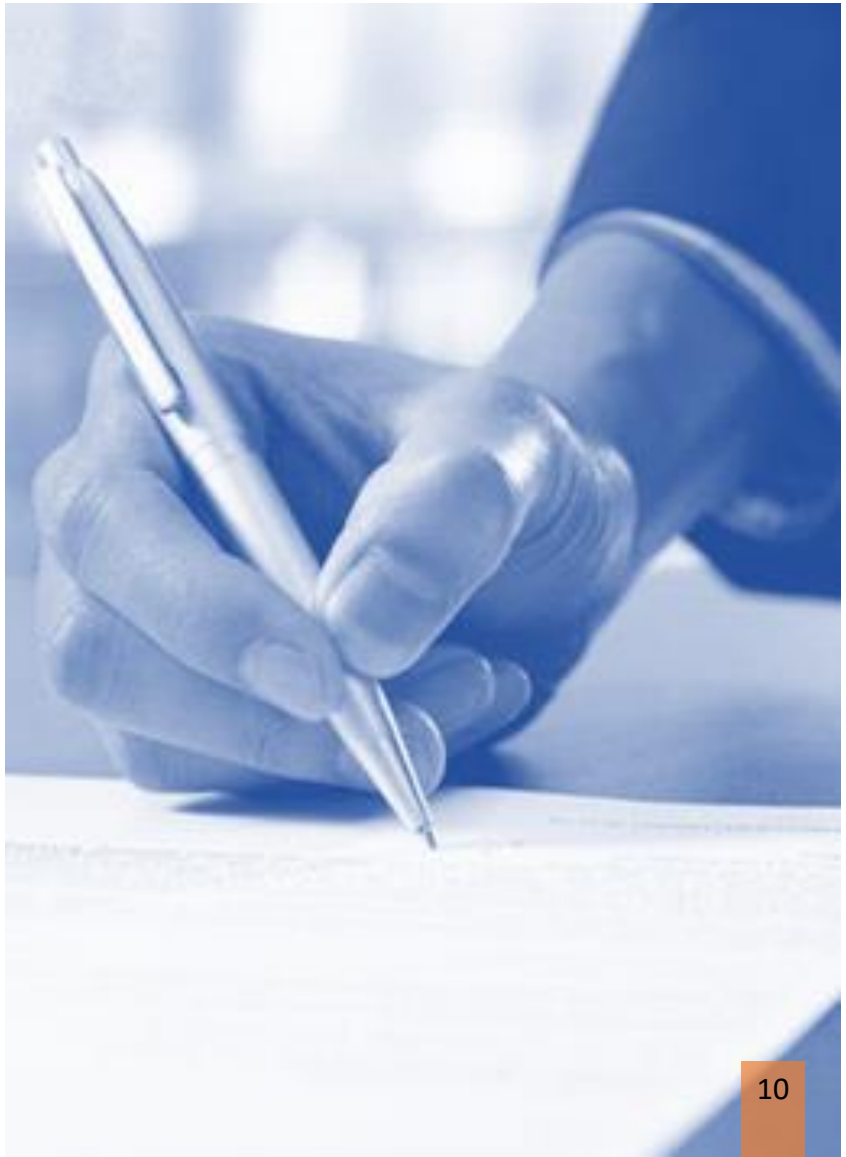
- High Court/Supreme Court
- Tribunal
- Mutual Agreement Procedure
- Advance Pricing Agreement
- Authority for Advance Ruling
- Settlement Commission
- Union Cabinet

Adjudicating Forums not available in India

- Arbitration (Article 25 of the OECD and UN Convention)

Basic Treaty Principles

- Treaty commitments must be honored by the parties in good faith
- A party may not invoke the provisions of its internal law as justification for its failure to honor its treaty commitments
- A treaty should be interpreted in good faith in accordance with the ordinary meaning of its terms, in their context and in light of its object and purpose



India

- The **Courts** in India freely use International Court decisions especially from the Commonwealth countries and the United States and is fairly receptive to the OECD Commentary and views of International academicians
- Azadi Bachao Aandolan 263 ITR 706(SC)
- Drafted by Diplomats and not by lawyers
- Application of Principle of good faith
- Vienna Convention - Article 31
- Ram Jethmalani v. UOI 339 ITR 107(SC)

Treaties and Domestic Law: A Synergy

- An interplay exists between treaties and the statute governing income tax in India.
- S.90 of Income Tax Act, 1961: delegated & valid legislation
- Mini legislations
- Binding on parties
- Conflict between law and treaty – which prevails?
- Application of treaties – optional to taxpayer

- **Dimension Data Asia Pacific Pte Ltd v/s DY CIT ITA 1635/M/2017**

In view of Section 90(2), the assessee is entitled to claim benefits of the Double Tax Avoidance Agreement to the extent the same are more "beneficial" as compared to the provisions of the Act.

While doing so, in cases of multiple sources of income, an assessee is entitled to adopt the provisions of the Act for one source while applying the provisions of the DTAA for the other.

- **IBM World Trade Corporation Vs. A011(2012)20 taxmann.com 728 (Bang)**

The concerned contracts are different; the source of income is different; and the provisions under which royalty income is taxable, ore different and the assessee was, therefore justified or offering the royalty income arising under two different contracts at two rates - one under the Act and one under the Treaty.

- **AGT International Gmbh v/s DCIT ITA No 7465/Mum/2018**

Services PE being triggered under India – Swiss treaty on account of rendition of services in India, can never make the assessee worse off so far as the tax liability in source jurisdiction is concerned.

Important Treaty Concepts

Article 4: Residence

- International legal concept
- Concept of ‘Fiscal Domicile’
- Right to tax sufficient – exercise of that right irrelevant
- Azadi Bachao Aandolan 263 ITR 706(SC)

International Tax Treaties – Basic Concepts

- Concept of Person
- A person must be “Resident” namely Liable to tax in other contracting state this is determining factor for treaty entitlement
- Treaty relief is available to persons who are resident
- Article 3(2) – effect of domestic law in interpretive process

Liable to tax

- Union of India v. Azadi Bachao Andolan 263 ITR 706 (SC)
- Serco BPO Pvt Ltd. V. AAR 280 CTR 1 (P&H)
- Emirates Shipping Line, FZE v. ADIT 349 ITR 493 (Del)
- ADIT v. Green Emirate Shipping & Travels 100 ITD 203 (Mum)
- Maerskline UK Ltd v. DDIT WP Nos.1295/2008 & 272/2009 (Cal HC)
- Linklaters LLP v/s ITO 132 TTJ 20(Mum)

International Tax Treaties – Basic Concepts

- **Article 3(3) of the India –UK DTAA**

"As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention.

Sanofi Pasteur Holdings SA 354 ITR 316 Andhra Pradesh High Court

- Issue – Whether the gain arising out of alienation of shares of a French subsidiary (having underlying shares in an Indian co) by a French Holding company (seller) to another French company (buyer) be liable to tax in India under the treaty between India and France?
- Held:
  - French subsidiary company is a distinct entity of commercial substance.
  - Article 14(5) does not contemplate a see through unlike Article 14(4) dealing with immoveable property.
  - Retrospective amendments in domestic law do not apply to a treaty in absence of a clear non obstinate clause.
  - Meaning of any term not defined in Treaty can have the meaning under the similar domestic law unless the context otherwise requires.
  - Taxation right allocated to France under the DTAA.

Article 3(2)

Art. 3(2) OECD MC 2017 has the following wording. The 2017 additions are written in italics:

"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** *or the competent authorities agree to a different meaning pursuant to the provisions of Article 25*, 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."

Heads of Income under Treaties

- Income from Immovable property – Article 6
- Business Income – Article 7
- Shipping and Airline Business – Article 8
- Dividend – Article 10
- Interest – Article 11
- Royalty – Article 12
- Capital Gains – Article 13
- Income from Employment – Article 15
- Directors' Fees – Article 16
- Artists and Sportsperson – Article 17
- Pension – Article 18
- Government Service – Article 19
- Students – Article 20
- Other Income – Article 21

Articles allowing source based taxation

- Income from Immovable property
- Business Income (if PE)
- Interest / Royalty / FTS (if arising or payer is in source jurisdiction)
- Capital Gains
  - Situs of immovable property / Movable property if part of PE
  - Co-owns shares – residence of shareholders*
  - Shares of a company deriving more than 50 per cent* of its value from immovable property

Article allowing residence based taxation

- Business Income – If no PE
- Shipping / Airline
- Capital gains – owner of shares in resident state
- Dividend
- Royalty

Mauritius conundrum

- How was the problem created
- Who is responsible for treaty shopping
- CBDT Circular No 682 dated 30 March 1994
- CBDT Circular No 789 dated 13 April 2000
- Press Release dated 1 March 2013
- General Anti Avoidance Rules (GAAR) deferred till FY 2017-18 (to apply prospectively to investments made on or after 1 April 2017)

Union of India v Azadi Bachao Andolan 263 ITR 706 (SC)

- Issue – Whether Circular No. 789 dated 13.4.2000 with regard to the application of Indo – Mauritius Double Taxation Avoidance Convention issued by the CBDT is ultra vires of S.90 and S.119 of Income Tax Act, 1961?
- Held :
- Principles adopted in interpretation of Treaties are not the same as those in interpretation of Statutory Legislation.
- Treaties are negotiated and entered into at a political level and have several consideration as their bases.
- Circular briefly defines Article 4 of the Indo – Mauritius DTAC and states that FIIs and other investor funds incorporated in Mauritius are invariably residents of the country and thus liable for taxation in Mauritius.
- SC states that Circular No. 789 does not interfere with S. 90 and S. 119 and is well within the ambit of the Indian Income Tax Act.

New Multilateral Instrument (MLI) of OECD

- Signed by India on 7 June 2017. Entered into force 1 October 2019.
- 60 States have ratified it as of 21 December 2020.
- Covered Agreements
  - Agreement for avoidance of double taxation on income between States that have ratified the MLI.
- Non- Covered Agreements

Principle Purpose Test (PPT) under MLI

- Notwithstanding the other provisions of this convention, **a benefit under this convention shall not be granted in respect of an item of income or capital** if it is reasonable to conclude, having regards to all relevant facts and circumstances, that obtaining that benefit was **one of the principal purposes of any arrangement or transaction** that resulted directly or indirectly in that benefit unless it is established that granting that benefit in these circumstances would be in accordance **with the object and purpose of the relevant provisions of this convention**.

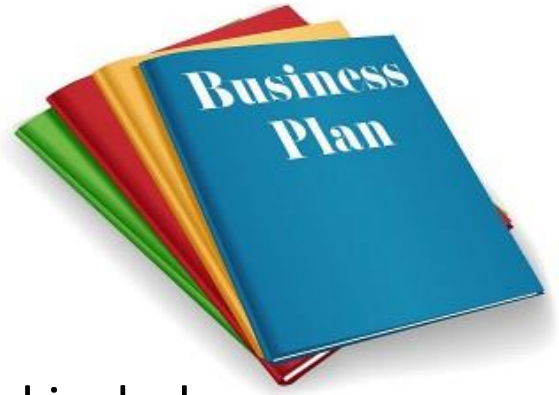
New MLI

- Preamble + PPT = Retrospective end of Mauritius/Singapore treaty?

- GAAR is Grandfathered

Article 5 : Permanent Establishment

- Fixed place of the business of an enterprise in a particular country.
- Types of PE include :
  - Fixed Place PE
  - Agency PE
  - Service PE
  - Construction PE



- PE excludes those places where activities involved include:
  - Ancillary services
  - Storage facilities or display of merchandise
  - Maintenance of fixed place of business for supply of information

Formula One World Championship Ltd 394 ITR 80 (SC)

- Assessee entered into a Race Promotion Contract (RPC) by which it granted to Jaypee Sports, right to host, stage and promote Formula One Grand Prix of India event at motor racing circuit owned by Jaypee.
- During the period prior to the race and post the race the assessee had full access to circuit and could dictate as to who was authorized to access circuit and organizing any other event on circuit was not permitted.
- Assessee, as well as its affiliates, undertook all possible commercial rights, including advertisement, media rights etc. and even right to sell paddock seats, such arrangement clearly demonstrated that entire event was taken over and controlled by assessee and its affiliates on the one hand and Jaypee sports on other.
- Fixed place of business in the form of physical location, i.e. Circuit, was at the disposal of assessee through which it conducted business, taxable event had taken place in India, and non-resident assessee was liable to pay tax in India
- Whether question of PE had to be examined keeping in mind duration of event, which was for limited days, and for entire duration, assessee had full access through its personnel. Hence, number of days for which access was there would not make any difference
- They said circuit constituted Permanent Establishment of assessee in India, mere construction track by Jaypee or its ownership or organizing other events was immaterial.

ADIT v/s E-Funds IT Solutions Inc 399 ITR 34 (SC)

- The Indian subsidiary company only rendered support services which enable assessees, in turn, to render assistance to their clients abroad.
- Business income of companies incorporated in the US will be taxable only in US unless it is found that they have PEs in India, in which event their business income, to extent to which it is attributable to such PEs, would be taxable in India.
- Whether since no part of main business and revenue-earning activity of assessees was carried on through a fixed business place in India which had been put at their disposal and Indian company only rendered support services, outsourcing of work to India would not give rise to a fixed place PE.
- Whether so far as service PE is concerned, requirement of article 5(2)(1) of DTAA is that an enterprise must furnish services within India and that such services are furnished through employees or other personnel.
- Merely because auxiliary operations that facilitated such services were carried out in India, first ingredient contained in article 5(2)(1) was not satisfied and, thus, it was not necessary to advert to other ground namely, that other personnel would cover personnel employed by Indian company as well , and that US company through such personnel were furnishing services in India.
- Whether so far as agency PE was concerned, it has never been case of revenue that Indian subsidiary was authorized to or exercised any authority to conclude contracts, on behalf of US company, nor was any factual foundation laid to attract any of clauses contained in article 5(4) of the DTAA 'agency PE' aspect of case needed not be gone into.
- Where transaction between assessees and Indian entity was at ALP, no further profits could be attributed even if there existed a PE in India.

Honda Motor Co Ltd 301 CTR 601 (SC)

- Notice issued for reassessment was based only on allegation that it had permanent establishment in India.
- Once arm's length principle has been satisfied , there can be no further profit attributable to a person even if it has a permanent establishment in India.
- Followed E-Funds IT Solutions Inc 399 ITR 34 (SC)
- Review Petition has been dismissed in 265 Taxman 542(SC)

Article 23 : Methods for Elimination of Double Taxation

- Aims to do away with double taxation.
- Methods adopted to eliminate double taxation :
  i) Exemption Method (Full exemption/exemption with progression
     - State of Residence will not tax the income which has been earned and taxable in the State of Establishment.
  ii) Credit Method (Full credit/Ordinary credit)
     - State of Residence will calculate tax on the entity's total income in State of Establishment and permits a credit for tax paid in the other state

Recent decisions

- ESSM Star Sports Mauritius ITA Nos.3760 & 4542/Del/2016 dt. 22.10.2020
  - Sale of airtime to Indian advertisers. ITAT held that no profit can be attributable if transaction at arm's length price. If foreign MNE has a Dependant Agent PE, and transactions are at arm's length, no attribution required. Here ESSM Star Sports transacted at arm's length and hence no attribution was made.
- Tata Consultancy Services Ltd. [2019] 111 taxmann.com 42 dt. 30.10.2019
  - Deductibility of taxes paid in foreign jurisdictions. The ITAT held that "*Like Article 25 of the Indo-USA treaty, treaties with various other countries such as Indo-Denmark, Indo-Hungary, Indo-Norway, Indo-Oman, Indo-US, Indo-Saudi Arabia, Indo-Taiwan also have similar provision providing for benefit of foreign tax credit even in respect of income not subjected to tax in India. However, Indo-Canada and Indo-Finland treaties do not provide for such benefit unless the income is subjected to tax in both the countries*."

Article 25 : Mutual Agreement Procedure (MAP)

- Dispute resolution mechanism adopted for resolving differences out of interpretation of the Convention.
- Efficient and flexible tool; provides for co-operation.

- Dispute resolution mechanism adopted for resolving differences out of interpretation of the Convention.
- Efficient and flexible tool; provides for co-operation.
- MAP could be invoked if an individual believes that the actions of the Contracting State would result in taxation not in accordance with Convention provisions.
- Competent authorities shall resolves any doubts pertaining to the interpretation and application of the Convention.
- MAP guidelines are binding on tax authorities of both the Contracting States, if accepted by the assessee.

Article 26 : Exchange of Information

- Device adopted to enhance tax clarity and crackdown on fiscal evaders with aid of State cooperation.
- Competent authorities in the Contracting States can share certain specified information with respect to :
  - Convention
  - Domestic law governing taxation.
- Necessary to prevent fraud and/or evasion of taxes.
- Generally, such information is secret and cannot be disclosed.
- Information can be made public once it has been disclosed in court proceedings.

Soignee R. Kothari 386 ITR 466 (Bom HC)

- Information (bank account in HSBC, Geneva, Switzerland) received from the French Government.
- The CBDT passed the Information to the AO.
- The AO on the basis of information issued reassessment notice.
- The Assessee challenged the reassessment notice before the High Court
- The Court considered the Serious allegation raised against the Assessee and the assessee should have made available the documents, which it failed to do.
- The conduct on the part of the Petitioner is not forthcoming, and thereby no interference is called.

Pre General Anti-Avoidance Rule era

- Tax Planning v/s Tax Avoidance
- Form v/s Substance
- Treaty Shopping – Mauritius

Legal Precedents of the Supreme Court in the Pre – GAAR Era

- McDowell & Co Ltd 154 ITR 148 (SC) – Colourable Devices dubious methods under the guise of planning are not allowable
- Azadi Bachao Andolan 263 ITR 706 (SC) – Citizen is free to carry out the business with the four corners of the Law. Mere Tax planning without the motive to evade taxes with the colourable device shall not be frowned upon.
- Walfort Shares & Stock Brokers (P) Ltd 326 ITR 1(SC) – Followed Azadi and did not apply McDowell
- Vodafone International Holding B.V 341 ITR 1(SC)– No conflict between McDowell and Azadi. Courts need to consider the documentation and the facts before determining the transaction

Principles of General Anti Avoidance Rule (GAAR)

SECTION 96(2)

"(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit."

SECTION 144BA

***"**(1) If, the Assessing Officer, at any stage of the assessment or reassessment proceedings before him having regard to the material and evidence available, considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement and to determine the consequence of such an arrangement within the meaning of Chapter X-A, then, he may make a reference to the Principal Commissioner or Commissioner in this regard."*

Principles of General Anti Avoidance Rule (GAAR)

RULE 10 UB

(1) For the purposes of sub-section (1) of section 144BA, the Assessing Officer shall, before making a reference to the Commissioner, issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of Chapter X-A in his case.

(2) The notice referred to in sub-rule (1) shall contain the following:—

*(*i*) details of the arrangement to which the provisions of Chapter X-A are proposed to be applied;*

*(*ii*) the tax benefit arising under the arrangement;*

*(*iii*) the basis and reason for considering that the main purpose of the identified arrangement is to obtain tax benefit;*

*(*iv*) the basis and the reasons why the arrangement satisfies the condition provided in clause (*a*), (*b*), (*c*) or (*d*) of sub-section (1) of section 96; and*

*(*v*) the list of documents and evidence relied upon in respect of (*iii*) and (*iv*) above.*

Position of GAAR vis-à-vis Treaty

- Limitation of Benefit v/s Principle Purpose Test
- Principle Purpose Test v/s General Anti Avoidance Rules

Major Current International Tax issues

- Taxation of digital economy
- MLI coming into force
- Country by Country Reporting come into force
- Taxpayer Rights?

Timeline of International Current Tax Issues

2013-2015 **BEPS One (2013-2015)**

Country-by-country reporting

Value Creation

MLI

2019-Present **BEPS Two (2019 - Present)**

November 2019 **Pillar One – Allocation of Taxing Rights:**

- Unified Approach – *A Standard-based Regulation*
  - Amount A – Non-routine Profits – Global Formulary Apportionment
  - Amount B – Routine Functions – Arm's Length Price and Transfer Pricing
  - Amount C – In case of discrepancy, resolved through dispute resolution mechanism.

December 2019 **Pillar Two – Remaining BEPS Issues - Global Minimum Rate of Tax**

OECD Pillar One and Two Reports

- Pillar One addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules;

  Pillar Two (also referred to as the "Global Anti-Base Erosion" or "GloBE" proposal) calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

THANK YOU