Chapter-Overview of Model Tax Conventions

Introduction

In order to enable various countries to enter into treaties, OECD and UN have developed certain Model Tax Treaties. These treaties can be used by various countries as a starting point in their negotiations with other countries. While these Models are not legally binding, they have been extensively used by various countries as a reference point while entering into Tax Treaties.

The significant model conventions have been briefly discussed hereunder-

OECD Model

- OECD Model is essentially a model treaty between two developed nations.
- This model advocates the residence principle, i.e. , it lays emphasis on the right of state of residence to tax the income.

UN Model

- The UN model is a compromise between the source principle and the residence principle. However, it gives more weight to the source principle as against the residence principle of the OECD MC.
- UN MC is designed to encourage flow of investments from the developed countries to developing countries.
- It takes into account sharing of tax-revenue with the country providing capital.

US Model

- This Model Convention is used by the United States while entering into tax treaties with various countries.

OECD Model contains VII chapters comprising of 32 articles and UN Model also contains VII chapters but comprising of 31 articles. US Model comprises of total 30 articles.

Significant Articles in the Model Conventions

Article I- Persons Covered

- The OECD and UN Model Convention would apply to persons who are residents of one or both of the Contracting States.
- Income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State. However, the same would be treated as income only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Example-State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest that it receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a Firm, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. Therefore, in such case, half of the interest shall be considered for the purpose of treaty benefit, to be income of a resident of State B.

Article 2- Taxes Covered

- Taxes on Income and capital-The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
- Taxes on Income and capital includes-
  - taxes on gains from the alienation of movable or immovable property
  - taxes on the total amounts of wages or salaries paid by enterprises
  - taxes on capital appreciation

The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signing of the Convention in addition to, or in place of, the existing taxes.

Article 4- Residence

- A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder.

"resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.

However, it does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

- **Residential status of Individual-is determined as follows**
- He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

- If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
- If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
- If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

- **Residential status of persons other than individual-**

In case of a person other than individual, residential status is determined by the competent authorities by mutual agreement having regard to its POEM, the place of incorporation or otherwise constituted, etc.

Article 5- Permanent Establishment

- The concept of "Permanent Establishment" (PE), defined in Article 5, has considerable importance as business profits of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE.
- Article 5(1) states the "basic rule" for a PE and expresses the primary meaning of PE. The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.
- A PE exists if the following conditions are satisfied cumulatively-
  - There is an "enterprise".
  - Such enterprise is carrying on a "business";
  - There is a "place of business";
  - Such place of business is at the disposal of the enterprise (may be owned / rented but must be one which the enterprise has the effective power to use);
  - The place of business is "fixed", that is, it must be established at a distinct place with a certain degree of permanence.

The business of the enterprise is carried on wholly or partially through this fixed place of business.

As per Article 5(2), the term "permanent establishment" includes especially-

- A place of management;
- A branch;
- An office;
- A factory
- A workshop, and
- A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

- As the PE concept confers the source state the right to tax, it is an important article for developing countries. As a result, the UN Model Convention differs from the OECD Model Convention in number of ways.

S No.	Basis	OECD Model Convention	UN Model Convention
1.	What constitutes PE?	As per OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months.	As per UN Model Convention, it is wider as it covers "assembly and installation project" and "supervisory" activities in connection thereto and requires the activity in question to continue only for six months.
2.	Reference to Service PE	There is no reference in OECD Model of Service PE, however, the presence has to be ascertained through general principles under Article 5(1).	The UN Model makes a specific reference to service PE, which reads as follows- "The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 months period commencing or ending in the fiscal year concerned".

S No.	Basis	OECD Model Convention	UN Model Convention
3.	Insurance	There is no reference related to insurance in OECD Model. In such absence, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD model.	The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model. As per this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

- Agency PE under OECD and UN Models targets activities done by a dependent agent of the enterprise in the Source State. The recent update expands the definition of dependent agent PE to include instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

Article 7- Business Profits

- Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction.
- As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a limited Force of Attraction rule (FOA).
- The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State, whether through the PE or not, can be taxed by it (State of Source State).

- As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to-
  - that PE;
  - sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or
  - Other business activities carried on in that other State of the same or similar kind as those effected through that PE.

Article 11- Interest

- Paragraph 1 of this Article provides the right to Residence State to tax interest. Paragraph 2, however, also confers right to the Source State to tax interest. Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.
- It may be noted that the definition of interest in both the models viz. OECD and UN Model is similar in that it essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

Article 12- Royalties

- This Article provides the right of Contracting States to tax income from royalty.
- Key differences between the two Models are as follows-

(a) As per the OECD Model, royalties arising in the Source State and beneficially owned by a resident of the Residence State are taxable only in the Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.

(b) The definition of 'royalties' under the OECD Model does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

Article 12A- Fees for Technical Services

- In its 2017 update, the UN Model has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in the OECD Model.
- Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State.
- Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

  Example- R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, guarantees, foreign exchange, negotiable instruments. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty which contains an article akin to Article 12A. Payments received for services provided by a financial institution would constitute FTS if the services involve use of knowledge, skill and expertise to provide research, analysis or advice to a specific client related to particular circumstances. This has to be distinguished from provision of non-specialized services such as payment and transmission services, debit and credit card services, etc.

Article 13- Capital Gains

- This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State, or shared between the Residence and Source States.
- The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. The Article contains rules for taxation of gains made from alienation of different assets such as immovable property, immovable property forming part of a PE, ships and aircrafts, etc. In respect of shares, both Models have been updated and are identical. Rights are conferred to the Source State if more than 50 percent of the value of shares during the preceding 365 days is derived from immovable property in such Source State.

Article 14- Independent Personal Services

- Article 14 is only present now in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on "Issues Related to Article 14 of the OECD Model Tax Convention". The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as 'Business Profits' (Article 7) under the OECD MC.
- This Article deals with the taxation of income derived by a person for professional or specified services which are offered in the Source State through some presence. This article on Independent personal services in the UN Model states as under-

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State-

   a. If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

   b. If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-months period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 21- Other Income

- This Article deals with taxation of items of income which are not specifically taxable under any other specific Article.
- Key differences are as under-
  - OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income.
  - Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).

Article 23A & 23B- Elimination of Double Taxation

Articles 23A and 23B contains provisions relating to elimination of double taxation have to applied. Articles 23A and 23B provide for the mechanism through which tax credit/ exemption may be available in the Residence State for taxes deducted in the Source State.

Article 25- Mutual Agreement Procedure (MAP)

- There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not as per the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article. This Article requires competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations. This would take place as follows-

S No.	Basis	OECD Model Convention	UN Model Convention
1.	MAP Request	Under OECD Model, the taxpayer may make a request to either Contracting State.	The UN Model Convention provides two alternatives- Alternative A- Tax payer has to approach to his resident country. Alternative B- Reference to an arbitration process as part of the Mutual Agreement Procedure. The decision arrived at, through the process is binding unless a person directly affected does not accept it.
2.	Time Limit	Two years from the date when all the information required by the competent authorities in order to address the case need to be provided to both competent authorities.	Arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case (Alternative B).
3.	Request for arbitration	Arbitration must be requested in writing by the person who initiated the case.	Arbitration must be requested by the competent authority of one of the Contracting States(Alternative B).
4.	Departure from arbitration	No specific provision	The UN Model allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

Article 26- Exchange of Information

- In order to complete tax cases, a country may require certain information which may be available with the treaty partner. Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made.
- **Purpose of Article 26-**
  1. Facilitate effective exchange of information between Contracting States.
  2. Curtails cross-border tax evasion and avoidance.
  3. Curtail the capital flight that is often accomplished through such evasion and avoidance. This is particularly relevant in the perspective of developing countries.

Similar provisions are contained in OECD and UN Model Conventions-

- A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons.
- A Contracting State can avoid the exchange of information obligations by showing that the information pertains to communication between an attorney and his client which is protected from disclosure under domestic law.
- Lack of interest or use in such information cannot form the basis for a Contracting State to not co-operate with the exchange of information obligations.

Overview

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Article 21	Other Income
Article 23A & 23B	Elimination of Double Taxation
Article 25	Mutual Agreement procedure
Article 26	Exchange of Information

Application & Interpretation of Tax Treaties

Sources of International Tax Law

1. **DTAA-** It includes the protocols, memorandum of understanding, and exchange of information, etc. forming part of the DTAA which enables interpretation of a DTAA.
2. **Customary international law and general principles of law-** Customary international law is the aspect of international law that derives from customs and conventions. For example, principles of law recognised by civilized nations in their national legal systems, customary law and judicial decisions and the practices of international organizations.
3. **Multinational International Agreements (MIA)/ Multilateral treaty-** Agreement signed by more than two countries is called as "MIA". For example- Vienna Convention on Law of Treaties (VCLT) is a multilateral treaty signed and ratified by several countries, which codifies the customary international law for interpretation of tax treaties.

Double Taxation and Connecting Factors

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country.

If a company is doing business **in another country** (i.e. host/source country), for example, through its branch in that country, then it would be subject to tax in both host country and home country. Home country because of residence link and host country on the basis of its source link as the company would be heavily engaged in doing business in the territory of other country.

However, if a company is doing business **with another country** (i.e., host/source country), then, it would be subject to tax in its home country alone, based on its residence link, since the company is not engaged in carrying on the business in the territory of source country (for example, export of goods to another country).

I. Juridical double taxation

When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

In order to avoid such double taxation, a company can invoke provisions of DTAAs (also known as Tax Treaty or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

Example Company ICO is a resident of India. It has set up a branch in UK. Here, India would be the country of residence for ICO, whereas UK would be the country of source. UK would tax the profits earned by the branch of ICO located in UK, whereas ICO would be taxed on worldwide basis in India, including profits of its UK branch. However, ICO can claim relief in respect of taxes paid in UK while filing its tax return in India under the Indo-UK Double Taxation Avoidance Agreement.

If, instead of UK, ICO has a branch in a state with which India does not have tax treaty, then it can claim unilateral relief under section 91 of the Income-tax Act, 1961 in respect of taxes paid by its branch in that state.

2. Economic double taxation

'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

Example- Suppose Fargi Inc. (USA Co.) distributes dividend and paid DDT in USA & same dividend is received by Indian resident is taxed in India. In this case, same income is taxed in the hands of Fargi Inc. as well as Indian resident.

Types of DTAAs

Types of DTAAs

- Limited of DTAAs
- Comprehensive DTAAs

Limited DTAAs are those which are limited to certain types of incomes only. e.g., DTAA between India and Pakistan is limited to income from international air transport only.

Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time, a treaty also covers gift tax, surtax, etc.

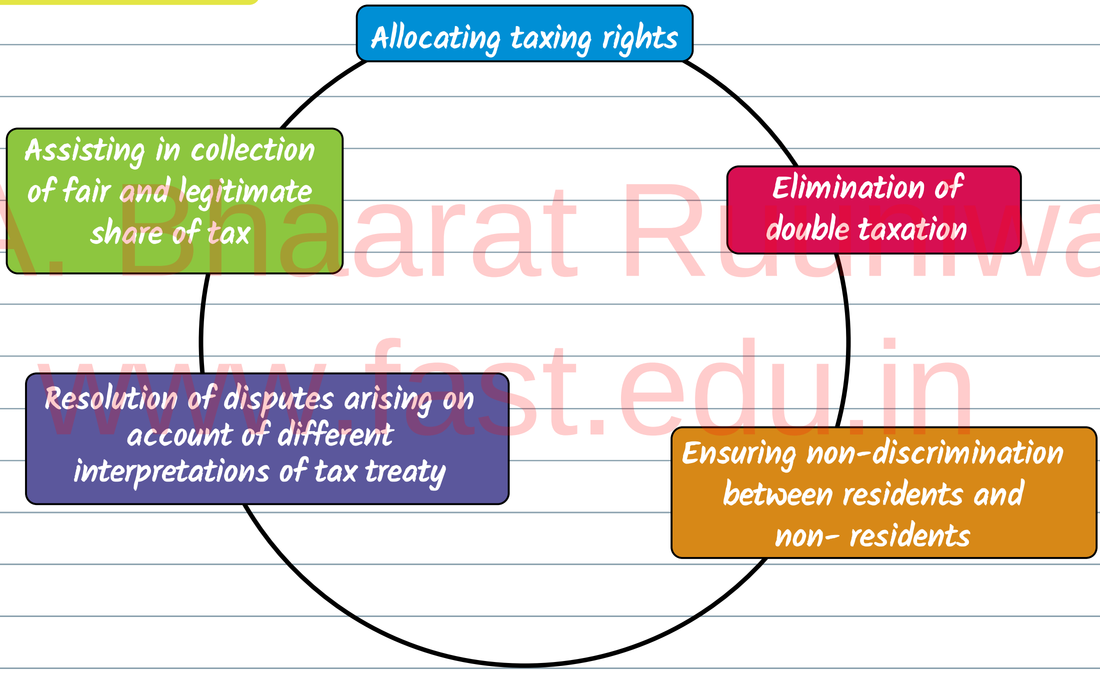
Directives Principle set out in the Indian Constitution

Article 51 of the Indian Constitution has, inter alia, set out some directive principles which must be followed by the State in the context of International agreements and relationships. It has been provided that-

The State shall endeavor to –

a) Promote international peace and security;
b) Maintain just and honourable relations amongst nations;
c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and
d) Encourage settlement of international disputes by arbitration.

Need for Tax Treaties



Further, in addition to above, there are some other principles which must be considered by countries in tax treaties –

i) **Equity and fairness-** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.
ii) **Neutrality and efficiency-** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.
(a) Capital export neutrality (CEN) - It provides that business decision must not be affected by tax factors between the country of residence and the target country.

(b) Capital import neutrality (CIN)- It provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment-** In some cases, the avoidance of double taxation is not the sole purpose. The other aim could be to stimulate a country's growth and global economic development.

Interpretation of Tax Treaties

Interpretation of any statute, especially international tax treaties, requires that we follow certain rules of interpretation. In subsequent paragraphs, we shall deal with basic principles of interpretation of law for interpretation of tax treaties.

Basic principles of Interpretation of a treaty derived by Customary International law.

Some of the important principles of Customary International law in interpretation of tax treaties are as follows-

i Golden Rule- Objective Interpretation

Ideally, any term or word should be interpreted keeping its **objective or ordinary or literal meaning** in mind. The term has to be interpreted contextually.

Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked **inconsistency** with other portions of the treaty, or would clearly go beyond the intention of the parties, it **should not be adopted.**

ii Subjective Interpretation

The terms of a treaty are to be interpreted according to the **common intention** of the contracting parties at the time the treaty was concluded. The intention must be **ascertained from the words used in the treaty and the context** thereof.

iii Purposive Interpretation/ Objects and Purpose Method

The treaty is to be interpreted so as to facilitate the **attainment of the aims and objectives** of the treaty. For identifying the intention of the parties entering into treaty, reference can be made to the preamble of the treaty, its protocol and the technical memorandum.

iv The Principle of Effectiveness

According to this principle, a treaty should be interpreted in a manner as to have effect rather than make it void i.e. which will enable the provisions of the treaty to work and to have their appropriate effects.

v Principle of Contemporanea Expositio

A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

vi Liberal Construction

It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

vii Treaty as a whole- Integrated Approach

A treaty should be construed as a whole and effect should be given to each word which would be construed in the same manner wherever it occurs. Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

viii Reasonableness and Consistency

Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law.

Extrinsic Aids to Interpretation of a Tax Treaty

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. One may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted-

i Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

ii A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

iii Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

iv Other treaties, in pari materia (i.e., relating to the same subject matter), in case of doubt.

Extrinsic Aids to Interpretation of a Tax Treaty

- Provisions in Parallel Tax Treaties
- International Articles/Essays/ Reports
- Protocol
- Preamble
- Mutual Agreement Procedure [MAP]

Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? Though the interpretation or explanations in treaty X would not be binding while interpreting the treaty Y, however, if the language is similar between the two treaties, one can make a reference to treaty X for understanding the intention of the Contracting parties.

International Articles/Essays/Reports

Courts many a times refer to the Commentaries of International articles/essays/reports for interpretation for understanding the tax treaties as they are considered authoritative source.

Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favored Nation (MFN) Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

Under this clause a country agrees to extend the benefits (such as application of lower rate of tax or narrowing the scope of the income liable to tax or allowing higher deduction of executive and general administrative expenses of head office) to the residents of the other country, which it had (first country) promised to the residents of third country. It tries to avoid discrimination between residents of different countries.

Example Suppose as per India-Mauritius treaty resident of Mauritius liable to pay tax in India on royalty derived from India @ 12%. After some time India entered into DTAA with Sri Lanka & as per India-Sri Lanka DTAA, resident of Sri Lanka liable to pay tax in India on royalty derived from India @ 7%. Now in this example suppose India-Mauritius treaty contain MFN clause then Resident of Mauritius liable to pay tax in India only @ 7%.

Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. As mentioned above, in case of Azadi Bachao Andolan, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty.

Mutual Agreement Procedure (MAP)

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/ documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision.

Commentaries on OECD/UN Models and their importance

There are two model conventions – OECD Model Convention and the UN Model Convention. The OECD Model was framed by the members from the developed countries. It gives importance to residence based taxation. UN Model Convention represents a compromise between the developing and developed countries. UN Model focusses on source based taxation. The OECD or UN Model Convention provides template to the tax administrations for negotiating the tax treaties. There are commentaries annexed to the Model Convention which helps in interpreting the model conventions.

Foreign Court's Decisions

Tax treaties may be interpreted differently by the different countries. A treaty signed between country A and B, may be interpreted by courts of Country A and B differently. Therefore, there may be no harmonization in the interpretation of tax treaties. A same income may be classified as royalty by one country and business income by another country. Therefore, reliance on foreign court rulings may result in harmonious interpretation.

Ambulatory v. Static Approach

In order to decide what meaning is assigned to a particular term, two views can be taken-
Static- it examines the meaning at the time of signing the treaty.
Ambulatory- it examines the meaning at the time of application of treaty provisions.
Ambulatory approach cannot be applied when there is a radical amendment in the domestic law thereby changing the sum and substance of the term.

Principles laid down by the Vienna Convention on Law of Treaties

Article No.	Article Heading	Principle laid down
26	Pacta Sunt Servanda (in good faith)	Every treaty in force is binding upon the parties and must be followed by them in good faith.
27	Internal law and observance of treaties	A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. For instance, the parties to the treaty should not dishonour their international commitments with each other by retrospectively amending their domestic tax laws or by not abiding by the treaty terms.
28	Non-retroactivity of treaties	Treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party. In other words, unless otherwise provided, treaties cannot have retrospective application
29	Territorial Scope of Treaties	The treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.
31	General Rule of Interpretation	• A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose. • The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure o Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; o Any instrument which was made by one or more parties in connection with the conclu sion of the treaty and accepted by the other parties as an instrument related thereto.

		o Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto. • The following shall be taken into account, together with the context in that: o Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; o Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; o Any relevant rules of international law applicable to relation between the parties. • A special meaning shall be given to a term if it is established that the parties so intended.
32	Supplementary means of interpretation	In order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous; or (b) leads to a result which is unreasonable.
33	Interpretation of Treaties Authenticated in two or more languages	• When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language. • A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree. • The terms of the treaty are presumed to have the same meaning in each authentic text. • Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the

		• meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.
34	General Rule regarding third states	A treaty does not create either obligations or rights for a third State without its consent.
42	Validity and Continuance in force of treaties	• The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the Convention.. • The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the Convention. The same rule applies to suspension of the operation of a treaty.
60	Termination or Suspension of the operation of a treaty as a consequence of a breach	• A material breach of a bilateral treaty by one of the parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part. • A material breach of a multilateral treaty by one of the parties entitles: a. the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either: ▸ in the relations amongst themselves and the defaulting State, or ▸ as between all the parties; b. a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State; c. any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in

		o whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every other party with respect to further performance of its obligations under the treaty. • Material breach means- (i) Repudiation (rejection) of the treaty not sanctioned by the convention. (ii) Violation of an essential provision.
61	Supervening impossibility of performance	In case of permanent disappearance or destruction of an object indispensable for the execution of the treaty, a party may terminate or withdraw from the treaty. If the impos sibility is temporary, it may be invoked only as a ground for suspending its operation. But impossibility of performance shall not be invoked if impossibility is a result of a breach of an obligation by that party.
62	Fundamental change of circumstances	• A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless – o the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and o the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. • A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty – (i) if the treaty establishes a boundary; or (ii) if the fundamental change is the result of a breach by the party invoking it either of an

		• obligation under the treaty or of any other international obligation owed to any other party to the treaty. • If a party invokes fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending its operation.
64	Emergence of new peremptory norm of general international law	If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and stands terminated.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