CHAPTER 9

OVERVIEW OF MODEL TAX CONVENTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the need for Model Tax Conventions;
- **appreciate** the key features of the OECD and UN Model Tax Conventions;
- **identify** the subject of the various articles of the OECD and UN Model Tax Conventions;
- **differentiate** between the principles enshrined in the Articles of the OECD Model Tax Convention *vis-à-vis* the corresponding Articles of the UN Model Tax Conventions;
- **analyse, integrate and apply** the above principles to make computations and address relevant issues.

9.1 INTRODUCTION

In order to enable various countries to enter into treaties, which are standardized to some extent, Organization for Economic Cooperation and Development (OECD) and the United Nations (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. In some cases, they have been incorporated verbatim or with minor changes. However, in other cases, countries have made suitable changes in the draft model according to their economic environment and commercial and tax considerations.

The significant model conventions have been briefly discussed hereunder:

→ **OECD Model** - The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. In 1946 the model convention was published in Geneva by the Fiscal Committee of U.N. Social & Economic Council and later by the Organisation for European Economic Co-operation (OEEC) in 1963. However, in 1961, the Organisation for Economic Co-operation and Development (OECD) was established, with developed countries as its members, to succeed the OEEC, and OECD approved the draft presented to the OEEC. In 1977, the final draft was prepared in the present form which has been revised several times; the latest being in the year 2017.

OECD Model Convention (OECD MC) is essentially a model treaty **between two developed nations.** This model advocates the residence based taxation, i.e., it lays emphasis on the right of state of residence to tax the income.

→ **UN Model** – In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this Group finalised the UN Model Convention (UN MC) in its present form. It has further been revised a number of times, the latest being in the year 2017.

The UN MC 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.

The United Nations MC seeks to be balanced in its approach. As a corollary to the principle of taxation at source, the Articles of the Convention are based on a recognition by the source country that

(a) taxation of income from foreign capital should take into account expenses allocable to the earnings of the income so that such income is taxed on a net basis,

(b) taxation should not be so high as to discourage investment and

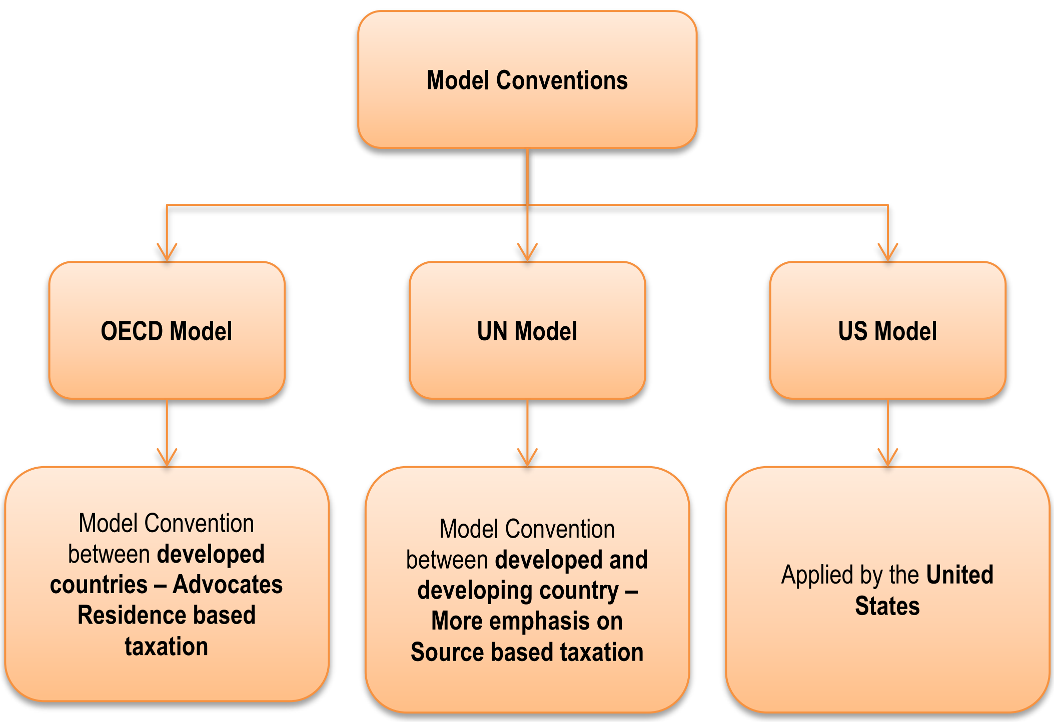
(c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations MC embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model Convention.

→ **US Model** – This Model Convention is used by the United States while entering into tax treaties with various countries. The US Model Convention was last revised in 2016.

These Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The above model conventions have been illustrated in the following diagram:



OECD Model contains VII chapters comprise of 32 articles and UN Model also contains VII chapters but comprise of 31 articles. List of articles of OECD MC and UN MC is given below:

Article	OECD Model Convention, 2017	UN Model Convention, 2017
	Chapter I : Scope of the Convention	
1	Persons covered	Persons covered
2	Taxes covered	Taxes covered
	Chapter II : Definitions	
3	General definitions	General definitions
4	Resident	Resident
5	Permanent establishment	Permanent establishment
	Chapter III : Taxation of Income	
6	Income from immovable property	Income from immovable property
7	Business profits	Business profits
8	International shipping and air transport	International shipping and air transport (Alternative A & B)
9	Associated enterprises	Associated enterprises
10	Dividends	Dividends
11	Interest	Interest
12	Royalties	Royalties
12A		Fees for technical services
13	Capital gains	Capital gains
14		Independent personal services
15	Income from employment	Dependent personal services
16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
17	Entertainers and sportspersons	Artistes and sportspersons
18	Pensions	Pensions and social security payments (Alternative A & B)
19	Government service	Government service
20	Students	Students
21	Other income	Other income
	Chapter IV : Taxation of Capital	
22	Capital	Capital

	Chapter V : Methods for the Elimination of Double Taxation	
23A	Exemption method	Exemption method
23B	Credit method	Credit method
	Chapter VI : Special Provisions	
24	Non-discrimination	Non-discrimination
25	Mutual agreement procedure	Mutual agreement procedure (Alternative A & B)
26	Exchange of information	Exchange of information
27	Assistance in the collection of taxes	Assistance in the collection of taxes
28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
29	Entitlement to benefits	Entitlement to benefits
30	Territorial extension	Entry into force
	Chapter VII : Final Provisions	
31	Entry into force	Termination
32	Termination	

Now, let us discuss the comparative analysis of some of the significant Model Tax conventions.

9.2 COMPARATIVE ANALYSIS OF SOME OF THE SIGNIFICANT ARTICLES OF OECD AND UN MODEL CONVENTIONS

For the purpose of this chapter, a comparative analysis of OECD and UN Model Conventions has been made in a tabular format. Such comparative analysis shall enable easy reference and identification of different words, phrases, sentences, clauses and paragraphs used/ omitted in the various articles of these Model Conventions.

The differences in the text of various articles of the Model Conventions have been indicated by appropriately using **Bold**, ***Bold and Italics*** and <u>***Bold, Italics and underline***</u> (as per the below key).

KEY FOR COMPARATIVE ANALYSIS	
→	The Comparative analysis and article-wise/ para-wise chart has been prepared taking OECD Model Convention (OECD MC) as base.
→	The comparative differentiating words have been highlighted in **Bold** in OECD MC column, at appropriate places for ease of identification and reading.
→	Additional paras, phrases in UN MC as compared to OECD MC have been shown in ***Bold and Italics***.

→	Changes in Words, Phrases, Sentences etc. in UN MC as compared to OECD MC have been shown in ***Bold, Italics & Underlined*** at appropriate places in the comparative similar paragraphs.
→	As far as possible, articles, paras and clauses similar to those in OECD MC have been placed in parallel Columns in UN MC.

In cases where the articles prescribed in the OECD MC and UN MC are identical, only the text of the article has been mentioned and relevant summary have been provided. However, in other cases, necessary brief comments about the differences and other relevant observations have been provided in a summarised manner (after each clause/para of various articles for facilitating proper understanding of the comparative analysis).

Title and Preamble to the Model Conventions

The title of the OECD MC reads as follows:

"Convention between State A and State B for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance"

There is now a specific reference to "the prevention of tax evasion and avoidance" in the title to emphasize its significance in the Model Convention.

The Preamble of the OECD MC reads as follows:

"(State A) and (State B),

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 this Convention for the indirect benefit of residents of third States),"

The Title and Preamble to the UN MC is almost identical to that of OECD MC. The only minor difference is the reference to "tax avoidance and evasion" in the place of "tax evasion and avoidance" in the Title and Preamble.

The Preamble now clearly indicates that OECD and UN MCs do not intend to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping.

This language of the Preamble would help ensuring that the provisions of the Conventions are interpreted and applied to prevent abusive treaty shopping arrangements.

Significant Articles in the Model Conventions

Over the years, both Model Conventions have seen a lot of convergence and the language is identical in quite a few Articles. However, there are key differences in approach and language in some Articles which will be the focus of our discussion, in the section below.

The jurisdiction or country of residence of the taxpayer is referred to as the Residence State and the jurisdiction or country where the source of income is located is referred to as the Source State.

ART 1	PERSONS COVERED

This Article deals with persons, who shall be eligible to claim benefit under a particular Treaty. Since Tax Treaties are always agreed upon and signed between two countries ("Contracting States"), the benefits of the same shall be available only to persons who are residents of one or both of the Contracting States.

Para	OECD Model Convention 2017[1]	UN Model Convention 2017[2]
1	This Convention shall apply to persons who are residents of one or both of the Contracting States.	
Note - *Article 1(1) of the OECD MC and UN MC are identical. The OECD and UN Model Convention would apply to persons who are resident of one or both of the Contracting States.*		
2	For the purposes of this Convention, 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 but 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.	
Note - *Article 1(2) of OECD and UN MCs are identical. It addresses the situation of the income of entities or arrangements that one or both Contracting States treat as wholly or partly fiscally transparent for tax purposes, such as trusts and partnership firms.* *The concept of "fiscally transparent" used in the paragraph refers to situations where, under the domestic law of a Contracting State, the income (or part thereof) of the entity or arrangement is not taxed at the level of the entity or the arrangement but at the level of the persons who have an interest in that entity or arrangement.* *For the purposes of these Conventions, 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.*		

[1] OECD Model Tax Convention on Income and on Capital 2017
[2] UN Model Double Taxation Convention between Developed and Developing Countries 2017

Para	OECD Model Convention 2017[1]	UN Model Convention 2017[2]
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 partnership, 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. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.*		
3	This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, **23 [A] [B]**, 24, **25** and 28.	This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, ***23 A 23 [B]***, 24, ***25A 25B*** and 28.
Note - *Article 1(3) of UN and OECD MC provides that, with the exception of benefits granted under certain Articles of these conventions, these Conventions would not affect the taxation, by a Contracting State, of its resident. The intent of the saving clause is to put at rest the argument that some provisions aimed at the taxation of non-residents could be interpreted as limiting a Contracting State's right to tax its own residents.*		

ART 2 TAXES COVERED

This Article provides the details of taxes, which would be covered for the purpose of tax treaty. Any tax which is not provided in Article 2 is outside the purview of the tax treaty.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	This Convention shall 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.	
Note - *Article 2(1) of the OECD MC and the UN MC are* ***identical****. Paragraph 1 provides the scope of application of the tax treaty. The tax treaty shall apply to taxes on income and on capital. It further elaborates that the taxes can be imposed by the Contracting States including its political sub-divisions and local authorities and it is immaterial if the taxes are levied through direct assessment or through deduction of tax at source, in the form of surtaxes or surcharges or as additional taxes. The tax treaty only intends to clarify the categories of taxes to which it would apply.*		

Para	OECD Model Convention 2017	UN Model Convention 2017
2	There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.	
Note - *Article 2(2) of the OECD MC and the UN MC are* ***identical.*** *It provides definition of the term 'taxes on income and on capital'. It includes taxes on total income and on elements of total income, on total capital and elements of capital. Taxes on elements of total income/capital include tax on dividend, interest and capital gains*[3]*. Article 2(2) also includes taxes on alienation of movable and immovable property, on wages or salaries disbursed by enterprises and on capital appreciation. The provisions of the tax treaty do not apply to other charges such as social security charges where a direct nexus can be established towards the levy and individual benefits to be received.*		
3	The existing taxes to which the Convention shall apply are in particular: a) (in State A): …………………….. b) (in State B): ……………………..	
Note - *Article 2(3) of the OECD MC and the UN MC are* ***identical.*** *It creates a provision for the Contracting States to itemize the taxes in force at the time of signature of the Convention. The list of taxes in force shall not be exhaustive but only an illustrative list to support the preceding Paragraphs of the Article. However, in principle, the States shall enumerate all the taxes to which the tax treaty applies, which are in force at the time of signature of the Convention.*		
4	The Convention shall also apply to any identical or substantially similar taxes **that** are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes **that have been made in their taxation laws.**	The Convention shall also apply to any identical or substantially similar taxes ***which*** are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made ***to*** their ***tax law***.
Note – *Article 2(4) is phrased to accommodate any subsequent changes in the taxation laws of the Contracting States. The tax treaty, in effect, would apply to all the taxes that are*		

[3] Cyril Eugene Pereira, In re (1999), 239 ITR 650

Para	OECD Model Convention 2017	UN Model Convention 2017
identical or substantially similar to the taxes in force at the time of entering into the tax treaty and this Paragraph is essentially included to avoid the necessity to conclude a new treaty every time the tax laws of the Contracting States are amended. In order to facilitate the same, each Contracting State is to notify the other of any significant changes made to its taxation laws by communicating to it, for example, details of new or substituted taxes. Member countries are encouraged to communicate other significant developments as well, such as new regulations or judicial decisions; many countries already follow this practice.		

ART 3 GENERAL DEFINITIONS

This Article provides the meaning of various terms used in the tax treaty. If a particular term is not defined in a tax treaty, Article 3 may provide that the meaning of such term should be construed as per the domestic tax laws.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	For the purposes of this Convention, unless the context otherwise requires:	
(a)	the term "person" includes an individual, a company and any other body of persons;	
Note - *Article 3(1)(a) of the OECD and UN MC are* ***identical****. The definition of 'person' is very significant because under Article 4, only a "person" can be a "resident" and, therefore, eligible for most benefits under the treaty. Also, it is only the "person" as defined in this paragraph of Article 3 who is eligible to claim relief under Article 25 (Mutual Agreement Procedure). The definition of person is not exhaustive and it should be read as indicating that the term "person" is used in a very wide sense.*		
(b)	the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;	
Note – *Article 3(1)(b) of the OECD/UN MC defines the term "company" to also include "any entity that, although not incorporated, is treated as a body corporate for tax purposes. Thus, partnerships will also be considered to be "persons" either because they fall within the definition of "company" or, where this is not the case, because they constitute other bodies of persons.*		
(c)	**the term "enterprise" applies to the carrying on of any business;**	-
(h)	**the term "business" includes the performance of professional services and of other activities of an independent character.**	-

Para	OECD Model Convention 2017	UN Model Convention 2017
***Note -** The UN Model Convention does not contain a definition of the term "enterprise" and "business". In common parlance, enterprise means an economic activity carried on by a person capable of producing profits.* *It would be important to note that, as per the OECD MC, the performance of professional services or other activities of an independent character would constitute an "enterprise" irrespective of the meaning of that term as per the domestic laws. This is due to the reason that enterprise is defined as carrying on of any business and the term "business" has been explicitly defined in Article 3(1)(h) of the OECD MC to include the "performance of professional services and of other activities of an independent character". This definition was included to enable income from professional services or other activities of an independent character to be taxed under Article 7 of the OECD MC and not under Article 21 (Other Income).*		
(d)/ (c)	the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;	
***Note -** Article 3(1)(d) of the OECD MC is **identical** to Article 3(1)(c) of the UN MC. The above-mentioned sub-paragraph is self-explanatory. However, it may be noted that the residency of the enterprise depends on the residential status of the person carrying the enterprise and not the place from which the business is carried on.*		
(f)/(e)	the term "competent authority" means: (i) (in State A): .... (ii) (in State B):	
***Note -** The competent authorities are those bodies of each Contracting State vested with the authority to determine issues relating to the convention in particular under the Mutual Agreement Procedures (Article 25) and the Exchange of Information (Article 26). The definition has regard to the fact that under certain treaties, execution does not exclusively fall within the jurisdiction of the highest tax authorities. Where the jurisdiction on some matters are reserved for or delegated to other authorities, this definition enables each country to designate one or more authorities as being competent to determine issues relating to the convention.* *In India, the competent authority is the Ministry of Finance (Department of Revenue) of the Central Government or their authorised representative.*		
(g)/(f)	the term "national", **in relation to a Contracting State,** means: (i) any individual possessing the nationality **or citizenship** of **that** Contracting State; and (ii) any legal person, partnership or association deriving its status as such from the laws in force in **that** Contracting State;	The term "national" means: (i) any individual possessing the nationality of ***a*** Contracting State; (ii) any legal person, partnership or association deriving its status as such from the laws in force in ***a*** Contracting State.

Para	OECD Model Convention 2017	UN Model Convention 2017
Note - *The definition of "national" is primarily relevant to Article 24 dealing with non-discrimination. The usage of the word "citizenship" has been particularly excluded in Article 3(1)(f) of the UN MC. The meaning of the term "national" depends on the sense in which the term is used and also on the rules pertaining to acquisition or loss of nationality adopted by each Contracting State.* *With respect to legal persons, partnerships or association, their nationality depends on the laws in force in that respective Contracting State. Further, the distinct mention of partnership is necessary to avoid confusion as some domestic laws may categorise an entity as a 'person' but not a 'legal person' for tax purposes.*		
2	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.	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, 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.
Note – *Article 3(2) essentially contains a general rule concerning the meaning of terms used but not defined in the tax treaty. The general rule as embodied in the MC is that if any undefined term is used in the tax treaty, its meaning can be adopted from the meaning assigned to such a word under the domestic law of the Contracting State* ***at the time when the tax is being levied****.* *If, however, such a term is defined in both the tax and non-tax laws of a Contracting State, the definition provided in the tax law has to be considered. Moreover, where multiple definitions are provided, the definition used for purpose of the particular provision at issue, if any, should be used.* *The OECD and UN MC were identical until the 2017 update to the OECD MC which now provides that the domestic law meaning of an undefined term applies only if the context does not require an alternative interpretation and the competent authorities do not agree to a different meaning pursuant to Mutual Agreement Procedure under Article 25.* *OECD MC explains that the context is to be determined by the intention of the Contracting States when signing the tax treaty and the meaning given to the term in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which tax*		

Para	OECD Model Convention 2017	UN Model Convention 2017
treaties are based). This approach seeks to balance the need to ensure the permanency of commitments entered into by States when signing a convention (since a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention) and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated concepts should be avoided).		

ART 4	RESIDENT

Article 4 plays a significant role in determining the scope of application of the Convention and helps in avoiding juridical double taxation in many situations. Double taxation is, generally, by way of taxation of the same income in the hands of the same person in two different tax jurisdictions. A person whose income is subjected to such double taxation can mitigate it through access to the tax treaty between the two Contracting States. In this regard, the primary condition for accessing the tax treaty is residence of a person as per the fiscal laws and, hence, the concept of residence assumes tremendous importance.

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.

Article 4 of the OECD and UN Model Conventions provide the definition of the term ‘resident of Contracting State’. It is an exhaustive definition, which determines the applicability or non-applicability of the tax treaty to a person.

In case the application of such criteria results in dual residency, the rules of determining the residential status of a person (tie breaker rule) are generally provided in the tax treaty.

The concept of ‘resident of a Contracting State’ has various functions and assumes significance in the following three scenarios:

- In determining a convention’s scope of application;
- In solving cases where double taxation arises as a consequence of double residence;
- In solving cases where double taxation arises as a consequence of taxation in the Residence State and also in the Source State.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	For the purposes of this Convention, the term "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,	For the purposes of this Convention, the term "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

Para	OECD Model Convention 2017	UN Model Convention 2017
	residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof **as well as a recognised pension fund of that State**. This term, however, 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.	management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, 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.

Note – *Article 4(1) of the OECD Model does not differ from Article 4(1) of the UN Model except that (a) the UN Model has added the criterion of "place of incorporation" to the list of criteria for residency and (b) OECD Model specifically mentions a recognized pension fund of the State.*

Coverage of only persons subject to comprehensive tax on total income - *As per this paragraph, a person is a resident of a Contracting State if he is liable to tax under the laws of that Contracting State as per the criterion mentioned therein, i.e., domicile, residence, place of management etc. The convention in this regard, intends to cover only the persons subject to comprehensive tax on their total income and thereby specifically excludes any person, who is paying tax only on income from sources in the State.*

Meaning of "liable to tax" - *A resident is a person who is 'liable to tax'. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, pension funds, charities and other organisations are subject to tax law but may be exempt under domestic laws upon satisfying some conditions. Most States view such entities as 'liable to tax'. However, some States do not consider entities as being resident if they are exempt from tax under domestic tax laws.*

Coverage in case of a fiscally transparent entity - *"Liable to tax" is a precondition to consider a person as resident of a Contracting State, however, where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State.*

In such a case, since the income of the partnership "flows through" to the partners under the domestic law of that State, the partners are the persons who are liable to tax on that income and are thus the appropriate persons to claim the benefits of the conventions concluded by the States of which they are residents. This latter result will be achieved even if, under the domestic law of the State of source, the income is attributed to a partnership which is treated as a separate taxable entity.

For States which could not agree with this interpretation of the Article, it would be possible to provide for this result in a special provision which would avoid the resulting potential double taxation where the income of the partnership is differently allocated by the two States.

Consequently, Article 1(2) clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, for purposes of taxation by that State, as the income of a

Para	OECD Model Convention 2017	UN Model Convention 2017
	partner who is a resident of that State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State.	
2	Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows: a) 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); b) 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; c) 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; d) 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.	

Note - *The aforesaid Paragraphs of OECD and UN Model Convention relates to a case where, under provisions of Paragraph 1, an individual is a resident of both Contracting States. A series of tie-breaker rules are provided in the above Paragraph to determine single state of residence for an individual.*

(i) The first test is based on where the individual has a ***permanent home****. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time. Any place taken for a short duration of stay or for temporary purpose, may be for reasons such as short business travel, educational purpose or a short holiday etc. is not regarded as a permanent home.*

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his ***personal and economic relations are closer****, in other words, the place where lies his centre of vital interests. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.*

(iii) Sub-paragraph (b) establishes a secondary criterion for two quite distinct and different situations:

- *The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;*
- *The case where the individual has a permanent home available to him in neither Contracting State.*

In the aforesaid scenarios, preference is given to the Contracting State where the

Para	OECD Model Convention 2017	UN Model Convention 2017
	individual has a ***habitual abode****.* *Habitual abode refers to the frequency, duration, regularity of stays that are part of settled routine of an individual life and are therefore more than transient. In this case, all stays made in a State must be considered without it being necessary to ascertain the reasons for them.*	
(iv)	*If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is* ***a national****.*	
(v)	*If the individual is a national of both or neither of the Contracting States, the matter is left* ***to be considered by the competent authorities*** *of the respective Contracting States under the Mutual Agreement Procedure (Article 25).*	
3	Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.	

Note – *Paragraph 3 of the OECD and UN MC concerns companies and other bodies of persons, other than individuals. The situation of dual residence may arise in case of companies and other non-corporate bodies in case where one Contracting State attaches importance to the place of incorporation and the other State to the place of effective management.*

Case by Case approach - *Until 2017, the sole tie-breaker rule for resolving double taxation disputes was place of effective management. In 2017, the Committee on Fiscal Affairs recommended a change to case by case approach considering the number of tax avoidance cases involving dual resident companies. Determination under the case by case approach will be requested by the concerned taxpayer through Article 25 (Mutual Agreement Procedure).*

Factors to be taken into account during the MAP proceedings - *Competent authorities would be expected to take account of various factors, such as, where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc.*

Entitlement to treaty relief in case of a dual resident person - *The last sentence of paragraph 3 provides that in the absence of a determination by the competent authorities, the*

Para	OECD Model Convention 2017	UN Model Convention 2017
	dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person.	

ART 5	PERMANENT ESTABLISHMENT

The Concept of “Permanent Establishment” (PE) is defined in Article 5 of tax treaties. This expression is invariably used in all tax treaties. It has considerable importance as Article 7 mandates that business profits of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE. If the existence of a PE is proven in Source State, then, that State can only tax such profits of the enterprise to the extent that the profits are attributable to the PE.

In this Article, the jurisdiction or country of residence of the person is referred to as the Resident State (or State R) and the jurisdiction or country where the PE is located is referred to as the Source State (or State S).

The definition of PE is significant for several Articles. The term “Fixed base” in Article 14 (Independent Personal Services) of UN Model Convention can be understood by reference to the term “permanent establishment”. Articles 10, 11, 12 (in both OECD and UN MC) and Article 12A (in UN MC) dealing with dividends, interest, royalties and fees for technical services, respectively, provide for reduced rates of tax at sources on payments of these items of income to a resident of the Residence State when income is **not** effectively connected to a PE in Source State. The concept of PE is also relevant in determining which Contracting State may tax certain gain under Article 13 (Capital gains) and certain “Other Income” under Article 21.

In order to decide whether a PE is constituted, one has to undertake a functional and factual analysis of each of the activities undertaken by the establishment. Further, while deciding whether a PE exists or not, Article 5 has to be read as a whole.

PE under Income-tax Act, 1961

As per Section 92F(iiia), "Permanent establishment” includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

The comparable term to PE under the Indian tax law is "business connection" [Section 9(1)(i)]. There exists a distinction between a "business connection" and a PE. Generally speaking, the concept of "business connection" is wider than PE and hence, a business connection may exist even without a PE, but the absence of a "business connection" may indicate absence of a PE.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.	

<table>
<tr><th>Para</th><th>OECD Model Convention 2017</th><th>UN Model Convention 2017</th></tr>
<tr><td colspan="3">Note - 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.
Paraphrasing Article 5(1), 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.
A PE does not exist unless all the aforesaid conditions are satisfied.</td></tr>
<tr><td>2</td><td colspan="2">The term "permanent establishment" includes especially:
a) a place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop, and
f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.</td></tr>
<tr><td colspan="3">Note - Article 5(2) provides a list of specific inclusions which may constitute a PE e.g. an office, workshop, place of management.
The common thread in all these examples is that an enterprise can carry on business in Source State through these establishments. Since Article 5(2) only provides a list of inclusions, accordingly, what is not included in Article 5(2) is not automatically excluded from Article 5(1).</td></tr>
<tr><td>3</td><td>A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.</td><td>The term "permanent establishment" also encompasses:
(a) A building site, <u>a</u> construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than <u>six months;</u>
(b) The furnishing of services, including consultancy services, by an</td></tr>
</table>

Para	OECD Model Convention 2017	UN Model Convention 2017
		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-month period commencing or ending in the fiscal year concerned.

Note - *Article 5(3) of the OECD MC differs from Article 5(3)(a) of the UN MC on the following points:*

- *The OECD MC does not specifically mention "assembly projects" and "supervisory activities" in connection with building sites, construction, assembly or installation projects. Further, the threshold time in OECD Model is 12 months vis-à-vis 6 months in the UN MC.*
- *Article 5(3)(b) of the UN Model makes a specific reference to the Service PE which is absent in the OECD MC.*

Article 5(3)(b) of the UN MC deals with the furnishing of services, including consultancy services, the performance of which does not, by itself, create a PE in the OECD MC. In the absence of provision for Service PE in OECD MC, the presence has to be ascertained in accordance with the principles of Article 5(1). Article 5(3)(b) of UN MC provides that if a non-resident provides services in a country for more than 183 days, the non-resident's involvement in the commercial life of that country clearly justifies the country taxing the income from those services whether the services are provided for one project or multiple projects. The degree of the non-resident's involvement in the source country's economy is the same, regardless of the number of projects involved.

Para	OECD Model Convention 2017	UN Model Convention 2017
4	Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed **not** to include:	
(a)	The use of facilities solely for the purpose of **storage, display or delivery** of goods or merchandise belonging to the enterprise;	The use of facilities solely for the purpose of ***storage or display*** of goods or merchandise belonging to the enterprise;

Note – *This paragraph lists a number of business activities which are treated as exceptions to the general definition of PE laid down in paragraph 1 and which are not sufficient to constitute a PE. The final part of the paragraph [i.e., after sub-clause (f)] provides that* ***these exceptions only apply if the listed activities have a preparatory or auxiliary character.***

Article 5(4)(a) of the UN MC, applies to the use of facilities by an enterprise for storage or display of goods or merchandise belonging to it.

Para	OECD Model Convention 2017	UN Model Convention 2017
Unlike the OECD Model, Article 5(4)(a) of the UN Model does not include "delivery" and restricts sub-paragraph (a) to "storage" or "display". The word "delivery" is absent in the UN Model because stocking of goods in State S for ensuring quick delivery to the customers facilitates sales of the products and thereby earning of profit in State S. Consequently, a warehouse used for "delivery" could be a PE under the UN Model. However, income attributable to such activity may not be significant.		
(b)	The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of **storage, display or delivery;**	The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of ***storage or display***;
Note – *Article 5(4)(b) of the UN MC, relates to the stock of goods or merchandise and provides that maintenance of such stock shall not be treated as a PE if it is maintained solely for the purpose of storage or display for the enterprise. Unlike the OECD MC, sub-para (b) of Article 5(4) of the* ***UN MC does not include "delivery"*** *and restricts the maintenance of stock of goods or merchandise for the purpose of "storage" or "display", to qualify as an exception to the definition of PE. Hence, again the definition of PE under UN MC is wider than under OECD MC displaying a preference to Source State jurisdiction.*		
(c)	The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;	
Note – *This paragraph provides that a PE is not constituted when a stock of goods or merchandise belonging to a foreign enterprise is maintained solely for processing by another enterprise in Source State.*		
(d)	The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;	
Note – *The first part of sub-paragraph (d) relates to the case where premises are used solely for the purpose of purchasing goods or merchandise for the enterprise and the second part of sub-paragraph (d) relates to a fixed place of business that is used solely to collect information for the enterprise. An enterprise will frequently need to collect information before deciding whether and how to carry on its core business activities in a State. If a fixed place of business is maintained solely for that purpose, a PE is not constituted.*		
(e)	The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;	
Note – *"Any other activity" referred to in sub-clause (e) should be of preparatory or auxiliary character, if the maintenance of a fixed place of business solely for the purpose of carrying on such activity is to be excluded from the definition of PE.*		

Para	OECD Model Convention 2017	UN Model Convention 2017

Fixed place of business

In a recent Supreme Court case[4] the Court relied on renowned international tax expert Philip Baker's views to explain that a PE must have three characteristics: stability, productivity and dependence. In order to ascertain whether an establishment has a fixed place of business, such physically located premises has to be "at the disposal" of the enterprise. The Supreme Court used these tests to hold that the formula one racing circuit which was at the disposal of a non-resident, FOWC, was a fixed place of business from where FOWC's economic activity was carried out. The number of days for which FOWC had access would not make any difference.

Project Office

There is a view that a project office set up by a non-resident in India primarily as a support office for the purpose of facilitating the performance of a contract, falls within the purview of Article 5(4)(e). In National Petroleum Construction Company v DIT (2016) 383 ITR 648 (AAR) (Delhi-HC), the AAR held that a project office only used as a communication channel and not for execution of contracts by an assessee engaged in fabrication and installation of petroleum platforms, would qualify as an auxiliary activity not constituting a PE. The determination, thus, depends on the overall facts of each case.

Liaison office

There is a divergence of views regarding liaison offices constituting a PE:

- *In UAE Exchange Centre LLC, In re, the AAR[5] held that an Indian liaison office of a foreign enterprise engaged in remittance services, performs an essential activity and thus, falls outside Article 5(4)(e) when such liaison office downloads information (such as names and addresses of beneficiaries, amount to be remitted, etc), prints cheques/ draft and dispatches them to the addresses of beneficiaries through courier. In certain other cases[6] it was held that the liaison/ representative office was not a PE. Where no violation was reported by the RBI, the activities of the liaison office were presumed to be of preparatory and auxiliary character[7].*
- *Identifying new customers, marketing activities, price negotiation, discussion of commercial issues, securing and processing orders have led to the liaison office forming a PE[8]. Courts have observed that merely because the Head Office received orders and payments directly from the buyers and also sent goods to them directly, would not mean that only liaison work was done by the liaison office. However, receiving information, enquiries and feedback for passing it on to the Head Office and co-ordination activities*

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4 *Formula One World Championship Ltd. v. Commissioner of Income-tax (International Taxation) [2017] 394 ITR 80 (SC)*

5 *(2004) 268 ITR 9 AAR.*

6 *Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP HC), Motorola Inc. (2005) 95 ITD 269 (Del ITAT)SB)*

7 *Metal One Corpn (2012) 52 SOT 304 (Del ITAT)*

8 Jebon Corporation India v CIT (2012) 206 Taxman 7 (Kar HC), Brown And Sharpe Inc v CIT (2014) 369 ITR 704 (All HC),

Para	OECD Model Convention 2017	UN Model Convention 2017
have been held as preparatory in nature. • *In the case of GE Energy Parts Inc[9], the Delhi Tribunal held that as the activities carried out were substantial and core, the liaison office of one of the group entity was a fixed place PE of the assessee as well as of other overseas entities in the group for which such activities were carried out.* *The fact whether a liaison office constitutes a PE will, thus, have to be examined based on facts and circumstances of each case and it cannot be presumed that a liaison office will always be excluded from the purview of Article 5.* ***Advertising activity*** *There is no PE in Source State when a fixed place of business engages solely in promotional advertising for the goods manufactured by the foreign enterprise.*		
(f)	The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that such activity or, in the case of subparagraph (f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.	
Note – *This paragraph provides that where a fixed place of business combines any of the activities mentioned in sub-paragraphs (a) to (e) that, by itself, does not lead to a conclusion that a PE exists. As long as the combined effect of the overall activity of such fixed place of business is preparatory or auxiliary, a PE should not be deemed to exist.* *The terms "preparatory" and "auxiliary" have not been defined in the Convention. The OECD MC mentions that it is often difficult to distinguish between the activities which are "preparatory or auxiliary" in character and those which are not. The facts of each case have to be individually examined. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole.* *As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a*		

[9](2017) 184 TTJ 570 (Del ITAT)

<table>
<tr><th>Para</th><th>OECD Model Convention 2017</th><th>UN Model Convention 2017</th></tr>
<tr><td colspan="3">whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.
Whether an activity has preparatory or auxiliary character should not be interpreted rigidly and ought to be considered in light of the facts and circumstances. However, enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each part is merely engaged in a preparatory or auxiliary activity.</td></tr>
<tr><td>4.1</td><td colspan="2">Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and:
(a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or
(b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,
provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.</td></tr>
<tr><td colspan="3">Note - Paragraph 4.1 is an anti-fragmentation rule. The purpose of this new paragraph 4.1 is to prevent an enterprise from fragmenting its activities (either within the enterprise or between closely related enterprises) in order to qualify for the specific activity exemptions in paragraph 4 of Article 5.
Example: RCO, a bank resident of State R, has a number of branches in State S which constitute PEs. It also has a separate office in State S where a few employees verify information provided by clients that have made loan applications. The verifications done by the employees are forwarded to the headquarters in State R where other employees analyse the information included in the loan applications and provide reports to the branches where the decisions to grant the loans are made. In that case, the exceptions of paragraph 4 will not apply to the office because another place (i.e. any of the other branches where the loan applications are made) constitutes a PE of RCO in State S and the business activities carried on by RCO at the office and at the relevant branch constitute complementary functions that are part of a cohesive business operation (i.e. providing loans to clients in State S).</td></tr>
<tr><td>5</td><td>Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes</td><td>Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph <u>7</u>, where a person is acting in a Contracting State on behalf of an enterprise, that enterprise shall be deemed to have a permanent</td></tr>
</table>

Para	OECD Model Convention 2017	UN Model Convention 2017
	contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are a) in the name of the enterprise, or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c) for the provision of services by that enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.	establishment in that State in respect of any activities which that person undertakes for the enterprise, if such a person: (a) habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are (i) in the name of the enterprise, or (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or (iii) for the provision of services by that enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or ***(b) the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise.***
- / 6		***Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, 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.***

Para	OECD Model Convention 2017	UN Model Convention 2017
Note - *The UN MC has additional Article 5(6) relating to insurance which is absent in OECD MC. As per this paragraph, insurance companies of a State (except with regard to re-insurance) are deemed to have a PE in the other State if they collect premiums in that other State through an agent established there (other than an agent who already constitutes a PE by virtue of paragraph 5) or insure risks situated in that territory through such an agent.* *However, if an insurance agent is independent, then, the enterprise would not be deemed to have a PE and the profits of the insurance company attributable to his activities would not taxable in the Source State.* *In the absence of similar Article in the OECD MC, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD MC.*		
6 / 7	Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.	Paragraphs 5 ***and 6*** shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.
Note - ***Agency PE : Dependent agent PE*** *Article 5(5) of the OECD/UN Model refers to what is popularly known as "Agency PE". It contains a deemed inclusion clause and commences with a non-obstante clause overriding Article 5(1)/(2). Accordingly, a foreign enterprise may be treated as having an Agency PE in Source State even though it may not satisfy all the tests in Article 5(1) (such as not having a fixed place of business at its disposal in State of Source within the meaning of Article 5(1) and 5(2), or not satisfying the time threshold of six or twelve months, as the case may be).* *Article 5(5) and Article 5(6)/(7) address the artificial avoidance of PE status through commissionaire arrangements and similar strategies.* *Articles 5(5) and 5(6) of the OECD MC and Articles 5(5), 5(6) and 5(7) of the UN MC must be read together. On such combined reading, the following two principles emerge:* • *Article 5(5) applies only to a case where the person, who acts on behalf of a non-resident, is not an agent of independent status within the meaning of Article 5(6) of OECD Model or*		

Para	OECD Model Convention 2017	UN Model Convention 2017
	Article 5(7) of UN Model. • *Even when an agent fails to come up to the standard of independence mentioned in Article 5(6)/(7), the issue regarding PE is not closed but has to be resolved in terms of Article 5(5). In other words, a dependent agent does not automatically constitute a PE for its principal unless it (agent) satisfies the requirements of Article 5(5).* *For paragraph 5 of Article 5 to apply, all the following conditions must be met:* *(i) a person acts in a Contracting State on behalf of an enterprise;* *(ii) in doing so, that person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and* *(iii) these contracts are either in the name of the enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.* *(iv) the person is not be an independent agent to whom Article 5(6)/(7) applies',* *(v) activities performed by such person are not limited to those mentioned in Article 5(4)* *UN MC has an additional subparagraph (b) in Article 5(5), relating to the maintenance of a stock of goods which is broader in scope than the OECD MC. It is interpreted that if sales-related activities (for example, advertising or promotion) including delivery are conducted in Source State on behalf of the resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, then a PE may exist.* ***Test to determine Agent's Independence*** *Article 5(6) of the OECD and 5(7) of the UN MC are identical.* • *An agent is independent if it acts for the enterprise in its ordinary course of business.* • *A person is not considered to be an independent agent where the person acts exclusively or almost exclusively for one or more enterprises to which it is closely related.* ***Article 5(5) and 5(1) & (2)*** *If a dependent agent works at the fixed place of business of its non-resident principal in State of Source, a PE of the principal may exist under Article 5(1) and (2), even if the agent is not authorised to conclude contracts. In other words, if the principal has a PE within the meaning of Article 5(1) and (2) from where the agent works, it is not necessary to show that the agent would fall under Article 5(5).*	
7 / 8	The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.	
	Note - *Article 5(7) of the OECD MC is identical to Article 5(8) of the UN MC. This paragraph of Article 5 clarifies that a company of Residence State is not deemed to have a PE in Source State merely because it controls, or is controlled by, a company that is a resident of Source*	

Para	OECD Model Convention 2017	UN Model Convention 2017
	State. The determination of whether a company is a PE of a related company or not is to be made solely on the basis of the requirements under the other paragraphs of Article 5 and the mere existence or possibility of existence of close relationships is not sufficient to constitute a PE[10]. Hence, the existence of a subsidiary does not, by itself, make that subsidiary company a PE of its parent nor is a PE constituted on account of identical shareholding. *Likewise, since each company constitutes an independent legal entity, the mere fact that the subsidiary company is managed by its parent or that the parent exercises strict control over activities of its subsidiary and desires stringent financial reporting, does not make the subsidiary a PE of the parent.*	
8 / 9	For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.	
	Note – *Paragraph 8 of the OECD MC is identical to Paragraph 9 of the UN MC. This para explains the meaning of the concept of a "person closely related to an enterprise" for the purpose of the Article. That concept is to be distinguished from the concept of "associated enterprises" used for Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.* *This paragraph is divided into two parts. The first part includes the general definition. It provides that a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises; and the second part provides certain circumstances in which the definition of "person closely related to an enterprise" is automatically satisfied.*	

ART 7 BUSINESS PROFITS

This Article provides for the situation when business profits of a non-resident would be taxable in the Source State and also lay down the criteria and extent of deduction of expenses. The business profits would be taxable only when the non-resident has a PE as per Article 5 in the Source State.

[10] *DIT v E-Funds IT Solution (2014) 364 ITR 256 (Del HC), Adobe Systems Incorporated v ADIT (2017) 292 CTR 407 (Del HC)*

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits **that are attributable to the permanent establishment in accordance with the provision of paragraph 2** may be taxed in that other state**.**	***The*** profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits ***of the enterprise*** may be taxed in the other State ***but only so much of them as is*** attributable to ***(a)*** that permanent establishment; ***(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.***

Note - *Article 7(1) of the OECD Model does not incorporate the "Force of Attraction" rule, which is incorporated in UN Model.*

Article 7(1) of the UN Model provides as follows:

- *Source State can tax the profits of an enterprise of State of Residence only if:*
  - *the enterprise carries on business in Source State; and*
  - *such business is carried on through a PE in that Source State.*
- *If the above conditions are not fulfilled, the profits can be taxed only in State of Residence. However, if both the conditions are fulfilled, State of Source can tax only so much of the profits of the enterprise as are attributable to:*
  - *the PE [Article 7(1)(a)];*
  - *sales in Source State of same or similar goods or merchandise as those sold through that PE [Force of Attraction (FOA) Rule, Article 7(1)(b)]; or*
  - *other business activities carried on in Source State of the same or similar kind as those effected through that PE. [FOA Rule, Article 7(1)(c)].*

Under the OECD MC, only profits attributable to the PE may be taxed in the Source State. The UN MC amplifies this attribution principle by a limited FOA rule, which permits Source State taxation of the enterprise, not only in respect of the business carried on by it through a PE in the Source State, but also on business profits arising from certain other transactions by the enterprise in the Source State, which are not through the PE.

The aforesaid FOA is limited to business profits covered by Article 7 and do not apply to income from capital i.e., Article 10 (Dividends), 11 (Interest) or 12 (royalties) which can be taxed under these articles even in the absence of a PE.

Para	OECD Model Convention 2017	UN Model Convention 2017
Business profits not attributable to a PE cannot be taxed in Source State except under FOA rule in Article 7(1)(b) and (c) as per UN Model. ***Force of Attraction (FOA) Rule*** *The FOA rule implies that when a foreign enterprise sets up a PE in the Source State, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that all profits that the enterprise derives from Source State, whether through the PE or not, can be taxed by it (Source State).* ***Example:*** *To illustrate, consider the case of a sale of jeeps in Source State through a showroom in that State. If the enterprise also sells jeeps directly to some customers, i.e. not through the showroom, by way of, say, direct exports from outside the State of Source to a bulk customer in the Source State, then, the profits arising on such bulk sale would also be attributed to the PE and would be treated as profits arising from the PE, under the FOA principle.* *Further, due to deletion of Article 14 in the OECD [which continues to remain in UN MC], income derived from furnishing of independent personnel services falls under Article 7 of the OECD MC.*		
2	**For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise,** if it were a separate and **independent** enterprise engaged in the same or similar activities under the same or similar conditions, **taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.**	***Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make*** if it were a ***distinct*** and separate enterprise engaged in the same or similar activities under the same or similar conditions ***and dealing wholly independently with the enterprise of which it is a permanent establishment.***
Note - *Article 7(2) of OECD and UN Models advocate a distinct and separate entity approach for attribution of profits to a PE with difference in language. It is a machinery provision, which provides the methodology for computation of profits of the PE.* *In addition, Article 7(2) of the OECD Model makes a reference to FAR Analysis [Functions, Assets and Risks] in attributing profits, which is absent in Article 7(2) of the UN Model.* *In simple words, the Article 7(2) of the UN Model provides that profits attributable to PE should*		

Para	OECD Model Convention 2017	UN Model Convention 2017
be computed after making the following assumptions: • The PE is a separate and distinct enterprise. • It is engaged in the "same or similar" activities as that of the foreign enterprise of which it is a PE. • It is operating under the same or similar conditions as that of the foreign enterprise of which it is a PE. • It was dealing wholly and independently with the foreign enterprise of which it is a PE.		
- / 3	-	***In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for***

Para	OECD Model Convention 2017	UN Model Convention 2017
		management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

Note – *Article 7(3) of the UN MC relating to deduction of expenses, is absent in OECD MC.*

The basic principle behind paragraph 3 is that profits and gains of the business would be worked out by deducting all expenses related to the business activity, other than capital expenditures which are currently not deductible or expenses of a personal or non-business nature which cannot be attributed to the business of the enterprise. The objective is to ensure that the expenditure claimed as a deduction in determining the taxable profits is relevant, referable and necessary for carrying out the business operations.

Paraphrasing Article 7(3) of the UN MC:

(i) Expenses

- a. *All expenses incurred for the purposes of the business of the PE shall be allowed as a deduction, in determining profits of a PE.*
- b. *Such expenses include executive and general administrative expenses.*
- c. *Such expenses could be incurred within or outside the State in which the PE is situated (Source State).*
- d. *In case of a banking enterprise, such expenses would include interest on moneys lent by the head office or other offices to the PE.*
- e. *Such expenses would include reimbursement by the PE of actual expenses incurred by the head office or other offices.*
- f. *Subject to (d) and (e) above, no deduction shall be allowed in respect of amounts paid by the PE to the head office or other offices by way of:*
    - *royalties, fees or similar payments in return for use of patents and use of other rights;*
    - *commission for specific services performed or for management;*
    - *interest on moneys lent to the PE (in case of non-banking enterprise).*

(ii) Receipts

- a. *In case of a banking enterprise, receipts of PE would include interest on moneys lent by the PE to the head office or other offices.*
- b. *Receipts of the business shall include reimbursement to a PE by the head office or other offices.*
- c. *Subject to (a) and (b) above, receipts of PE would not include amounts paid to the PE by the head office or other offices by way of:*
    - *royalties, fees or similar payments in return for use of patents and use of other rights;*
    - *commission for specific services performed or for management;*
    - *interest on moneys lent to the head office or other offices (in case of non-banking enterprise).*

Para	OECD Model Convention 2017	UN Model Convention 2017
3 / -	**Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.**	-

Note - *Article 7(3) of the OECD Model is absent in UN MC which provides for adjustment in the tax charged on the profits attributable to the PE in other Contracting State to eliminate double taxation on such profits, where one State makes an adjustment in conformity with Article 7(2).*

Example*: A manufacturing plant located in State R of an enterprise of State R has transferred goods for sale to a PE of the enterprise situated in State S. For the purpose of determining the profits attributable to the PE under Article 7(2), a notional arm's length price must be determined for that dealing. The enterprise's documentation shows a notional price of Rs.90 has been used to determine the profits attributable to the PE. State S accepts the price used by the enterprise but State R considers that the amount is low and the arm's length price that should have been Rs.110 and adjusts the amount of tax payable in State R accordingly after reducing the amount of exemption or the credit claimed with respect to the profits attributable to the PE.*

In that situation, since the price of the same dealing will have been determined as Rs.90 in State S and Rs.110 in State R, profits of Rs.20 may be subject to double taxation. Paragraph 3 requires State S to provide a corresponding adjustment to the tax payable in State S on the profits that are taxed in both States, to the extent that there is indeed double taxation and that the adjustment made by State R is in conformity with Article 7(2).

If State S does not agree that the adjustment made by State R was warranted by Article 7(2), it will not make the adjustment and the issue will be solved under a mutual agreement procedure under Article 25.

Para	OECD Model Convention 2017	UN Model Convention 2017
- / 4	-	***In so far as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.***

Note - *Article 7(4) of the UN MC relating to determination of the profits to be attributed to a PE on the basis of an apportionment of the total profits of the enterprise to its various parts, is absent in the OECD MC .*

Paraphrasing, profits can be attributed to the PE by apportionment of the total profits of the enterprise to its various parts, provided:

- *it is customary in Source State to determine the profits in such a manner;*
- *the method of apportionment adopted is such that the result is in accordance with the principles in Article 7.*

Article 7(4) determines the profits to be attributed to a PE by apportioning the total profits of the enterprise on the basis of various formulae. It is a machinery provision and not a charging provision. The underlying principle of Article 7(4) is that all parts of an enterprise contribute to its profitability and such contribution can be determined on the basis of the adopted criteria.

Article 7(4) prescribes a method different from that in Article 7(2), since, unlike Article 7(2), it does not contemplate an attribution of profits on a separate enterprise footing. It is not as scientific a method as under Article 7(2). Hence, Article 7(4) might produce a result which is different from that produced by applying Article 7(2) and hence, should be used only where it has been customarily used in the past and accepted both by the tax authorities and taxpayers as being satisfactory.

Para	OECD Model Convention 2017	UN Model Convention 2017
- / 5	-	***For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.***

Para	OECD Model Convention 2017	UN Model Convention 2017
***Note -** Article 7(5) of the UN Model relating to use of same method for attribution of profits to a PE year by year unless there is good and sufficient reason to the contrary, is absent in OECD Model.*		
4 / 6	Where profits include items of income which are dealt with separately in other Articles of this Convention, then, the provisions of those Articles shall not be affected by the provisions of this Article.	
***Note -** Article 7(4) of OECD Model is identical to the Article 7(6) of UN Model, which provides that the articles dealing with specific categories of income (e.g., dividends, interest, royalties, etc.) override the provisions of Article 7, unless such articles state otherwise. Even otherwise, it is a well-settled principle that a specific provision overrides a general one. Hence, dividends, interest, royalties, etc. are taxable under Article 10 to 12 even if they are earned in the course of business. Thus, Article 7 applies to industrial and commercial income which does not belong to categories of income covered by the special articles.*		

ART 11	INTEREST

This Article provides the right to both the countries in respect of taxation of interest. Generally, interest is taxed in the Source State at a given rate on gross basis. Thereafter, such income may be taxable in the Residence State with credit for taxes paid in the Source State.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.	
***Note -** Article 11(1) of the OECD and UN MC provides that the Residence State can always tax the income unless a tax treaty prohibits it. Even without this clause, the Residence State could tax interest. The two important phrases used in this article are "paid" and "may be taxed".* *The term "paid" should not be restricted to physical payment in cash as it might include performance in kind or set off amounts. The term "may be taxed" gives right to the Residence State to tax the interest income. In doing so, it does not stipulate an exclusive right to tax in favour of the Residence State.*		
2	However, **interest arising in a Contracting State** may also be taxed in **that State** according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not	However, ***such interest*** may also be taxed in ***the Contracting State in which it arises and*** according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent ***(the percentage is to be established***

Para	OECD Model Convention 2017	UN Model Convention 2017
	exceed **10 per cent** of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.	***through bilateral negotiations)*** of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

***Note** - Article 11(2) of the OECD MC differs from Article 11(2) of the UN MC to the extent that it provides that the tax in Source State "shall not exceed 10% of the gross amount of interest", whereas the UN MC leaves this percentage to be established through bilateral negotiations. Article 11(2) provides to the Source State, a limited right to tax interest as per its domestic laws at concessional rate.*

Thus, it may be seen that interest is taxed in both the States, the Source State as well as the Residence State. The benefit of concessional tax rate is given subject to fulfilment of certain conditions. Accordingly, the recipient of interest should be:

a) the beneficial owner of interest; and

b) a resident of other country.

Para	OECD Model Convention 2017 / UN Model Convention 2017
3	The term "interest" as used in this Article 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 shall not be regarded as interest for the purpose of this Article.

***Note** – Article 11(3) provides for an exhaustive definition of interest. It nevertheless remains understood that, in a bilateral convention, two Contracting States may widen the formula employed so as to include in it, any income which is taxed as interest under either of their domestic laws but which is not covered by the definition.*

The definition of interest in the first sentence of paragraph 3 does not normally apply to payments made under certain kinds of non-traditional financial instruments where there is no underlying debt (for example, interest rate swaps). However, the definition will apply to the extent that a loan is considered to exist under a "substance over form" rule, an "abuse of rights" principle, or any similar doctrine.

The second sentence of Paragraph 3, excludes from the definition of interest, penalty charges for late payment but Contracting States are free to omit this sentence and treat penalty charges as interest in their bilateral convention.

Para	OECD Model Convention 2017	UN Model Convention 2017
4	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest

Para	OECD Model Convention 2017	UN Model Convention 2017
	Contracting State in which the interest arises through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	arises, through a permanent establishment situated therein, ***or performs in that other State independent personal services from a fixed base situated therein***, and the debt-claim in respect of which the interest is paid is effectively connected with ***(a)*** such permanent establishment ***<u>or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7.</u>*** In such ***<u>cases</u>*** the provisions of article 7 ***or article 14, <u>as the case may be,</u>*** shall apply.
Note – *Article 11(4) of OECD MC is similar to provisions of UN MC, with two modifications. First, the UN MC refers to a fixed base as well as a PE. Second, since UN Model, unlike OECD Model, adopts a limited force of attraction rule (FOA), it applies if the debt-claim, on which the interest is paid, is effectively connected with the PE or fixed base or with business activities in the Source State of the same or similar kind as those effected through the PE.* *Article 11(4) states that Article 11 (1) & (2) will not apply if the beneficial owner of the interest i.e. the lender has a PE in the interest source state which carries on business and debt claim is effectively connected with that Source State PE. In such a case, Article 7 – Business Profits or Article 14 - Independent Personal Services (in case of UN Model) will apply.* ***Example:*** *Citibank, USA has a branch in India. A Ltd, an Indian Co., has taken a loan from Citibank, India branch and is paying interest to it. This interest shall be taxable as business profits as per Article 7 in the hands of Citibank, USA in India as it is effectively connected with the PE in India.*		
5	Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.	Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment ***or a fixed base*** in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment ***or fixed base***, then such interest shall be deemed to arise in the State in which the permanent establishment ***or fixed base*** is situated.

Para	OECD Model Convention 2017	UN Model Convention 2017
Note - *Article 11(5) of the OECD MC does not differ from Article 11(5) of the UN MC, except that the OECD MC does not refer to a 'fixed base'.* *Article 11(5) lays down the principle that the Source State of interest is the State of which the payer of the interest is a resident. However, it also provides an exception to this rule in the case of interest-bearing loans which have an economic link with the PE owned in the other Contracting States, by the payer of the interest. If the loan was contracted for the requirements of that establishment and the interest is borne by the latter, then, the source of interest is in the Contracting State in which the PE or fixed base (in case of UN Model) is situated irrespective of the place of residence of the owner of the PE/fixed base even when he resides in neither of the Contracting States. The existence of the nexus between the indebtedness and the needs of the PE/fixed base is the essential requirement for holding the state of location of PE/fixed base as the source of interest. The absence of the nexus will render this rule inapplicable.* ***Example:*** *There is a UK Co. which has taken loan from a US Co. The UK Co. has a branch (which constitutes a PE) in India. The loan taken from US Co. is for the branch in India. Interest is paid by the UK Co. to the US Co. which is ultimately borne by the branch in India. Therefore, in such a case, the interest arises in the State in which the PE is located i.e. India and hence India-US tax treaty will apply.*		
6	Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.	
Note - *This rule will operate where a special relationship prevails between the payer of interest and beneficial owner of the interest and the amount of the interest paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length. Therefore, benefit of Article 11 for lower tax rates applies only to the arms' length interest.* ***Examples of special relationship*** *a) an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him* *b) relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of interest.*		

ART 12	ROYALTIES

This Article provides the right to Contracting States to tax income from royalty. Generally, the right to tax are shared by both the countries. However, OECD MC lays down the principle of exclusive taxation of royalties in the State of beneficial owner's residence with some exception. UN MC provides a separate Article to cover income from fees for technical services. However, in some treaties, Article 12 also covers fees from technical services. In case these are not covered under Article 12, they may be taxable as business profits under Article 7 or as other income under Article 21.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Royalties arising in a Contracting State and **beneficially owned by** a resident of the other Contracting State **shall be taxable only** in that other State.	Royalties arising in a Contracting State and paid to a resident of the other Contracting State ***may be taxed*** in that other State.
- / 2	-	***However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.***
Note - *As per Article 12(1) of the OECD MC, royalties arising in Source State and beneficially owned by resident of the Residence State are taxable only in Residence State. However, the UN MC omits the word "only" and provides that royalties may be taxed in the Residence State. Article 12(2) of UN MC is an addition flowing logically from the premise underlying Article 12(1), which is that royalties may be taxable in the Source State as well as Residence State. Hence, the UN MC departs from the principle of exclusive right to tax provided to Residence State in the OECD MC. However, the benefit of concessional tax rate in Source State in UN MC is given subject to fulfilment of certain conditions. Accordingly, the recipient of royalty should be:* *a) the beneficial owner of royalty; and* *b) a resident of other Country.* *A provision corresponding to Article 12(2) of the UN MC is absent in the OECD MC, since the OECD MC does not allow sharing of taxing rights by Contracting States. However, the OECD MC requires that the royalties should be beneficially owned by a resident of the Residence State.*		
2 / 3	The term "royalties" as used in this Article means payments of any kind received as a	The term "royalties" as used in this article means payments of any kind received as a consideration for the use of, or the right to use,

Para	OECD Model Convention 2017	UN Model Convention 2017
	consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.	any copyright of literary, artistic or scientific work including cinematograph films, ***or films or tapes used for radio or television broadcasting***, any patent, trade mark, design or model, plan, secret formula or process, or ***for the use of, or the right to use, industrial, commercial or scientific equipment*** or for information concerning industrial, commercial or scientific experience.

Note - *Article 12(2) of the OECD MC is identical to Article 12(3) of the UN MC except that the OECD MC does not include the following within the definition of "royalties":*

→ *Rentals for "films or tapes used for radio or television broadcasting";*

→ *Equipment rentals like rentals for industrial, commercial or scientific equipment.*

Such rentals would, therefore, be taxable under Article 7 (Business Profits) or 21 (Other Income) of the OECD MC.

Para	OECD Model Convention 2017	UN Model Convention 2017
3 / 4	The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	The provisions of paragraphs 1 ***and* 2** shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, ***or performs in that other State independent personal services from a fixed base situated therein,*** and the right or property in respect of which the royalties are paid is effectively connected with ***(a)*** such permanent establishment ***or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7.*** In such ***cases*** the provisions of article 7 ***or article 14, as the case may be,*** shall apply.

Note - *Article 12(3) of the OECD Model differs from Article 12(4) of the UN Model in the following two respects:*

→ *OECD MC does not provision reference of independent personnel services from a fixed base since OECD MC, now, does not have separate Article on Independent Personal Services ; and*

→ *It does not include reference to Article 7(1)(c) (Force of Attraction rule) since such a provision is present only in the UN MC.*

Article 12(3) of both the MCs states that the income will not be taxable as royalty under

Para	OECD Model Convention 2017	UN Model Convention 2017
paragraph 1 or 1 & 2, if the beneficial owner of the royalties has a PE in the Source State which carries on business and right or property is effectively connected with that PE in the Source State or with business activities in the Source State of the same or similar kind as those effected through the PE (in case of UN Model). In such a case, Article 7 – Business Profits or Article 14 - Independent Personal Services (in case of UN Model) will apply.		
- / 5	-	***Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.***
Note - *A provision corresponding to Article 12(5) of the UN MC is not present in Article 12 of the OECD MC since the latter does not confer right to tax to the Source State.* *Article 12(5) of the UN MC lays down the principle that the Source State in case of royalty is the State in which the payer of the royalty is a resident. However, an exception to this rule is provided in cases where the payer of royalty incurs a liability* ***in connection with*** *the PE/fixed base owned in other Contracting States. If the right or property was contracted for the requirements of PE/fixed base and the royalty is borne by such PE/fixed base, then, the source of royalty is in the Contracting State in which the PE/fixed base is situated irrespective of the place of residence of the owner of the PE/fixed base even when he resides in neither of the Contracting States. The existence of the nexus between the usage of property or right and the needs of the PE/fixed base is the essential requirement for holding the state of location of PE/fixed base as the source of royalty. The absence of the nexus will render this rule inapplicable.* ***Example****: There is an Australian Co. which has obtained right to manufacture cellular mobiles from a UN Co. The Australian Co. has a branch (which constitutes a PE) in India. The right obtained from UN Co. is for the branch in India. Royalty is paid by the Australian Co. to the UN Co. which is ultimately borne by the branch in India. Therefore, in such a case, the royalty shall be deemed to arise in the State in which the PE is located i.e., India and hence India-UN tax treaty will apply.*		
4 / 6	Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid,	

Para	OECD Model Convention 2017	UN Model Convention 2017
	exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.	

***Note** – This paragraph provides for adjustment of an amount which is in excess of what would be allowed under the arm's length principle. The purpose is to restrict the operation of the provisions concerning the taxation of royalties in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length. The excess part of the royalty shall remain taxable according to the laws of the two Contracting States due regard being had to the other provisions of the Convention.*

Examples of special relationship

a) an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him

b) relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the royalty.

ART 12A FEES FOR TECHNICAL SERVICES (UN MODEL CONVENTION)

Fees for Technical Services: In its 2017 update the UN MC has inserted a specific article (Article 12A) pertaining to FTS. In its absence, taxability of FTS has to be considered either under Article 7 or Article 14 or Article 21, depending upon the facts.

However, most Indian tax treaties have a specific provision for taxing FTS with common operating provisions, as for 'royalties'.

The newly inserted Article 12A in UN MC reads as follows:

Para	UN Model Convention 2017
1	Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

***Note** – Until the addition of Article 12A, income from services derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a PE (Article 7) or provided professional or independent personal services through a fixed base (Article 14) in the Source State. With the rapid changes in technology, it is now possible to operate in countries without a substantial physical presence. This*

<table>
<tr><th>Para</th><th>UN Model Convention 2017</th></tr>
<tr><td colspan="2">led to issues of tax avoidance, especially for developing countries who are disproportionately importers of services.

Article 12A(1) 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.</td></tr>
<tr><td>2</td><td>However, notwithstanding the provisions of Article 14 and subject to the provisions of Articles 8, 16 and 17, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ percent of the gross amount of the fees [the percentage to be established through bilateral negotiations].</td></tr>
<tr><td colspan="2">Note – Article 12A(2) lays down the principle that the Contracting State in which FTS arises may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the FTS arises should not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the payments</td></tr>
<tr><td>3</td><td>The term “fees for technical services” as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:
(a) to an employee of the person making the payment;
(b) for teaching in an educational institution or for teaching by an educational institution; or
(c) by an individual for services for the personal use of an individual.</td></tr>
<tr><td colspan="2">Note - The definition of “fees for technical services” in Article 12A(3) is exhaustive. “Fees for technical services” are limited to the payments described in Article 12A(3); other payments for services are not included in the definition and are not dealt with in Article 12A.

Definition - Article 12A(3) defines FTS as payments for managerial, technical or consultancy services. It also sets out specific exceptions such as payment for teaching in an educational institution, payments for services for personal use.

Meaning and scope of “Management” – It involves application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Payments made to a consultant for advice related to the management of an enterprise (or of the business of an enterprise) would be fees for technical services.

Meaning and scope of “Technical” – It involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Therefore, fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering would constitute FTS.</td></tr>
</table>

Para	UN Model Convention 2017
Meaning and scope of "Consultancy" - *The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature. Professionals usually provide advice or services that fit within the general meaning of consultancy services although; they may also constitute management or technical services.* *The terms "management," "technical" and "consultancy" do not have precise meanings and may overlap. Thus, for example, services of a technical nature may also be services of a consultancy nature and management services may also be considered to be services of a consultancy nature.*	
4	The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with: (a) such permanent establishment or fixed base, or (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply
Note - *Article 12A(4) is similar to the paragraph 4 of Articles 11 and 12; it provides that income will not be taxable as FTS under paragraphs 1 and 2 if beneficial owner of FTS has a PE or fixed base in the State in which the fees arise and the services rendered are effectively connected with such PE in Source State or with business activities in the Source State of the same or similar kind as those effected through the PE. In such a case, Article 7 – Business Profits or Article 14 - Independent Personal Services (in case of UN Model) will apply.*	
5	For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.
6	For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such fees are borne by that permanent establishment or fixed base.
Note - *Article 12A(5) lays down the principle that the State in which FTS arises is the State of which the payer of the fees is a resident or the State in which the payer has a PE or fixed base, if the FTS are borne by the PE or fixed base. The existence of the nexus between the technical services being*	

Para	UN Model Convention 2017
provided and the PE/fixed base is the essential requirement for holding the State of location of PE/fixed base as the source of FTS. The absence of the nexus will render this rule inapplicable. *Article 12A(5) is subject to Article 12A(6). Article 12A(6) deems FTS paid by a resident of a Contracting State not to arise in that State, in a case where that resident/the payer carries on business through a PE in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State or in a third State and the FTS is borne by that PE or fixed base.*	
7	Where, by reason of a special relationship between the payer and the beneficial owner of the fees for technical services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.
Note - *The purpose of Article 12A(7) is to restrict the operation of the provisions in cases where, by reason of a special relationship, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length.* ***Examples of special relationship*** *a) an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him* *b) relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the royalty*	

ART 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.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.	
Note - *On account of use of the word 'may', both the countries i.e. the Source State and the Residence State, have the right to tax the aforesaid income. The country of source is the*		

<table>
<tr><th>Para</th><th>OECD Model Convention 2017</th><th>UN Model Convention 2017</th></tr>
<tr><td colspan="3">country in which the immovable property is physically located. If such income is taxed in the Source State, the State of Residence will either grant credit for taxes paid in Source State or exempt such income in accordance with Article 23 of the tax treaty.

Meaning of "immovable property" - The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall, in any case, include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall <u>not</u> be regarded as immovable property [Article 6(2) of the UN and OECD Model].

Coverage of the phrase "alienation of property" - This Article does not give a detailed definition of capital gains. The words "alienation of property" is used to cover, in particular, capital gains resulting from the sale or exchange of property and also from a partial alienation, the expropriation (compulsory acquisition by the Government), the transfer to a company in exchange for stock, the sale of a right, the gift and even the passing of property on death.

Manner of computation of capital gain not specified - This Article does not specify how to compute a capital gain, this being left to the domestic law applicable.</td></tr>
<tr><td>2</td><td>Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.</td><td>Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.</td></tr>
<tr><td colspan="3">Note - Article 13(2) of the OECD MC and UN MC are similar, except that the OECD MC does not refer to provision of independent personnel services from a fixed base. The said reference is absent on account of deletion of Article 14 from OECD MC i.e. Provision of Independent Personnel Services.

Taxation of gains from alienation of movable property - Article 13(2) deals with movable property forming part of the business property of a permanent establishment of an enterprise (both OECD and UN MC) or pertaining to a fixed base (in the case of UN MC) used for performing independent personal services. Gains from the alienation of such assets may be</td></tr>
</table>

Para	OECD Model Convention 2017	UN Model Convention 2017
taxed in the State in which the PE (both OECD and UN MC) or fixed base (in case of UN MC) is situated. ***Meaning of "movable property" -****The term "movable property" means all property other than immovable property which is dealt with in Article 13(1). It includes also incorporeal property, such as goodwill, licences, etc.* ***Taxability when PE or fixed based is alienated*** *- The paragraph makes clear that its rules apply when movable property of a PE or fixed base is alienated as well as when the PE as such (alone or with the whole enterprise) or the fixed base as such is alienated. If the whole enterprise is alienated, then the rule applies to such gains which are deemed to result from the alienation of movable property forming part of the business property of the PE.* *The gains from the alienation of all other movable property are taxable only in the State of residence of the alienator as provided in Article 13(6).*		
3	Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.	
Note – *Article 13(3) of the OECD and UN MC are identical. As per this para, gains from the alienation of ships or aircraft, or of movable property pertaining to the operation of ships or aircraft are taxable only in the State of the enterprise operating such ships and aircraft.*		
4	Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.	
Note - *Article 13(4) of the OECD MC is identical to Article 13(4) in the UN MC.* ***Interpretation of the phrase "may be taxed" -*** *By providing that gains from the alienation of shares or comparable interests which, at any time during the 365 days preceding the alienation, deriving more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State* **may** *be taxed in that State, paragraph 4 provides that gains from the alienation of such shares or comparable interests and gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in both States.* ***Method of computation of value of interest or shares derived from immovable property situated in other Contracting State -*** *Paragraph 4 allows the taxation of the entire gain attributable to the shares or comparable interests to which it applies even where part of the value of these shares or comparable interests is derived from property other than immovable property located in the Source State. The determination of whether shares of a company or comparable interests derive, at any time during the 365 days preceding the alienation, more*		

Para	OECD Model Convention 2017	UN Model Convention 2017
than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company, entity or arrangement without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property).		
-/ 5	-	***Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or trust, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least __ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.***
Note - *This paragraph provides for taxation of a gain from the alienation of shares and comparable interests as contemplated in the Article 13(5) but excludes gains from the alienation of shares to which Article 13(4) of the UN MC applies.* *The wording clearly stipulates that a gain on the alienation of any number of shares may be taxed in the State in which the company is a resident as long as the shareholding is substantial at any time during the 365 days preceding the alienation. A substantial shareholding is determined according to the percentage shareholding decided in the relevant bilateral negotiations.*		
5/6	Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 **and 4**, shall be taxable only in the Contracting State of which the alienator is a resident.	Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, ***4 and 5*** shall be taxable only in the Contracting State of which the alienator is a resident.
Note – *The aforesaid paragraph is a residuary clause and accordingly, seeks to cover within its ambit, gains arising on alienation of all the properties which are otherwise not covered in the earlier paragraphs.* *This paragraph allows the country of residence of the alienator to tax the income in the nature of capital gains sourced from other countries. Thus, all the movable properties, other than those specifically set out in the earlier paragraphs, shall be subject to taxes only in the Residence State of the alienator.*		

ART 14	INDEPENDENT PERSONAL SERVICES (UN MODEL)

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. Currently, this article on Independent Personal Services is only present in the UN MC which reads as under:

Para	UN Model Convention 2017
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-month 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.

Note - *Article 14 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.*

Meaning of "professional services" - *This Article of UN MC covers independent activities involving professional skills. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive.*

It normally covers services rendered by individuals. However, in case of Double Tax Avoidance Agreements ('DTAAs'/ 'tax treaty') with Australia, UK, USA, etc., partnership firms are also covered.

It suggests 'Principal to Principal relationship'.

Activities excluded from the scope of Article 14 – *(1) It excludes industrial and commercial activities that are covered under the Article 7 Business Profits. (2) It also excludes professional services performed in employment which are covered under the Article on Dependent Personal Services, e.g. a physician serving as a medical officer in a factory. (3) Independent activities of artists and sportsmen, etc. are also not covered by this Article.*

Para	UN Model Convention 2017
Sub-paragraph (a) of Article 14(1) provides that the income may be taxed if the individual has a fixed base regularly available to him for performing his activities. Though the presence of a fixed base gives the right to tax, the amount of income that is subject to tax is limited to that which is attributable to the fixed base. *Sub-paragraph (b) extends the source country's right to tax by providing that the source country may tax if the individual is present in the country for a period or periods aggregating at least 183 days in any twelve-month period commencing or ending in the fiscal year concerned, even if there is no fixed base. Only income derived from activities exercised in that country, however, may be taxed.* ***Definition of "fixed base" -*** *The provisions of this Article are similar to those for business profits and rest in fact on the same principles as those of Article 7. Even if Articles 7 and 14 are based on the same principles, since the concept of permanent establishment is reserved for commercial and industrial activities, the term "fixed base" has been used. The term "fixed base" would cover, for instance, a physician's consulting room or the office of an architect or a lawyer. A person performing independent personal services would probably not as a rule have premises of this kind in any other State than of his residence. However, if there is, in another State, a centre of activity of a fixed or a permanent character, then, that State would be entitled to tax the person's activities.*	

ART 21 OTHER INCOME

This Article deals with taxation of items of income which are not specifically taxable under any other specific Article.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.	
Note – *Article 21(1) envisages that other income 'shall be taxable only' in the Residence State, hence, providing for an exclusive right to the Residence State to tax such income. In the UN MC, however, Article 21(3) gives right to the Source State to tax income not covered in any of the foregoing articles (i.e., upto Article 20)*		
2	The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State,	The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting

Para	OECD Model Convention 2017	UN Model Convention 2017
	carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	State through a permanent establishment situated therein, ***or performs in that other State independent personal services from a fixed base situated therein,*** and the right or property in respect of which the income is paid is effectively connected with such permanent establishment ***or fixed base.*** In such case the provisions of article 7 ***or article 14, as the case may be,*** shall apply.
Note – *Article 21(2) provides an exception to the general rule in Article 21(1) for income that is effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Article 7(Business Profits).* *In addition, the UN MC 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, the taxation of such income would be governed by the provisions of Article 14 (Independent Personal Services).* *Article 21(2) includes income from third States. In such a case, a right to tax is given to the Contracting State in which the PE or the fixed base is situated.* ***Example:*** *Income arising outside Country A that is effectively connected with a PE maintained in Country A by a resident of Country B generally would be taxable by Country A under the provisions of Article 7 (Business Profits).* ***Non-applicability of this paragraph to immovable property –*** *Article 21(2) does not apply to immovable property for which, according to Article 6(4), the State of situs has a primary right to tax. Therefore, immovable property situated in a Contracting State and forming part of the business property of a PE of an enterprise of that State situated in the other Contracting State shall be taxable only in the first-mentioned State in which the property is situated and of which the recipient of the income is a resident.*		
- / 3	-	***Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention and arising in the other Contracting State may also be taxed in that other State.***
Note - *Article 21(3) of UN MC is absent in the OECD MC. Article 21(1) of the OECD and UN MC provides for an exclusive right to the Residence State to tax other income. However, Article 21(3) of the UN MC provides right to tax such income to Source State as well. In such case, income would be taxable in both the States i.e. the State of Residence and State of Source. Under such scenario, the State of Residence will either grant credit for taxes paid in*		

Para	OECD Model Convention 2017	UN Model Convention 2017
Source State or exempt such income in accordance with Article 23 of DTAA.		

ART 23	METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

In many cases, the application of tax treaty may result into double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Article 23 which contains provisions relating to elimination of double taxation is applied. Article 23 provides for the mechanism through which tax credit/exemption may be available in the Residence State for taxes deducted in the Source State.

The OECD MC and UN MC specify two approaches- Exemption method (Article 23A) and Credit method (Article 23B). These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

The double taxation referred to here, is juridical double taxation, meaning the same income or capital is taxable in the hands of the same person by more than one State. It does not thus, encompass situations of economic double taxation, i.e. where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

Articles 23A and 23B apply to the situation in which a resident of State R, the Residence State, derives income from, or owns capital in, the other Contracting State E (where the non-resident person has a PE or fixed base) or State S (State of Source or situs), not being the State of residence within the meaning of the Convention and that such income or capital, in accordance with the Convention, may be taxed in such other State E or State S. The Articles, therefore, apply only to the State of residence and do not prescribe how the other Contracting State E or S has to proceed.

ART 23A	EXEMPTION METHOD

Article 23A sets out the exemption method to eliminate double taxation.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.	

Para	OECD Model Convention 2017	UN Model Convention 2017

Note – *This Article lays down that the Residence State must exempt from tax, income and capital which may be taxed by the other State E or S in accordance with the Convention, whether or not the right to tax is, in effect, exercised by that other State. This method is known as full exemption method and regarded as the most practical one since it relieves the Residence State from undertaking investigations of the actual taxation position in the other State. Indian tax treaties, generally, do not follow full exemption method.*

Example illustrating "Full Exemption" Method - *For easy understanding, an illustration for computation of relief under 'full exemption' method for A.Y.2020-21 has been tabulated below:*

Sl. No.	***Particulars***	***Amount (in ₹)***
1	*Income earned in Residence State*	*10,00,000*
2	*Income earned in Source State*	*3,00,000*
3	*Total income earned by the individual [1+2] in case there is* ***no exemption***	*13,00,000*
4	*Tax liability on (3) above based on income-tax slab (including health and education cess@4%)*	*2,10,600*
5	*Total income to be considered under* ***full exemption method*** *[only (1) above can be included]*	*10,00,000*
6	*Tax liability on (5) above based on income-tax slab (including health and education cess@4%)*	*1,17,000*

Para	OECD Model Convention 2017	UN Model Convention 2017
2	Where a resident of a Contracting State derives items of income which may be taxed in the other Contracting State in accordance with the provisions of **Articles 10 and 11 (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State)**, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.	Where a resident of a Contracting State derives items of income which, in accordance with the provisions of ***Articles 10 11, 12 and 12A***, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income which may be taxed in that other State.

Note - *Article 23A(2) of the OECD MC differs from Article 23A(2) in the UN MC, to the extent that OECD Model does not refer to Article 12 (Royalties) and Article 12A (Fees for Technical*

Para	OECD Model Convention 2017	UN Model Convention 2017

Services). This is on account of the fact that as per the OECD MC, royalties are taxable only in the Residence State and there is no separate article for Fees for Technical Services.

In Articles 10 and 11 (both OECD and UN MC) and 12 and 12A (in the case of UN MC), the right to tax dividends and interest is divided between the Residence State and the Source State. In these cases, the Residence State is left free not to tax if it wants to do so and to apply the exemption method also to the above-mentioned items of income. However, where the Residence State prefers to make use of its right to tax such items of income, it cannot apply the exemption method to eliminate the double taxation since it would, thus, give up fully its right to tax the income concerned. Hence, for the Residence State, application of the credit method would normally give a satisfactory solution.

3	Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Note -*.Under exemption with progression method, income earned in the Source State, though considered as exempt, is included in total income in the Residence State only for the purpose of determining effective tax rate.*

To make it simple, Residence State does not impose tax on such foreign income but includes such exempt income for the purpose of computing the tax rate applicable on the remaining income.

This principle of progression applies to income or capital exempted by virtue of paragraph 1 of Article 23A as well as to income or capital which under any other provision of the Convention "shall be taxable only" in the other Contracting State.

Example illustrating "Exemption with Progression" Method - *For easy understanding, an illustration of computation of relief under 'exemption with progression' method for A.Y. 2020-21 has been tabulated below:*

Sl. No.	*Particulars*	*Amount (in ₹)*
1	*Income earned in Residence State*	10,00,000
2	*Income earned in Source State*	3,00,000
3	*Total income earned by the individual [1+2]*	13,00,000
4	*Tax liability on (3) above based on income-tax slab (including health and education cess@4%)*	2,10,600
5	*Effective tax rate [i.e. (4)/ (3) * 100]*	16.20%
6	*Total income to be considered under* ***exemption with progression method*** *[only (1) above can be included]*	10,00,000
7	*Tax liability on (6) above based on the effective rate as computed in (5)*	1,62,000

Para	OECD Model Convention 2017	UN Model Convention 2017
4	The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of the Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of **Article 10 or 11** to such income.	The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of the Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of ***Article 10, 11, 12 or 12A*** to such income; ***in the latter case, the first mentioned State shall allow the deduction of tax provided for by paragraph 2.***

Note - *The purpose of this paragraph is to avoid double non-taxation as a result of disagreements between the Residence State and Source State on the facts of a case or on the interpretation of the provisions of the Convention.*

Article 23A(4) applies where the Source State interprets the facts of a case or the provisions of the Convention in such a way that an item of income or capital falls under a provision of the Convention that does not allow the Source State to tax the item while the Residence State adopts a different interpretation under which the item falls under a provision of the Convention that allows the Source State to tax the item.

In such a case, the Residence State cannot exempt an income which is not taxed by the Source State (on account of different interpretation of the convention) whereas it has the right to tax such income or capital in accordance with the provisions of the Convention.

However, Residence State must exempt that item of income where Source State has the right to tax an item of income or capital in accordance with the provisions of the Convention but it had not imposed such tax since no tax is actually payable on such income or capital under its domestic laws. Residence State must exempt such income because the exemption in the Source State does not result from the application of the provisions of the Convention but, rather, from the domestic law of the Source State.

ART 23B CREDIT METHOD

As mentioned for Article 23A above, the application of tax treaty may result in double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Article 23B provides for the mechanism through which tax credit may be available in the Residence State for taxes deducted in the Source State.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow: a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State; b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.	
Note – *Article 23B(1) of the OECD and UN MC incorporates the principle contained in Article 23A(2) of the OECD and UN MC. Article 23B, based on the credit principle, follows the ordinary credit method: the Residence State allows, as a deduction from its own tax on the income or capital of its resident, an amount equal to the tax paid in the other Contracting State on the income derived from, or capital owned in that other Contracting State, but the deduction is restricted to the appropriate proportion of its own tax.* *Under the principle of credit, the Residence State would determine the resident's worldwide income (including the foreign sourced income) and compute the tax liability thereon. From the tax liability so computed, the Residence State would grant a deduction in respect of foreign tax paid on the foreign sourced income in the Source State.* *If the tax payable in the Residence State is more than the taxes paid in the Source State, then, the resident would be liable to pay the differential tax in the Residence State. If the foreign tax exceeds the Residence State tax on the same income, the excess tax credit may be carried forward or forfeited.* *The main feature of the credit method is that the Residence State retains the right to tax the foreign income but it allows credit for the taxes paid in the Source State.* *Most of the tax treaties relieve double taxation only through credit method. For a Residence State, the loss of revenue is lower in credit method. Hence, generally, most countries prefer the credit method. It may be noted that India follows credit method for most of the incomes.*		
2	Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.	
Note – *Article 23B(2) enables the Residence State to retain the right to take the amount of income or capital exempted in that State into consideration when determining the tax to be imposed on the rest of the income or capital. The right so retained extends to income or capital which "shall be*		

Para	OECD Model Convention 2017	UN Model Convention 2017
	taxable only" in the other State. The principle of progression is thus safeguarded for the Residence State, not only in relation to income or capital which "may be taxed" in the other State, but also for income or capital which "shall be taxable only" in that other State.	

ART 24	NON-DISCRIMINATION

In order to provide equality in terms of tax treatment, this Article provides that the tax provision cannot be discriminatory merely because one person is a non-resident.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.	
	Note – *Article 24(1) establishes the principle that for purposes of taxation, discrimination on the grounds of nationality is forbidden, and that, subject to reciprocity, the nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances.* ***Parity in tax treatment of residents, whether of the same or different nationality*** *- In applying Article 24(1), the underlying question is whether two persons who are residents of the same State are being treated differently solely by reason of having a different nationality. Article 24(1) provides that the nationals of the other State must be treated on par with the nationals of the Contracting State for tax purpose.* ***Parity not required to be maintained in certain cases, where circumstances are different*** *- Consequently, if a Contracting State, in giving relief from taxation on account of family responsibilities, distinguishes between its own nationals according to whether they reside in its territory or not, that State cannot be obliged to give nationals of the other State who do not reside in its territory the same treatment as it gives its resident nationals but it undertakes to extend to them the same treatment as is available to its nationals who reside in the other State. Similarly, Article 24(1) does not apply where a national of a Contracting State (State R) who is also a resident of State R is taxed less favourably in the other Contracting State (State S) than a national of State S residing in a third State (for instance, as a result of the application of provisions aimed at discouraging the use of tax havens) as the two persons are not in the same circumstances with respect to their residence.* ***Non-applicability of provisions of this Article to special taxation privileges accorded to own public bodies*** *- Likewise, the provisions of Article 24(1) are not to be construed as obliging a State which accords special taxation privileges to its own public bodies or services as such, to extend the same privileges to the public bodies and services of the other State. Neither are they to*	

Para	OECD Model Convention 2017	UN Model Convention 2017
be construed as obliging a State which accords special taxation privileges to private institutions not for profit whose activities are performed for purposes of public benefit, which are specific to that State, to extend the same privileges to similar institutions whose activities are not for its benefit.		
2	Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.	
Note - *A Stateless Person is a person who is not considered as a national by any State under the operation of its law. The purpose of Article 24(2) is to limit the scope of the clause concerning equality of treatment with nationals of a Contracting State solely to Stateless persons who are residents of that or of the other Contracting State. By thus excluding Stateless persons who are residents of neither Contracting State, such a clause prevents their being privileged in one State as compared with nationals of the other State.*		
3	The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.	
Note – ***Addresses discrimination based on actual situs of an enterprise -*** *The type of discrimination which Article 24(3) is designed to end is discrimination based not on nationality but on the actual situs of an enterprise. It, therefore, affects without distinction, and irrespective of their nationality, all residents of a Contracting State who have a PE in the other Contracting State.* *By the terms of the first sentence of Article 24(3), the taxation of a PE shall not be less favourably levied in the State concerned than the taxation levied on enterprises of that State carrying on the same activities. The purpose of this provision is to end all discrimination in the treatment of PEs as compared with resident enterprises belonging to the same sector of activities, as regards taxes based on business activities, and especially taxes on business profits.* ***Conditions under which principle of equal treatment would apply -*** *However, the second sentence of Article 24(3) specifies the conditions under which the principle of equal treatment set forth in the first sentence should be applied to individuals who are residents of a Contracting State and have a PE in the other State. It is designed mainly to ensure that such persons do not obtain greater advantages than residents, through entitlement to personal allowances and reliefs for family responsibilities, both in the State of which they are resident, by the application of its domestic laws, and in the other State by virtue of the principle of equal treatment.*		

Para	OECD Model Convention 2017	UN Model Convention 2017
For purposes of Article 24(3), the tax treatment in one Contracting State of the PE of an enterprise of the other Contracting State should be compared to that of an enterprise of the first-mentioned State that has a legal structure that is similar to that of the enterprise to which the PE belongs. However, Article 24(3) does not require a State to apply to the profits of the PE of an enterprise carried on by a non-resident individual the same rate of tax as is applicable to an enterprise of that State that is carried on by a resident company. ***Regulated and unregulated activities do not tantamount to same activities -****Similarly, regulated and unregulated activities would generally not constitute the "same activities" for the purposes of Article 24(3). Thus, for instance, Article 24(3) would not require that the taxation on a PE whose activities include the borrowing and lending of money but which is not registered as a bank be not less favourably levied than that of domestic banks since the PE does not carry on the same activities. Another example would be that of activities carried on by a State or its public bodies, which, since they are controlled by the State, could not be considered, for the purposes of paragraph 3, to be similar to activities that an enterprise of the other State performs through a PE.*		
4	Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph **4** of Article **12,** apply, interest, royalties and **other disbursements** paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.	Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, paragraph ***6*** of Article ***12, or paragraph 6 of Article 12A*** apply, interest, royalties, ***fees for technical services,*** and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.
Note – *Article 24(4) is designed to end a particular form of discrimination resulting from the fact that, in certain countries, the deduction of interest, royalties and other disbursements allowed without restriction when the recipient is resident, is restricted or even prohibited when he is a non-resident. The same situation may also be found in the sphere of capital taxation, as regards debts contracted to a non-resident. It is, however, open to Contracting States to modify this provision in bilateral conventions to avoid its use for tax avoidance purposes.*		

Para	OECD Model Convention 2017	UN Model Convention 2017
Application of thin capitalization rules - *Article 24(4) does not prohibit the country of the borrower from applying its domestic rules on thin capitalisation insofar as these are compatible with the relevant Articles of this Convention. However, if such treatment results from rules which are not compatible with the said Articles and which only apply to non-resident creditors (to the exclusion of resident creditors), then such treatment is prohibited by Article 24(4).* ***Additional information requirements with respect to payments to non-residents permitted -*** *Also, Article 24(4) does not prohibit additional information requirements with respect to payments made to non-residents since these requirements are intended to ensure similar levels of compliance and verification in the case of payments to residents and non-residents.*		
5	Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.	
Note – *Article 24(5) forbids a Contracting State to give less favourable treatment to an enterprise, the capital of which is owned or controlled, wholly or partly, directly or indirectly, by one or more residents of the other Contracting State. This provision and the discrimination which it puts an end to, relates to the taxation only of enterprises and not of the persons owning or controlling their capital.*		
6	The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.	
Note – *Article 24(6) states that the scope of the Article is not restricted by the provisions of Article 2. The Article therefore applies to taxes of every kind and description levied by, or on behalf of, the State, its political subdivisions or local authorities.*		

ART 25	MUTUAL AGREEMENT PROCEDURE

There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which was introduced in 2011.

Para	OECD Model Convention 2017	UN Model Convention 2017
		Alternatives A & B
1	Where a person considers that the actions of one or both of the	Where a person considers that the actions of one or both of the Contracting States result or

Para	OECD Model Convention 2017	UN Model Convention 2017
	Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of **either Contracting State.** The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.	will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the ***competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national.*** The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.
Note - *Article 25 provides recourse to a taxpayer who feels he has not been or will not be taxed as per the provisions of the tax treaty. Under OECD MC the taxpayer may make a request to either Contracting State while UN MC contemplates taxpayer going to Residence State or the country of his nationality. The remedy under Article 25 is irrespective of those under domestic law and must be invoked within three years from the first notification of the action that gives rise to the grievance.*		
2	The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.	
Note - *When a request is received from a taxpayer, the competent authority shall try to resolve unilaterally at the first stage. If it is not possible then the competent authority of the other Contracting State shall be approached for resolution through mutual agreement. Any decision arrived through such process shall be implemented irrespective of any time limits set by domestic laws.*		
3	The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.	
Note - *The first sentence of this paragraph invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case.* ***Nature of difficulties which can be resolved by mutual agreement -*** *This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not*		

Para	OECD Model Convention 2017	UN Model Convention 2017
only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention. ***Examples of difficulties which can be resolved by mutual agreement -*** *Under this provision the competent authorities can, in particular:* *(i) where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;* *(ii) where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes;* *(iii) determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).* *(iv) conclude bilateral advance pricing arrangements (APAs) as well as conclude multilateral APAs with competent authorities of third States with which each of the Contracting States has concluded a bilateral tax convention in cases where difficulties or doubts exist as to the interpretation or application of the conventions.* *The second sentence of Article 25(3) enables the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention*.		
4	The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.	The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. ***The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedures provided for in this article.***
Note - *Article 25(4) of the UN MC consists of two sentences, the first of which reproduces the first sentence of the Article 25(4) of the OECD MC while the second sentence in UN MC, which is not contained in the OECD MC, relates to development of procedures and other matters relating to smooth implementation of MAP.*		

Para	OECD Model Convention 2017	UN Model Convention 2017
Manner of consultation between Competent Authorities – *Article 25(4) determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in Article 25(1)/(2) or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in Article 25(3).* ***Manner and Mode of communication between Competent Authorities*** *The first sentence of Article 25(4) provides that the competent authorities may communicate with each other directly. It would, therefore, not be necessary to go through diplomatic channels. The competent authorities may communicate with each other by letter, facsimile transmission, telephone, direct meetings, or any other convenient means. They may, if they wish, formally establish a joint commission for this purpose. As to this joint commission, Article 25(4) leaves it to the competent authorities of the Contracting States to determine the number of members and the rules of procedure of this body.* *The second sentence of Article 25(4) in the UN MC allows the competent authorities to develop bilateral procedures for the implementation of the MAP.*		
5/ 5 (Alt B)	Where, a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within **two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities**, any unresolved issues arising from the case shall be submitted to arbitration if **the person so requests in writing**. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State.	**[Only in Alternative B]** Where, (a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and (b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within ***three years from the presentation of the case to the competent authority of the other Contracting State***, any unresolved issues arising from the case shall be submitted to arbitration if ***either competent authority so requests. The person who has presented the case shall be notified of the request.*** These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be

Para	OECD Model Convention 2017	UN Model Convention 2017
	Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.	implemented notwithstanding any time limits in the domestic laws of these States ***unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or*** unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

Note - *Paragraph 5, which is only found in Alternative B of the Article of UN MC, provides for mandatory arbitration under which the competent authorities are obliged to submit unresolved issues to arbitration if one of them so requests after they were unable to resolve these issues within a given period of time.*

Paragraph 5 of the UN MC reproduces paragraph 5 of Article 25 of the OECD MC with four differences:

(1) ***Period within which arbitration is to be initiated –*** *Para 5 of UN MC provides that 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 rather than within* ***two years*** *as provided in the OECD MC.*

(2) ***Person entitled to make a request for arbitration*** *- While the OECD MC provides that arbitration must be requested by* ***the person who initiated the case****, paragraph 5 of Alternative B provides that arbitration must be requested by* ***the competent authority of one of the Contracting States*** *(this means that a case shall not be submitted to arbitration if the competent authorities of both Contracting States consider that such a case is not suitable for arbitration and neither of them make a request).*

(3) ***Departure from the arbitration decision*** *- Paragraph 5 of Alternative B of UN MC, unlike the corresponding provision of the OECD MC, allows the competent authorities to depart from the arbitration decision if they agree on a different solution* ***within six months after the decision has been communicated to them****.*

(4) ***Point of time from which period for initiation of arbitration is to be reckoned*** *- While the OECD MC provides that the two-year period begins* ***when all the information required by the competent authorities in order to address the MAP case has been provided****, paragraph 5 of alternative B of UN MC provides that the three-year period begins with the* ***presentation of the MAP case to the competent authority*** *of the State that did not initially relate it.*

ART 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. The purpose of Article 26 is to facilitate effective exchange of information between Contracting States.

Para	OECD Model Convention 2017	UN Model Convention 2017
1	The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.	The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws ***of the Contracting States*** concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. ***In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes.*** The exchange of information is not restricted by Articles 1 and 2.

Note - *Article 26 embodies rules under which information may be exchanged to the widest possible extent, both to facilitate proper application of the treaty and to assist the Contracting States in the enforcement of their domestic tax laws. Consequently, the obligation to exchange information under this Article should be interpreted broadly, and the limitations on that obligation should not be extended by analogy beyond their specific meaning.*

Objective - *In particular, the Article should be understood to require the Contracting States to promote an effective exchange of information. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.*

Meaning and scope of "Foreseeably relevant" *- The first sentence of Article 26(1) sets forth the basic obligation of the Contracting States concerning the exchange of information. It requires, subject to the limitations of Article 26(3), that the competent authorities exchange such information as is "foreseeably relevant" for the proper application of the Convention or for the administration or enforcement of their domestic tax laws, as long as taxation under those laws is not inconsistent*

Para	OECD Model Convention 2017	UN Model Convention 2017
*with the Convention. The standard of "foreseeably relevant" is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in "fishing expeditions" or to request information about a particular taxpayer that is highly unlikely to be relevant to the tax affairs of that taxpayer. **Scope of information to be exchanged** - The information covered by Article 26(1) is not limited to taxpayer-specific information. The competent authorities may also exchange other sensitive information related to tax administration and compliance improvement; for example, they might provide information about risk analysis techniques or tax avoidance or evasion schemes. They may also share information they have obtained about aggressive or abusive tax avoidance schemes. In addition, the competent authorities may exchange information relating to a whole economic sector (e.g. the oil, fishing or pharmaceutical industry, the banking sector, etc.) and not to particular taxpayers. The scope of the obligation to exchange information is not limited by Articles 1 or 2. That is, the obligation applies not only with respect to information relevant to the proper application of the Convention or to the administration or enforcement of domestic taxes mentioned in Article 2, but also to all other domestic taxes, including subnational taxes. In this respect, the UN MC and the OECD MC are identical.*		
2	Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.	Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and ***it*** shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes

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<tr><th>Para</th><th>OECD Model Convention 2017</th><th>UN Model Convention 2017</th></tr>
<tr><td></td><td></td><td>under the laws of both States and the competent authority of the supplying State authorizes such use.</td></tr>
<tr><td colspan="3"> Note - 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. The confidentiality rules apply to information provided in a request and information transmitted in response to a request.
Information to be used only for specified purposes - In general, the information received by a Contracting State may be used only for the purposes mentioned in paragraph 1. If the information appears to be of value to the receiving State for purposes other than those referred to in that paragraph, that State may not use the information for such other purposes without the authorization of the competent authority of the supplying State. That authorization should not be unreasonably withheld.
Non-disclosure of information to a third country - Similarly, the information received by a Contracting State may not be disclosed to a third country unless there is an express provision in the bilateral treaty between the Contracting States allowing such disclosure.
Conditions for sharing of information received for tax purposes - The last sentence of paragraph 2, therefore, allows the Contracting States to share information received for tax purposes provided two conditions are met: first, the information may be used for other purposes under the laws of both States and, second, the competent authority of the supplying State authorizes such use.
It allows the sharing of tax information by the tax authorities of the receiving State with other law enforcement agencies and judicial authorities in that State on certain high priority matters (e.g., to combat money laundering, corruption, terrorism financing). When a receiving State desires to use the information for an additional purpose (i.e. non-tax purpose), the receiving State should specify to the supplying State the other purpose for which it wishes to use the information and confirm that the receiving State can use the information for such other purpose under its laws.
Sharing of information with oversight bodies - The OECD and UN MCs include a provision that would allow the sharing of information obtained under Article 26 with persons charged with the oversight of the persons allowed to obtain such information. The disclosure should be limited to information necessary for those bodies to fulfil their oversight duties. Such oversight bodies include authorities that supervise tax administration and enforcement authorities as part of the general administration of the Government of a Contracting State. Such sharing is permitted only if the persons engaged in oversight activities are subject to confidentiality requirements at least as strict as those applicable to tax administration and enforcement officials. The competent authorities may want to agree as to the bodies that constitute an oversight body within the meaning of this paragraph. </td></tr>
<tr><td>3</td><td colspan="2">In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:
a) to carry out administrative measures at variance with the laws and administrative</td></tr>
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Para	OECD Model Convention 2017	UN Model Convention 2017
	practice of that or of the other Contracting State; b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State; c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).	

Note *- Paragraph 3 of Article 26 contains provisions that limit the obligation of the requested State under paragraph 1. The limitations provided in paragraph 3, however, may be superseded by the provisions contained in paragraphs 4 and 5. The provisions of paragraph 3, read in conjunction with the provisions of paragraphs 4 and 5, should not be read in a way that would prevent an effective exchange of information between the Contracting States. In addition, a Contracting State should disclose to the other Contracting State before it enters into a convention any specific provisions of its laws and administrative practice that it believes entitle it to avoid an obligation otherwise imposed by paragraph 1.*

Effect of restriction placed by internal laws *- Paragraph 3(a), subject to the limitations provided in paragraphs 4 and 5, contains the clarification that a Contracting State is not bound to go beyond its own internal laws and administrative practice in putting information at the disposal of the other Contracting State. For example, if a requested State is not permitted under its laws or administrative practice to seize private papers from a taxpayer without court authorization, it is not required to make such a seizure without court authorization on behalf of a requesting State even if the requesting State could make such a seizure without court authorization under its own laws or administrative practice. The purpose of this rule is to prevent Article 26 from creating an unintentional conflict between a Contracting State's obligation under Article 26 and its obligations under domestic law.*

Decline of request to disclose confidential communication and secret information *- In general, a requested State may decline, under paragraph 3(c), to disclose information that constitutes a confidential communication between an attorney, solicitor, or other admitted legal representative in his role as such and his client to the extent that the communication is protected from disclosure under domestic law. However, in no event may a requested State decline to disclose communications between attorneys, solicitors or other admitted legal representatives and their clients, if those persons have themselves participated with their clients in a plan to commit tax evasion or avoidance.*

A trade or business secret or trade process is generally understood to mean information which has considerable economic importance and which can be exploited practically and the unauthorized use of which may lead to serious damage (e.g. may lead to severe financial hardship). The purpose of the secrecy exception is to prevent an exchange of information from imposing unfair hardship on taxpayers by revealing to their competitors or potential competitors valuable secret information and thereby significantly diminishing the commercial value of that information. Secret information that once had substantial commercial value may be disclosed, if that information does not have substantial commercial value at the time the information is requested.

Para	OECD Model Convention 2017	UN Model Convention 2017
4	If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.	
Note - According to Article 26(4), a requested State must use its information gathering measures to obtain requested information even though those measures are invoked solely to provide information to the other Contracting State and irrespective of whether the information could still be gathered or used for domestic tax purposes in the requested Contracting State. Thus, for instance, any restrictions on the ability of a requested Contracting State to obtain information from a person for domestic tax purposes at the time of a request (for example, because of the expiration of a statute of limitations under the requested State's domestic law or the prior completion of an audit) must not restrict its ability to use its information gathering measures for information exchange purposes. ***Meaning of "information gathering measures" -****The term "information gathering measures" means laws and administrative or judicial procedures that enable a Contracting State to obtain and provide the requested information. That is, a requested State does not need to have a domestic tax interest in obtaining the requested information for the obligation to supply information under paragraph 1 to apply.*		
5	In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.	
Note - Paragraph 1 imposes a positive obligation on a Contracting State to exchange all types of information. Paragraph 5 is intended to ensure that the limitations of paragraph 3 cannot be used to prevent the exchange of information held by banks, other financial institutions, nominees, agents and fiduciaries, as well as ownership information. ***Overriding effect of Paragraph 5*** *- Paragraph 5 states that a requested State shall not decline to supply information to a requesting State solely because the information requested is held by a bank or other financial institution. Thus, paragraph 5 overrides paragraph 3 to the extent that paragraph 3 would otherwise permit a requested Contracting State to decline to supply information on grounds of domestic bank secrecy laws. Access to information held by banks or other financial institutions may be by direct means or indirectly through a judicial or administrative process. The procedure for indirect access should not be so burdensome and time-consuming as to act as an impediment to access bank information.* ***Supply of information held by persons acting in fiduciary capacity*** *- Paragraph 5 also provides that a Contracting State shall not decline to supply information solely because the*		

Para	OECD Model Convention 2017	UN Model Convention 2017
information is held by persons acting in an agency or fiduciary capacity. For instance, if a Contracting State has a law under which all information held by a fiduciary is treated as a "professional secret" merely because it was held by a fiduciary, such State could not use such law as a basis for declining to provide the information held by the fiduciary to the other Contracting State. ***Supply of information relating to ownership interest*** *- Paragraph 5 states that a Contracting State shall not decline to supply information solely because the requested information relates to an ownership interest in a person, which includes companies and partnerships, foundations or similar organizational structures. Information requests cannot be declined merely because domestic laws or practices may treat ownership information as a trade or other secret.*		
- / 6	-	***The competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made.***
Note – *Paragraph 6 of UN MC specifically grants to the competent authorities the authority to establish procedures for an effective exchange of information. The OECD MC does not contain paragraph 6 or an equivalent. The position taken in the OECD Commentary is that this authority is implicit in Article 26.* ***Modes of exchanges of information by competent authorities*** *- This language of paragraph 6 of UN MC authorize the competent authorities to exchange information in at least three modes: exchange by specific request, automatic exchange, and other exchanges, understood to include spontaneous exchanges.*		

Resources: The discussion on Model Tax Conventions in the above chapter is essentially based on the text and commentaries of the OECD and UN Model Tax Conventions, 2017 available at the websites http://www.oecd.org/tax/treaties/ and http://www.un.org, respectively.

SUMMARY

Article		OECD MC *vis-à-vis* UN MC Common paras & Significant differences
		Chapter I : Scope of the Convention
1	**Persons covered**	**Resident of CS** - For application of treaty, a person has to be a resident of one or both of the Contracting States (CSs). **Fiscally transparent entity** - Income derived by or through a fiscally transparent entity under the tax law of either CS to be considered to be income of a resident of a CS, to the extent such income is treated, for purposes of taxation by that State, as the income of a resident of that State.

2 Taxes covered

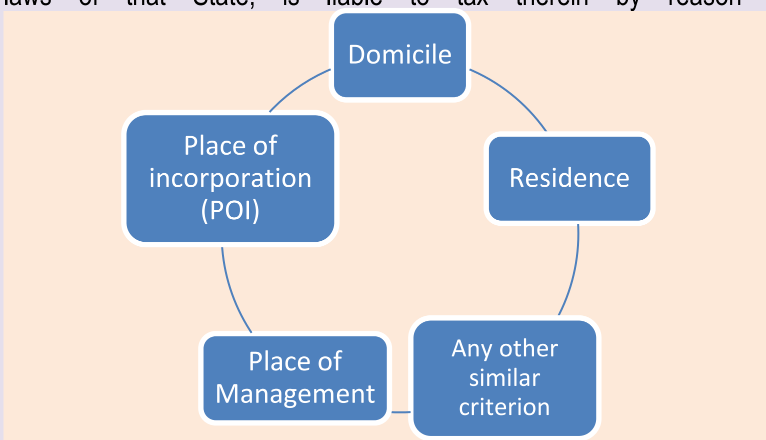
- **Taxes on income and capital** - The MCs apply to taxes on income and on capital imposed on behalf of a CS or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
- **Coverage of taxes -** Taxes on income and on capital covers:

Taxes imposed	Taxes included
• On total **income** • on total **capital** • on **elements** of income or of capital	• taxes on **gains from alienation** of movable or immovable property • taxes on total amounts of **wages or salaries** paid by enterprises • taxes on **capital appreciation**

Chapter II : Definitions

4 Resident

- **Resident of either CS -** A taxpayer has to demonstrate that he is a resident of one or both CSs to be able to gain access to a tax treaty and avail benefits thereunder.
- **Meaning of "Resident of a Contracting State"-** Any person who, under the laws of that State, is liable to tax therein by reason of his:



This term, however, 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.

***Note** - OECD MC does not contain reference to place of incorporation*

- **Tie-breaker Rule**

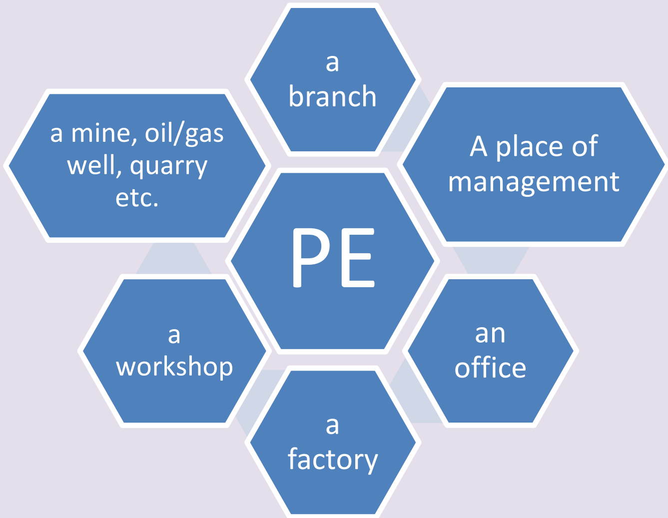
<u>In case of individuals</u>

Where an individual is a resident of both CSs as per domestic tax laws of that CS, then, his residential status shall be determined by applying the tie-breaker rule in the following sequence:

		Permanent Home ↓ Centre of vital interests ↓ Habitual abode ↓ Nationality ↓ Mutual agreement between Competent Authorities of the CSs **<u>In case of companies</u>** • Dual residence arises where one CS attaches importance to POI and the other CS to the POEM. • The tie-breaker test involves a case by case approach considering the no. of tax avoidance cases involving dual resident Cos. • Request has to be made by the tax payer through Article 25 (MAP). • Competent Authorities will rely on range of factors to resolve the question of dual residency.
5	**Permanent establish-ment (PE)**	**Meaning of PE [Article 5(1)]** • There should be an “**enterprise**” (Entr). • Such Entr should be carrying on a "**business**"; • There should be a "**place of business** (POB)"; • Such place of business (POB) should be at the **disposal of the Entr** (may be owned / rented but must be one which the Entr has the effective power to use); • The POB should be "fixed", i.e., 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 POB.

A PE does not exist unless all the aforesaid conditions are satisfied.

- **Specific inclusions in the meaning of PE [Article 5(2)]**



- **Expansion of scope of Agency PE**

- Agency PE targets activities done by a dependent agent (DA) of the Entr in the Source State (SS).
- DAPE now includes 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.

- **PE of an Insurance Enterprise**

UN MC	OECD MC
UN MC has an additional Article 5(6) relating to insurance. An insurance Entr of a CS is deemed to have a PE in the other CS if it collects premiums in the territory of that other CS or insures risks situated therein through a person.	In the absence of similar Article in the OECD MC, a PE of an insurance Entr is to be determined in accord with Article 5(1) or 5(2).

Chapter III : Taxation of Income

7 Business profits

- **Right of CS to tax business profits (BPs)**

OECD MC	UN MC
BPs of an Entr can only be taxed by the Residence State **(RS)**. Right of Source State **(SS)** to tax BPs of an enterprise only exists if a PE exists in its jurisdiction.	
Once a PE is proven, the **SS** can tax only such profits	• The attribution principle is amplified by a **<u>limited</u>** Force of Attraction rule (FOA). • The FOA rule implies that when a foreign enterprise sets up a PE in SS, it brings itself within the fiscal jurisdiction of that State to such a degree that profits that the Entr

<table>
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<tr><td>as are attributable to the PE</td><td>derives therefrom, whether through the PE or not, can be taxed by it (i.e., the SS).
Accordingly, if the Entr carries on business in the other CS through a PE, the profits of the Entr may be taxed in the other CS but only so much of them as is attributable to:
(a) that PE;
(b) sales in that other CS of goods or merchandise of the same or similar kind as those sold through that PE; or
(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.</td></tr>
</table>
</td></tr>
<tr><td>11</td><td>Interest</td><td>
Right of CSs to tax interest
<table>
<tr><th>Para of Article</th><th>Right of CS to tax interest</th></tr>
<tr><td>1</td><td>Confers the right to RS to tax interest</td></tr>
<tr><td>2</td><td>Confers right to the SS to tax interest.
Generally, interest is taxed in the SS at a given rate on gross basis.
However, if the beneficial owner of the interest is a resident of the other CS, the tax so charged ≤ specified % of the gross interest.
The specified % as per OECD MC is 10%, but the UN MC leaves this % to be established through bilateral negotiations.</td></tr>
</table>
Definition of interest in OECD & UN MCs - Interest 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.
Specific inclusions in the definition of interest as per OECD & UN MCs
• income from govt securities
• income from bonds or debentures
• premiums and prizes attaching to such securities, bonds or debentures.
Note - Interest does not include penalty charges for late payment.
</td></tr>
<tr><td>12</td><td>Royalties
(Roy)</td><td>
<table>
<tr><th></th><th>OECD MC</th><th>UN MC</th></tr>
<tr><td>Right of CS to tax Roy. income</td><td>Roy. arising in SS and beneficially owned by resident of the RS is taxable only in RS. Thus, RS has exclusive right to tax royalty income.</td><td>Roy may also be taxed in the SS. However, if the beneficial owner is a resident of the RS, the tax charged by SS ≤ the specified %, (to be established through bilateral negotiations) of gross royalty.</td></tr>
</table>
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</table>

		Definition of Roy	Definition of Royalty does not include: (a) rentals for films/tapes used for radio/ TV broadcasting; and (b) rentals for industrial, commercial or scientific equipment.	Royalty includes: (a) rentals for films or tapes used for radio or TV broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

12A **FTS**

In its 2017 update, the UN MC has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in OECD MC.

Right of CS to tax FTS [UN Model]

Para of Article	Right of CS to tax FTS
1	Confers right to the RS to tax FTS. However, does not state that FTS is exclusively taxable in the RS.
2	Establishes the right of the SS to tax FTS in accordance with its domestic law, subject to limitation on the max. rate of tax, to be established through bilateral negotiations, if the beneficial owner is a resident of the other CS.

Meaning of FTS [UN Model]

FTS means payments for managerial, technical or consultancy services

Exclusions from the meaning of FTS:

- **i** payment to an employee
- **ii** payment for teaching in an or by an educational institution
- **iii** payment by an individual for services for personal use

13 **Capital gains**

This Article provides for the taxation of income arising from transfer of a capital asset, including transfer of shares.

Right of CS to tax income from Capital Gains

- The right to tax capital gains may be exclusively with the RS, or shared between the RS and SS.
- The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law.

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The Article contains rules for taxation of gains from alienation of different assets such as immovable property, immovable property forming part of a PE, ships & aircrafts, etc.
In respect of shares, the 2017 OECD and UN MCs are identical. Rights are conferred to the SS if more than 50% of the value of shares during the preceding 365 days is derived from immovable property in such SS.

</td></tr>
<tr><td>14</td><td>Independent personal services</td><td>
This Article present only in the UN MC deals with the taxation of income derived by a person for professional or specified services which are offered in the SS through some presence.
Right of CS to tax income from professional services (IPS) [UN MC]
<table>
<tr><td>Right of RS</td><td>Income derived by a resident of a CS in respect of professional services or other activities of an independent character is taxable only in the RS.</td></tr>
<tr><td>Right of SS</td><td>In the following circumstances, however, IPS may also be taxed in the other CS (i.e., the SS):
<table>
<tr><th>Circumstance</th><th>Extent of income taxable in SS</th></tr>
<tr><td>If he has a fixed base regularly available to him in the SS for the purpose of performing his activities</td><td>Only so much of the income as is attributable to that fixed base may be taxed in the SS.</td></tr>
<tr><td>If his stay in the SS is for a period > 183 days in any 12 month period commencing or ending in the fiscal year concerned</td><td>Only so much of the income as is derived from his activities performed in the SS may be taxed in that State</td></tr>
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</td></tr>
</table>
Definition of “Professional Services” [UN MC]
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.
Note – OECD MC does not contain a separate article on IPS. The same is dealt with as “Business Profits (Article 7)” under the OECD MC.
</td></tr>
<tr><td>21</td><td>Other income (OI)</td><td>
This Article deals with taxation of items of income which are not specifically taxable under any other specific Article [i.e., upto Article 20].
<table>
<tr><th></th><th>OECD MC</th><th>UN MC</th></tr>
<tr><td>Right to tax OI</td><td>Exclusive right to tax is with the RS.</td><td>Contains an additional para, Article 21(3), which provides that SS may also tax other income</td></tr>
</table>
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		Right to tax income [other than income from immovable property] effectively connected with PE	Article 21(2) of both OECD and UN MC provides that for income effectively connected with a PE maintained in a CS by a resident of the other CS, 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 CS by a resident of the other CS, taxation would be governed by the provisions of Article 14 (IPS).
		Chapter V : Methods for the Elimination of Double Taxation	
23A/ 23B	**Exemption method/ Credit Method**	In many cases, the application of tax treaty may result into double taxation (DT) for tax payers. In such a case, Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the RS for taxes deducted in the SS.	

- **Two approaches for elimination of DT under MCs**:

Exemption method (Article 23A)	Credit method (Article 23B)
Tax exemption may be available in the RS for taxes deducted in the SS.	Tax credit may be available in the RS for taxes deducted in the SS.

These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

- **Juridical DT and Economic DT:**

	Juridical DT	Economic DT
Meaning	The same income or capital is taxable in the hands of the same person by more than one State	Two different persons are taxable in respect of the same income or capital
Example	FTS may be taxable in the hands of the recipient both in the RS as well as in SS, based on the domestic laws of the CSs.	In respect of dividend distributed by a Co., DDT may be payable by the Co. in SS, whereas the dividend may be taxable in the hands of the shareholder of the other CS, on the basis of his residence.
Type of DT addressed by Article 23A & 23B	Articles 23A & 23B address Juridical DT.	The Articles do not address Economic DT. If two States wish to solve problems of economic DT, they must do so in bilateral negotiations.

	Chapter VI : Special Provisions	
25	**Mutual agreement procedure (MAP)**	Where a tax payer believes that the treatment accorded by either or both CSs is not in accordance with the provisions of the tax treaty, this Article provides for dispute resolution through bilateral negotiations between competent authorities (CAS) of both CSs.

	OECD MC	UN MC
Request for MAP	The taxpayer may make a request to either CS	**Alternative A** - Taxpayer has to approach RS or the country of his nationality **Alternative B** - Reference to an arbitration process as part of MAP. The decision arrived at through the process is binding unless a person directly affected does not accept it.
Time limit	Stipulates a time limit of 2 years from the date when all the information required by the CAS in order to address the case need to be provided to both CAS.	An arbitration may be initiated if the competent authorities (CAS) are unable to reach an agreement on a case within 3 years from presentation of that case [Alternative B]
Who can request for Arbitration?	Arbitration must be requested in writing by the person who initiated the case	Arbitration must be requested by the CAS of one of the CS. Once such a request is made, the taxpayer will be notified [Alternative B]
Departure from arbitration by CAS	No specific provision for departure from arbitration.	The CAS may depart from the arbitration decision if they agree to do so within 6 months after the decision has been communicated to them [Alternative B]

26 **Exchange of information (EOI)**

Purpose of Article 26

In order to complete tax cases, a country may require certain info which may be available with the treaty partner.

Article 26 provides for:

- the info which may be exchanged

- the manner in which such a request has to be made.

Importance of Article 26:

- facilitates effective exchange of information between CSs.
- curtails cross-border tax evasion and avoidance,
- curtails the capital flight that is often accomplished through tax evasion & avoidance. This is particularly relevant in the perspective of developing countries.

Similar provisions contained in OECD and UN MCs

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