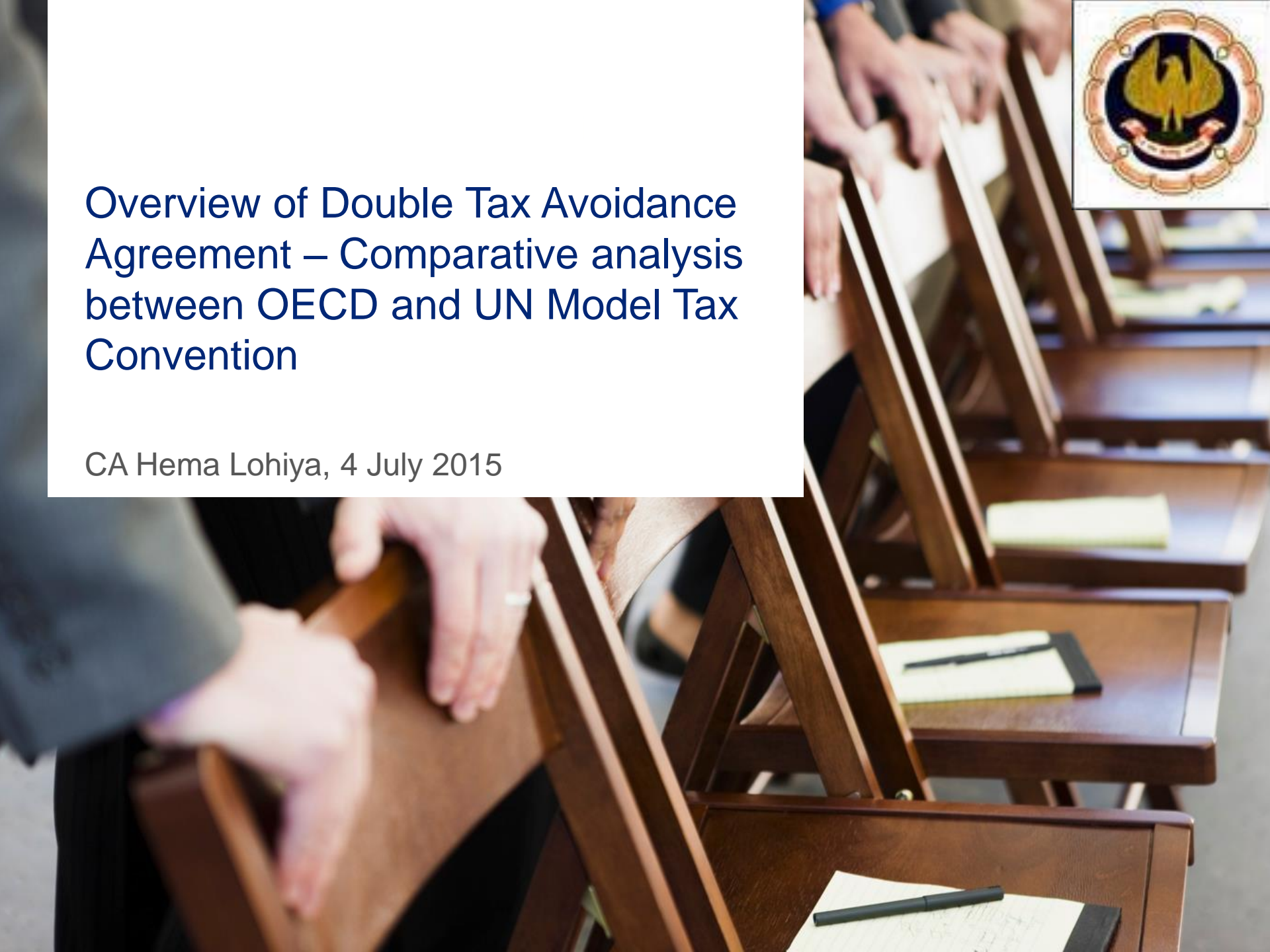


Overview of Double Tax Avoidance Agreement – Comparative analysis between OECD and UN Model Tax Convention

CA Hema Lohiya, 4 July 2015



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About UN Model

Why two models? Why a UN model?

- Unlike developed countries, their treaties with developing countries largely had income and capital flows (and revenue sacrifice) which were one-sided - hence OECD model not suitable in such cases
- Confirmed by OECD fiscal committee report of 1965 Para. 164 on fiscal incentives for private investment in developing countries
- Led to demand from “ECOSOC” for a treaty model suitable for developing countries with developed countries

Key issue: Allocation of taxing right -- Not avoidance of double taxation per se

United Nations Model Convention

- Tax treaties between countries with unequal economic status
 - Developed and lesser developed countries, or between developing countries
 - Commentaries based on, and mostly similar to, OECD commentary
- United Nations [UN] drafted UN MC in 1980, designed to encourage flow of investments from the developed to developing countries
- Is a compromise between source principle and residence principle
 - Gives more weightage to source principle, i.e., income should be taxed where it arises
- Key features:
 - Payer of income is considered as source of taxation
 - Service fee made taxable
 - Reduced threshold for PE

Objective of the UN Model

- Each member state has sovereignty over its taxing rights and is free to follow its own national tax and treaty policy.
- UN model treaty does not set out to provide a single universal approach but provide workable solution for treaty issues
- Unlike OECD model, the UN model and its commentaries are not binding but persuasive.
- UN model is meant to provides guidance particularly to developing countries on drafting, negotiating and implementing.
- UN model objective is avoidance of double taxation (not double non taxation) and prevention of tax evasion (not tax avoidance) – however increasing focus is now given to tax avoidance as in OECD model (both general and specific)

Institutional Difference

- OECD Model is a governmental model formally approved by the 34 OECD member countries
- Member and non-member countries are allowed to formally express disagreements (reservations, observations and positions) on the Articles and Commentary of the OECD Model
- The UN Model was drafted by a small group of experts acting in their personal capacity
- The UN Model is not formally approved by the member states of the UN
- The UN Model was designed from the perspective of negotiations between developed and developing countries

Comparative Analysis

Comparative View – OECD Model and UN Model

Article 1 – Persons Covered

OECD Model	UN Model
The OECD model covers persons who are residents of one or more or both of the Contracting States	Identical to OECD Model

- Key Difference – Partnerships and other non-corporate entities
- UN MC incorporates several new paragraphs on improper use of tax treaties and sophisticated tax-avoidance strategies.

Comparative View – OECD Model and UN Model

Article 3 – Definitions

OECD Model	UN Model
The OECD model provides definitions for person, company, enterprise of a contracting state, international traffic, competent authority, national and business	Similar to OECD Model, except that it does not contain the definitions of 'enterprise' and 'business'

Interpretation of Words of a Treaty

Classification of Words	Interpretation
Words defined in treaty for the purpose of the entire treaty: <ul style="list-style-type: none">– Definition - Article 3 (1)– Defined under specified article	As per definition (unless the context otherwise requires)
Words – not defined in treaty	As per domestic law (unless the context otherwise requires)
Other words / undefined words	As per normal principle of interpretation

Comparative View – OECD Model and UN Model

Article 4 – Residence

OECD Model	UN Model
This Article is intended to define the meaning of the term resident and deal with cases of dual residency	Similar to OECD Model, except that additional criterion i.e. place of incorporation is also considered in determining residential status

Comparative View – OECD Model and UN Model

Article 5 – Permanent Establishment

OECD Model	UN Model
<p>The concept of PE under the OECD Model is narrower than the UN Model, thereby restricting taxation in the source State.</p>	<ul style="list-style-type: none">• Threshold of 6 months in the case of Installation PE• Includes supervisory activities in relation to installation PE• Includes the concept of service PE• ‘Delivery’ of goods<ul style="list-style-type: none">– Excluded from exceptions– Included in Agency PE• Additional conditions for qualifying as independent agent• Insurance companies

Comparative View – OECD Model and UN Model

Article 6 – Income from Immovable Property

OECD Model	UN Model
Provides for source based taxation of immovable property	Identical to OECD Model

Comparative View – OECD Model and UN Model

Article 7 – Business Profits

OECD Model	UN Model
<p>The attribution of profits to a PE is to be determined taking into account the functions performed, assets used and risk assumed by the enterprise through the PE and other parts of the PE</p>	<ul style="list-style-type: none">• Contains limited force of attraction• Restrictive deductions in the hands of PE• Attribution of profits based on apportionment of total profits of the enterprise to its various parts, provided it is in line with other principles laid down in this Article

Comparative View – OECD Model and UN Model

Force of Attraction

- Types of force of attraction
- Full force of attraction: All profits derived in source State taxable as profits of the PE, whether or not through such PE
- Limited force of attraction: Profits derived through PE as well as profits from sale of goods / activities of same or similar to that of PE directly carried out by the HO in the source country taxable as profits of PE
- No force of attraction: Only profits derived through PE taxable

Comparative View – OECD Model and UN Model

Article 8 – Shipping, Inland Waterways Transport and Air Transport

OECD Model	UN Model
<p>Taxation of profits from shipping and aircraft operations in international traffic only in the state in which the effective management of the enterprise is situated</p>	<p>Two Alternatives</p> <p>Alternative A – Same as OECD</p> <p>Alternative B – Rights for taxing shipping operations in international traffic are provided to the source state, if the shipping operations are more than casual in that State.</p>

Comparative View – OECD Model and UN Model

Article 10 – Dividend

OECD Model	UN Model
<p>Taxing rights of dividend income to the state of residence.</p> <p>Also provides for the rates of tax, 5% (if capital is 25% or more) and 15% (in any other case).</p>	<p>Determination of the rate of tax in the source state is left on the bilateral negotiation between the countries.</p>

Comparative View – OECD Model and UN Model

Article 11 – Interest

OECD Model	UN Model
Primary taxing rights for interest income has been provided to the state of residence. It also provides taxing rights to the source state at a rate of 10%	Determination of the rate of tax in the source state is left on the bilateral negotiation between the countries.

Comparative View – OECD Model and UN Model

Article 12 – Royalty

OECD Model	UN Model
<p>Exclusive residence based taxation for royalty incomes</p>	<p>Broader definition as compared to OECD and also covers:</p> <ul style="list-style-type: none">– Payment made for films or tapes used for radio or television broadcasting; and– Rental for industrial, commercial or scientific equipment <p>It also provides taxing rights to the source state based on the bilateral negotiation between the countries</p>

Comparative View – OECD Model and UN Model

Article 13 – Capital Gains

OECD Model	UN Model
<p>Residence based taxation in respect of capital gains, except in case of immovable property, movable property of a PE and shares in a real estate company</p>	<p>The UN model is similar to OECD model except that capital gains on sale of shares of a company in which the seller has substantial participation (to be determined by bilateral negotiation) at any time during the preceding 12 month period shall be taxable in the source state.</p>

Comparative View – OECD Model and UN Model

Article 14 – Independent personal services

OECD Model	UN Model
Taxation of independent personal services is governed by Article 7 (business profits).	Provides for the taxation in respect of professional services of an independent character.

Comparative View – OECD Model and UN Model

Article 15 – Income from employment

OECD Model	UN Model
<p>Taxing rights have been provided to the residence state.</p> <p>The income can be taxed in the source state if the employment is exercised in that state, subject to a short stay exemption.</p>	<p>Similar to OECD model, except the article is entitled 'Dependent personal services'.</p>

Comparative View – OECD Model and UN Model

Article 21 – Other Income

OECD Model	UN Model
Other income will generally be taxable in the state of residence, except income attributable to the PE.	Primary taxing rights have been provided to the State of residence. Also provides for taxing rights to the Source State if the income arises in that State.

Comparative View – OECD Model and UN Model

Article 22 – Capital

OECD Model	UN Model
Residence based taxation in respect of capital except in case of immovable property and business property of a PE.	Identical to the OECD Model.

Comparative View – OECD Model and UN Model

Article 23 – Methods of Elimination of Double Taxation

OECD Model	UN Model
Two methods: <ul style="list-style-type: none">• Exemption Method• Credit Method	Broadly similar to OECD Model

Comparative View – OECD Model and UN Model

Article 24 – Non-Discrimination

OECD Model	UN Model
Contains a special provision to ensure non-discrimination for taxpayers.	Identical to OECD Model

Comparative View – OECD Model and UN Model

Article 25 – Mutual agreement procedure

OECD Model	UN Model
<p>Reference to the competent authorities of the two states can be made for resolution of issues under the Convention</p>	<p>The UN model provides for two alternatives. The difference between the two alternatives is that Alternative A does not provide arbitration whereas Alternative B does.</p> <p>The broad difference between Alternative B and the OECD Model is that under Alternative B, arbitration is at the request of either component authority; on the other hand, the OECD model provides for arbitration at the request of the taxpayer.</p>

Comparative View – OECD Model and UN Model

Limitation of Benefits

OECD Model	UN Model
No such Article in the OECD Model	No such Article in the UN Model

Comparative View

Comparative view – G-8 Countries

USA	<ul style="list-style-type: none">• Installation PE – Threshold of 120 days (less than UN threshold)• Service PE – Threshold of 90 days (less than UN threshold)• Articles 7, 8, 11, 12, 13 in line with UN convention
Canada	<ul style="list-style-type: none">• Installation PE – Threshold of 120 days (less than UN threshold)• Service PE – Threshold of 90 days (less than UN threshold)• Article 7, 11, 12, 13 in line with UN convention
France	<ul style="list-style-type: none">• Installation PE – Threshold of 183 days (on line with UN threshold)• No PE resulting from supervisory activities in relation to installation project (in line with OECD convention)• Service PE – Threshold of 90 days (less than UN threshold)
UK	<ul style="list-style-type: none">• Service PE – Threshold of 90 days (less than UN threshold)• Article 7 : Business profits – No force of attraction rule (in line with OECD convention)

Source rule favored but OECD model followed in some respects

Comparative view – Emerging Countries

Indonesia

- Threshold for Service PE and Installation PE close to or less than UN threshold
- Supervisory activities covered by installation PE (UN)
- Contains force of attraction rule (UN)
- Article 11 – tax on interest not to exceed 10 percent (OECD)
- Article 12, 13 in line with the UN convention

Malaysia

- Installation PE has threshold of 6 months (UN)
- No service PE (OECD)
- Article 7 : Business profits – no force of attraction rule (OECD)
- Article 11 : Tax on interest not to exceed 10 percent (OECD)
- Article 12 in line with the UN convention

Source rule favored but OECD model followed in some respects

Comparative view – Emerging Countries

Zambia

- Installation PE – Threshold of 9 months (closer to OECD)
- No Service PE (OECD)
- Contains force of attraction rule (UN)
- 11, 12, 13 in line with the UN convention

Sri Lanka

- Article 7, 11, 12, 13 in line with UN convention
- Time threshold for installation and service PE closer to UN convention
- Contains force of attraction rule (UN)
- Article 11 : interest not to exceed 10 percent (OECD)
- Article 12, 13 in line with UN

- Preference for source based taxation
- OECD convention followed in some respects
- No significant difference in treaty policy towards developed and developing nations

Indian Jurisprudence

Reliance on UN/OECD Conventions

Courts have often referred to UN and OECD model conventions/ commentaries

- Meanings assigned by OECD / UN Model or commentary should be given “due weightage”
 - CIT v Vishakapatnam Port Trust - 144 ITR 146 (Andhra Pradesh HC)
 - Graphite India Ltd. v. DCIT - 78 TTJ 418 (Calcutta ITAT)
 - DCIT v ITC - 85 ITD 162 (Calcutta ITAT)
- Referred to ‘reinforce’ / ‘confirm’ Court’s conclusion
 - Union of India v Azadi Bachao Andolan – 263 ITR 707 SC
 - CIT v Vijay Ship Breaking Corpn - 261 ITR 113 (Gujarat HC)

Reliance on UN/OECD Conventions

“Favoring” reference to Commentary

- British Airways Plc. vs DCIT – 73 TTJ 519 (Delhi ITAT)
 - Tribunal observed that Article 8 of India – UK treaty is in line with OECD convention
 - OECD commentary referred to for determining scope of Article 8 of India – UK treaty
- Graphite India Ltd. vs DCIT – 78 TTJ 418 (Calcutta ITAT)
 - Article 15 of India-US treaty almost same as Article 14 of OECD Model Convention
 - Tribunal ruled that OECD commentary was very important and relevant

Reliance on UN/OECD Conventions

“Favoring” reference to Commentary

- Morgan Stanley – 201 Taxation 160 (Supreme Court)
 - Reference made to UN model convention by Supreme court while interpreting Service PE under India - US treaty
 - No reference made to OECD model
- Aztec Software – 294 ITR 32 (Bangalore ITAT)
 - “India is not a member of OECD. However the organization has been supporting efforts of tax administration in India to properly and effectively administer and implement Transfer Pricing policy. A useful reference can always be made to OECD guidelines, for the purpose of resolving dispute of transfer pricing in India, however subject to statutory regulations.”
- Mentor Graphics - 112 TTJ 408 (Delhi ITAT)
 - TPO erred in neither applying the transfer pricing regulations nor the OECD Guidelines

Reliance on UN/OECD Conventions

“Favoring” reference to Commentary

- Set Satellite (Singapore) PTE Ltd – 106 ITD 175 (Mumbai ITAT)
 - Reliance on OECD’s 2006 report on attribution of profits while determining that income of the foreign company in India may be taxed even where it pays an arm’s length remuneration to its dependent agent in India
- Galileo International Inc and Maruthi Info and Tech Centre ITA No. 1733/Del/2001
 - Tribunal has referred to OECD commentary for construing the meaning of a fixed place of business in India- US treaty
- CIT vs VR SRM firm and others – 208 ITR 400 (Chennai HC)
 - “The articles in the OECD model convention and those in the treaty with Malaysia under consideration show wide range of difference and per se render the commentaries on the model convention wholly inapplicable and expose the unreasonableness and futility in seeking to apply the same” (Chennai HC)
 - Reliance sought to be placed by Revenue on OECD commentary considered inappropriate and unjustified

Reliance on UN/OECD Conventions

“Favoring” reference to Commentary

- P. No. 28 of 1999 - 242 ITR 208 (AAR)
 - On Article 5(1) and 5(2) of India – US treaty - AAR applied the principle of statutory interpretation observed for interpreting domestic law – “the inclusive definition is intended to add to the primary meaning”
 - Ruled that reference to OECD commentary was not appropriate as it ran contrary to well established principle of statutory interpretation
- TVM Ltd - 237 ITR 230 (AAR)
 - “Several observations in the Commentary on the UN Model will be equally apposite even for the interpretation of the India-Mauritius Treaty” AAR applied the UN Commentary while interpreting the meaning of permanent establishment under India – Mauritius treaty

Questions?

Thank You