



INDIA'S POSITION ON OECD MODEL CONVENTION & COMMENTARY

1

Girish Dave

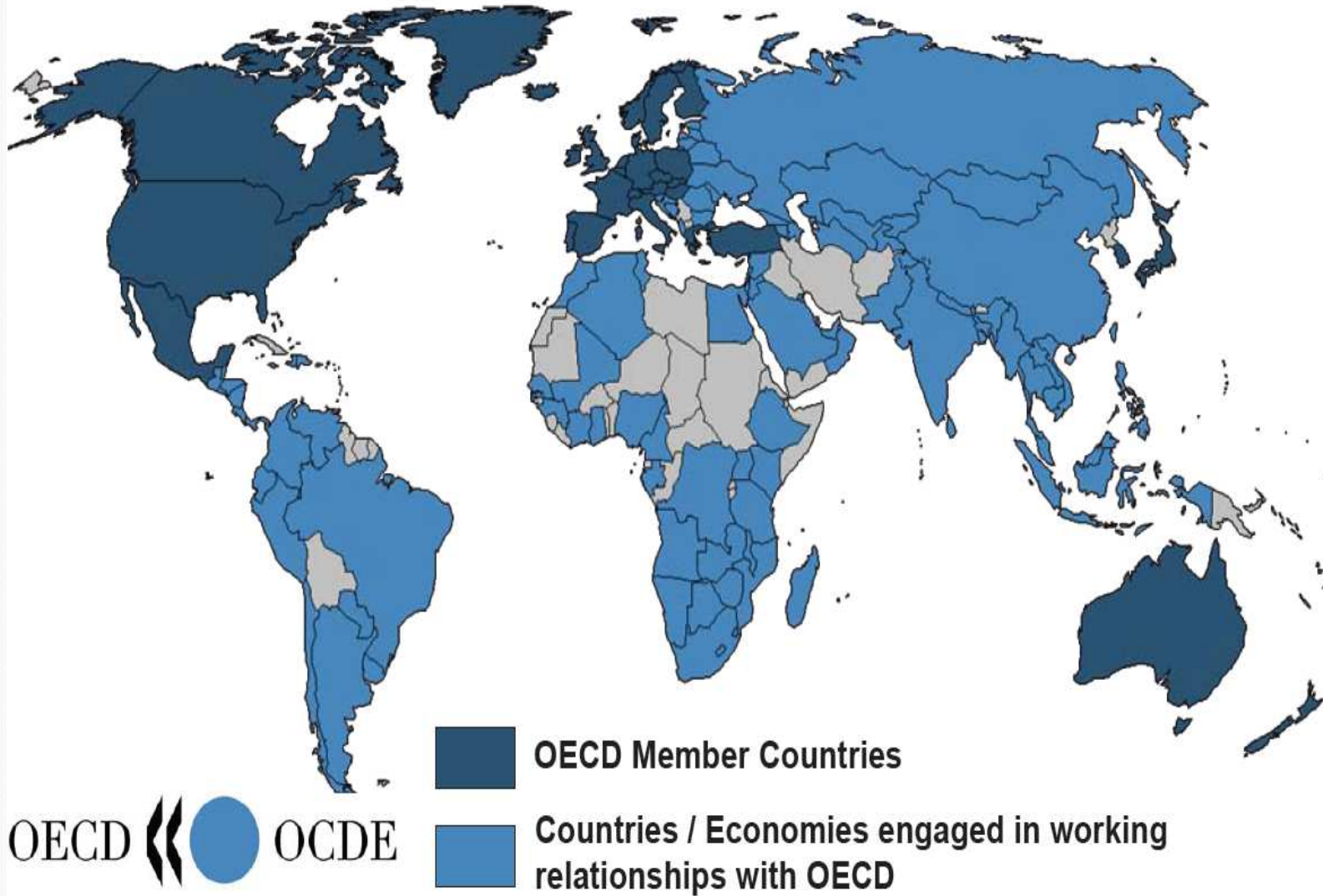
CONTENTS

- ▶ **HISTORY**
- ▶ **INDIA'S POSITION / RESERVATIONS AND IMPLICATIONS**
- ▶ **IMPLICATION OF INDIA'S POSITION**

HISTORY

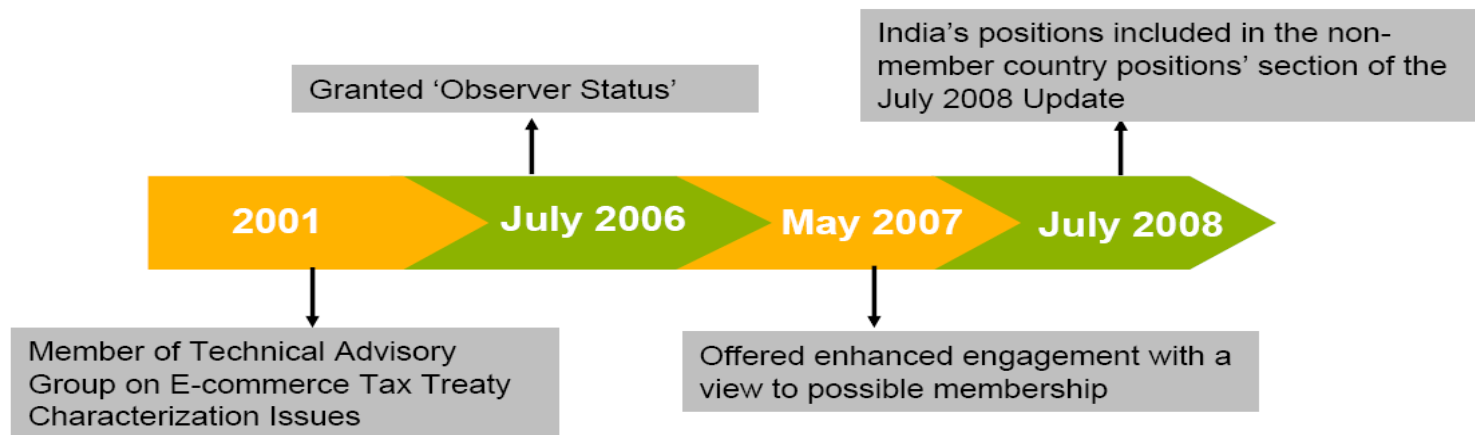
- ▶ **OECD, formed in 1961, is a group of 30 countries**
- ▶ **History of the OECD Model Tax Convention (“OECD MC”) dates back to 1963, when the first draft of double taxation convention on income and capital was issued**
- ▶ **Thereafter OECD MC has been revised a number of times, the last being revised in 2005**
- ▶ **Purpose of OECD model tax convention**
 - ▶ **Model agreement used to negotiate bilateral tax treaties**
 - ▶ **Includes commentary in interpreting various articles**
 - ▶ **Member countries permitted to have reservations / observations**
 - ▶ **Member countries to conform to OECD MC as interpreted by commentary**
 - ▶ **Predominantly supports ‘residence based’ taxation, hence favorable for developed countries**

LIMITED MEMBERSHIP BUT GLOBAL REACH



SIGNIFICANCE OF OECD MC

- ▶ **Significance of OECD MC and Commentary**
 - ▶ **Serves as a template / reference document in negotiating bilateral tax treaties even amongst non-member countries**
 - ▶ **Commentary guides in the resolution of disputes.**
 - ▶ **Considering its growing influence, positions of non-member countries included in 1997**
 - ▶ **India's Role:**



India's position On OECD MC & Commentaries

- ▶ **India's tax treaties are based on a combination of the OECD and UN model conventions with a higher emphasis on source country taxation.**
- ▶ **Most of India's tax treaties provide for source-country taxation of passive incomes such as dividends, interest, royalties and capital gains.**
- ▶ **Courts in India have been referring to the Commentaries in resolving the tax disputes arising in international transactions.**

IMPORTANT JURISPRUDENCE

Indian courts have placed reliance on OECD Commentaries:

- ▶ **CIT vs. Visakhapatnam Port Trust [(1983) 144 ITR 146 (AP)]**
- ▶ **CIT vs. RM Muthaiah[(1993) 202 ITR 508 (KAR)]**
- ▶ **Union of India vs. Azadi Bachao Andolan[(2003) 263 ITR 706 (SC)]**
- ▶ **CIT vs. Davy Ashmore India Limited [(1991) 190 ITR 626 (CAL)]**
- ▶ **Metchem Canada Inc vs. DCIT [100 ITD 251]**
- ▶ **Graphite India Limited vs. DCIT [86 ITD 384]**
- ▶ **Balaji Shipping (UK) Limited vs. DDIT(IT) [2008-TIOL-403-ITAT-MUM]**
- ▶ **British Airways Plc vs. DCIT [73 TTJ 519 (Delhi ITAT)]**
- ▶ **Graphite India Ltd vs. DCIT [78 TTJ 418 (Calcutta ITAT)]**

India's position On OECD MC & Commentary

ARTICLE 1 – PERSONS COVERED

“This Convention shall apply to persons who are residents of one or both of the Contracting States.”

- ▶ **OECD Position:** If a contracting state disregards an entity for tax purposes and levies tax on its partners; the partners should be entitled for the benefits of the treaty in the country where the partners are tax residents.
- ▶ **India's Position:** India does not agree with the above interpretation and believes that the same would be possible only if specific clauses to that effect are included in the tax treaty [C]
- ▶ **Analysis / Implications:**
 - ▶ Foreign transparent entities such as LLP, LLC etc and their partners, may not be eligible for treaty benefits and consequentially may be taxed under domestic tax laws
 - ▶ US, Sweden treaties have this provision

ARTICLE 3 –PERSON

“the term ‘person’ includes an individual, a company and any other body of persons”

▶ India’s Reservations (2):

- ▶ Reserves right to include in the definition of ‘person’ only those entities which are taxable units under the taxation laws in force in India and in the country with which it enters into a convention [A]
- ▶ Reserves right to define ‘tax’ and ‘fiscal year’ under this Article [A]
- ▶ Treaty Benefits to ‘pass through’ entities
- ▶ OECD MC amended in 2000 to address treaty eligibility to tax transparent entities; where entities denied, its members/partners to be considered as eligible.
- ▶ India’s position: This result is possible only and to the extent provisions to that effect are included in the tax treaty (e.g. Article 4(1)(b) of India – US tax treaty)

Article 4 – RESIDENT

TIE-BREAKER RULE FOR NON-INDIVIDUALS

- ▶ **Place Of Effective Management (POEM) in determining residence**

Residency of dual resident entity is determined having regard to its POEM (place where key management/commercial decisions necessary for the conduct of the entity's business as a whole are in substance made)

India's position: In determining POEM, place where the main and substantial activity of the entity is carried on is also to be considered

ARTICLE 4 –RESIDENT

▶India's Reservations (2):

- ▶ Reserved right to amend Article in order to specify that partnerships must be considered as residents of countries in view of their legal and tax characteristics [A]**
- ▶ Reserved right to include a provision with regard to approaching the competent authorities for determination of residential status in case of dual residency of enterprises of which the POEM cannot be determined [A]**

▶Analysis / Implications

- ▶ No specific clause in Article 4 of Indian treaties on partnerships –However, in Article 3 of some treaties, partnership included in the meaning of national**
- ▶ Several Indian treaties have clause for MAP resolution on POEM**

ARTICLE 5 –PE

FIXED PLACE PE

OECD position	India's position
Fixed Place PE	Fixed Place PE
Stated examples (branch, office, factory etc)- PE only if business of the enterprise is carried on through it	Stated examples in all cases will necessarily be regarded as PE- Certain circumstances may determine
2003 Update provides guidance on- (a)Existence of Commercial & geographic coherence – (b) Illustrations included by examples- no coherence- no PE	Geographic & commercial coherence not necessary- person working at different places on unrelated contracts for short duration may be held to have a PE if threshold period exceeded. Examples could be regarded PE
Mere leasing of tangible/ intangible property without maintenance- No PE for lessor	-Tangible/intangible property itself could be PE in certain situations. -Bare letting of property itself in certain situations can create Fixed Place PE

ARTICLE 5 – PE

AGENCY PE & ELECTRONIC COMMERCE

OECD position

Agency PE

Mere attending or participating in the negotiations by itself not sufficient to conclude that ‘authority to conclude contracts’ is exercised.

Electronic Commerce

OECD commentary (2003 Update) clarifies PE in relation to e-commerce operations-

- (a) website can not create PE.
- (b) No ‘place of business’ merely by hosting a website on a particular server situated at a particular location.

India’s position

Agency PE

In certain circumstances, mere participation is sufficient for the conclusion. Authority to negotiate essential elements (not necessarily all) of a contract is sufficient.

Electronic Commerce

In certain circumstances, website-

- (a) can create a PE.
- (b) may be considered as having a ‘place of business’.

ARTICLE 5 – PE

SERVICE PE & SUBSIDIARY AS PE

OECD position

Service PE

No specific rule on PE creation on a/c of furnishing of services; 2008 Update has provided guidance for including this concept, broadly:

- (a) Services performed outside the state – No taxation by source country .
- (b) Requirement of minimum level of presence in source state.
- (c) Taxation on gross basis not appropriate

Subsidiary as PE

2005 Update clarifies that a country cannot have a PE in another country merely it purchases goods manufactured by an affiliate in that country or the affiliate supplies services.

India's position

Service PE

Most of India's tax treaties contain this clause.

India's position:

- (a) Taxation rights even when services are furnished from outside that state.
- (b) Presence not relevant.
- (c) Taxation on gross basis is also appropriate and should be provided as an alternative.

Subsidiary as PE

Where a group company manufactures goods or provides services for or on behalf of a foreign enterprise, the first mentioned company could constitute a PE if the other requirements of the definition are also satisfied.

ARTICLE 6 –INCOME FROM IMMOVEABLE PROPERTY

6(1) “Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.”

- ▶ **India’s Reservation:** India wishes to address the issue of inclusion of the words including income from agriculture or forestry through bilateral negotiations [A]
- ▶ **Analysis / implication:** India may seek to have the right to tax income from agriculture and forestry on residence basis – although most of India’s existing tax treaties are consistent with OECD / UN MC

ARTICLE 7 –BUSINESS PROFITS

Construction PE –force of attraction

- ▶ **OECD Position** If any other part of the enterprise, provides some goods or services (such as planning, designs, drawings etc) outside the State in which construction PE is created, then such profits are not attributable to the PE [Para 25 of OECD MCC]
- ▶ **India's Position** India does not agree with the above position [C][Para 25 of OECD MCC]
- ▶ **Profits attributable to a PE in India would be taxable even if the payments are deferred until the PE has ceased to exist in India.**

ARTICLE 7 –BUSINESS PROFITS

▸ Attribution of profits to a PE

India does not concur with the OECD's view of limited circumstance for application of formulary apportionment. Profits derived by an enterprise from business activities independent of its PE in the source state would also be deemed to be attributable to that PE provided such business are same or similar in nature (FOA rule).

▸ India's Reservations on 7(3)

Reserves right to add in paragraph 3 that expenses to be allowed as deductions by a Contracting State shall include only expenses that are deductible under the domestic laws of that State [A] –consistent with most Indian treaties

ARTICLE 8 –SHIPPING AND AIR TRANSPORT

▶India's Reservations (3)

- ▶ India reserves the right to apply Article 12 and not Article 8 to profits from leasing ships or aircraft on a bare charter basis
- ▶ *–OECD MCC provides that Article 7 would normally apply -Para 5 of OECD MCC*
- ▶ Reserve the right not to extend the scope of the Article to cover inland waterways transportation in bilateral conventions *-most of the Indian treaties exclude profits from the operation of boats engaged in inland waterways transport from Article 8.*
- ▶ Reserve position on application of Article to income from ancillary activities as per Para 4 to 10.1 of OECD MCC
 - ▶ Wet lease
 - ▶ Code sharing, bus services to transport passengers
 - ▶ Onboard magazines
 - ▶ Rent for warehousing containers
 - ▶ IATP Pooling arrangements

ARTICLE 12 –ROYALTIES

Taxation of Royalties :

OECD MC revised in 1992 to provide guidance on classification of software license transactions, refined in 2000 Update, 2008 Update includes clarifications on issues relating to classification of intangible transactions. India has reserved its position on this interpretation as it believes that some of the payments referred to there like outright purchase of copy rights, distributors of goods & services, the development of a design, model or plan that already exist, 'network licenses' which permit the licensee to make multiple copies of the program for use only within the enterprise's computer network, relation to act of copying the program for example onto user's computer hard drive may constitute royalty.

'Fees for technical services' can be taxed at source on a gross basis.

ARTICLE 12 – ROYALTIES

Payments for the use of, or the right to use industrial, commercial or scientific equipment may be included in the definition of royalties.

ARTICLE 13 –CAPITAL GAINS

▶ India's Reservations:

- ▶ **India has reserved its right to tax gains from the alienation of shares or rights in a company that is a resident of India – *broadly consistent with UN MC and most Indian treaties provide for taxation in India***
- ▶ **Further, India has reserved its position on the interpretation adopted by OECD on paragraph 4 of Article 13, reproduced below:**

“Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.”

ARTICLE 25 –MAP

▸OECD position

▸Mutual Agreement Procedure may be opted to settle disputes arising on account of adjustments to transactions between associated enterprises on account of transfer pricing adjustments even in the absence of such provisions under Article 9

▸India's position

India does not agree with the above interpretation and is of the view that in the absence of any *specific provision, adjustments to transactions between associated enterprises on account of transfer pricing adjustments, will not fall under the scope of Article 25*

ARTICLE 25 –MAP

- ▶ **India is of the view that the competent authorities can reach an agreement under Article 25 during pendency of domestic law action. However, the taxpayer has an option to either accept or reject the resolution order. If the taxpayer accepts the resolution order, he has to withdraw domestic law action**
- ▶ **India does not agree with the view expressed that a taxpayer maybe permitted to defer acceptance of the solution agreed upon as a result of the mutual agreement procedure until the court had delivered its judgment**

INDIA'S POSITION ON OECD MC & COMMENTARY

- **The right to maintain in India's conventions, a specific article dealing with the taxation of "Independent Personal services". All corresponding modifications in the Articles & commentaries which are made with the elimination of Article 14 may be accordingly be restored to their previous positions.**
- **Indian does not agree to treat premium on debenture redemption as interest and such determination would be guided by its local laws. It has also reserved the right to treat interest element of sale on credit (part of the purchase price which could be attributed to the credit period) as interest income.**

IMPLICATION OF INDIA'S POSITION

Guide to taxpayers on likely approach of Indian tax authorities.

- India's tax treaty policy in future tax treaty negotiations/renegotiations.**
- Could it be regarded as an aid for interpreting tax treaties by courts in India?**
- Tax treaties entered into prior to July 2008.**
- Tax treaties entered post July 2008.**
- Ambiguity /uncertainty in some of India's positions- use of 'in certain circumstances' while expressing reservations.**

Implication of India's position

Significant departure from OECD's position on some key aspects.

- Could lead to substantial tax exposure.**
- Cause of concern for foreign companies doing business in India on the extent of deviations they may encounter in application of a tax treaty. Need to be factored while structuring future cross-border transactions .**
- A 'Tax- everything Approach'?**
- Would it invite provocation by tax administrators of nations where Indian Companies decide to invest?**
- At the same time taxpayers could have more certainty on those aspects where India has not expressed any reservations while dealing with Indian tax authorities.**
- Would it hit India in the event of it being in future a net exporter/ investor of goods, capital and services.**

THANK YOU