

# ARTILCE 1 TO 4 OF DTAA

# ARTICLE 1

- The first step in determining whether a specific tax treaty applies in a given case is to identify the 'person' who is potentially entitled to the benefits of such tax treaty.
- Article 1 invariably reads as 'This Convention or agreement shall apply to persons who are residents of one or both of the Contracting States' .
- The term "person" includes an individual, an estate, a trust, a partnership, a company, any other body of persons, or other taxable entity.
- The term 'resident of a Contracting State' means any person who, under the Tax laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.
- In order to qualify as 'resident of a contracting State' one need to qualify as 'person' as per the definition given in the tax treaty.
- The entitlement of fiscally transparent entities to invoke a tax treaty has always been a contentious issue as such transparent entities are generally not treated as 'person' due to the reason that such entities are not required to pay taxes, rather taxes are paid by the members of such entities.
- Generally, fiscally transparent entities are not mentioned in the definition clause of 'person' given in the tax treaty. In such cases, fiscally transparent entities try to fit themselves within the phrase 'any other entity which is treated as a taxable unit for tax purposes'.

# ARTICLE 1

- An UK LLP was not considered as resident of UK by the revenue authorities as it was not liable to tax in UK. The Calcutta High Court held that LLP is treated as 'person' under Indian Income-tax Act and thus, by virtue of Article 3(2) of India-UK tax treaty the UK LLP qualifies as person under the said treaty.
- The Australian Tax Office applying Article 3 (2) of US-Australia tax treaty opined that a US limited partnership not treated as body corporate under the domestic laws of Australia (source State) for tax purposes, shall not constitute a body corporate under the tax treaty.
- The Indian Authority for Advance Rulings denied treaty benefit to a Swiss partnership law firm *inter alia* on the ground that the firm was a fiscally transparent entity and was not liable to tax under the domestic laws of Switzerland.
- An individual resident of United Arab Emirates (UAE) was denied treaty benefit on the ground that no personal tax is levied on individuals in UAE by the Indian Authority for Advance Rulings.<sup>1</sup>
- The Bloemfontein Free State High Court, South Africa denied the benefit of tax treaty to a partner of the Lesotho based law firm (partnership firm) on the ground that partnership firm was not a taxable entity under the laws of Lesotho and thus, cannot be treated as 'person' for the purpose of tax treaty.
- The German Federal Tax Court held that a US S-corporation treated as transparent in US for tax purposes is entitled to lower withholding tax rate under the tax treaty as the income of the US S-corporation was taxed at the level of its US resident shareholders.

## ARTICLE 2 – Taxes Covered

- It defines the existing taxes which are the subject matter of DTAA on the date of signature and also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature in addition to, or in place of, the existing taxes.
- The competent authorities of the Contracting States are required to notify each other of any substantial or significant changes which are made in their respective taxation laws.
- It was held in the case of ITO (Intl Taxn) v. M Far Hotels Ltd [2013] 58 SOT 261/32 taxmann.com 100 (Cochin - Trib.) which was rendered in the context of India France treaty that if the provisions of DTAA are more beneficial to the taxpayer, then the provisions of DTAA would prevail over the Indian Income Tax Act. Since the DTAA is silent about the surcharge and education cess for the purpose of deduction of tax at source, the taxpayer may take advantage of that provision in the DTAA for deduction of tax.
- It was held by Hon'ble Kolkata Tribunal in the case of Deputy Director of Income-tax (IT)-1(1), Kolkata v. BOC Group Ltd reported in [2015] 64 taxmann.com 386 (Kolkata - Trib.) that Whether when tax rate is determined under DTAA, then tax rate prescribed thereon shall have to be followed strictly without any additional taxes thereon in form of surcharge or education cess .

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- There are other judgments also on the similar lines in the following cases:-
- ITO (Intl Taxn) v. M Far Hotels Ltd [2013] 58 SOT 261/32 taxmann.com 100 (Cochin - Trib.), Sunil V. Motiani v. ITO [2013] 33 taxmann.com 252/59 SOT 37 (Mumbai - Trib), R.A.K. Ceramics, UAE v. Deputy Commissioner of Income Tax, International Taxation(2), Hyderabad-[2019] 104 taxmann.com 380 (Hyderabad - Trib.), Soregam SA v. Deputy Director of Income-tax, Circle- 3 (2), Int. Taxation, New Delhi - [2019] 101 taxmann.com 94 (Delhi - Trib.), DIC Asia Pacific Pte. Ltd. v. Assistant Director of Income-tax, International Taxation (1), Kolkata - [2012] 22 taxmann.com 310 (Kol.), Capgemini SA v. Deputy Commissioner of Income-tax (International Taxation)-2 (1) (1), Mumbai - [2016] 72 taxmann.com 58 (Mumbai - Trib.) .
- Karnataka High Court in case of Wipro Ltd. v. Dy. CIT [2015] 62 taxmann.com 26/[2016] 236 Taxman 209/382 ITR 179, wherein it has been held that the Income-tax in relation to any country includes Income-tax paid not only to the Federal Government of that country, but also any Income-tax charged by any part of that country meaning a State or a local authority, and the assessee would be entitled to the relief of double taxation benefit with respect to the latter payment also. Therefore, even in the absence of an agreement under section 90, by virtue of the statutory provision, the benefit conferred under section 91 is extended to the Income-tax paid in foreign jurisdictions. Therefore, even though, India has not entered into any agreement with the State of a country and if the assessee has paid Income-tax to that State, the Income-tax paid in relation to that State is also eligible for being given credit to the assessee in India.

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- Similar decision was rendered by Hon'ble Delhi Tribunal in the case of Dr. Rajiv I. Modi v. Dy. CIT [2017] 86 taxmann.com 253/167 ITD 318 (Ahd. - Trib.) wherein it was held that an assessee is entitled to tax credits in respect of State income taxes paid abroad as section 91 does not differentiate between State and Federal taxes and provides for both types of Income taxes to be taken into account for purpose of tax credits against Indian Income Tax liability the assessee is, in principle, entitled to tax credits in respect of the same. Of course, as is the scheme of tax credit envisaged in section 91, tax credit in respect of foreign income tax is restricted to actual income tax liability in India, in respect of income on which taxes have been so paid abroad .
- It was held by the Hon'ble Delhi Tribunal in the case of Aditya Khanna v. Income-tax Officer (International Taxation), Ward-3(2), New Delhi - [2019] 105 taxmann.com 323 (Delhi - Trib.) that Provisions of section 91 (1) provides relief/deduction of taxes paid with respect to a person who is a 'resident' in India. The provisions of section 91 (2) also deals with the person who is a 'resident' in India. The provisions of section 91 (3) deals with the person who is a 'non-resident'. The revenue contends that as the assessee is not a 'resident' therefore he is not entitled to benefit of section 91 of the act. The provisions of section 6 of the income tax act provides for qualification of the persons who are residents in India. The provisions of section 6 (6) carves out another category of person in 'Residents' , who is said to be 'not ordinarily resident' in India. However such persons are also 'resident'. The category is also called a 'resident but not ordinarily resident' in India. Therefore persons who are 'resident but not ordinarily resident' in India are forming larger group of the persons who are 'resident' in India. In view of this, we reject the contentions of the revenue that benefit of section 91 (1) of the act does not apply to a person who is 'not ordinarily resident' in India. It was held that assessee is entitled for tax credit of federal as well as state taxes paid by him u/s 91 of the Act.

# ARTICLE 3 – GENERAL DEFINITIONS

- Article 3(1) defines various terms like meaning of person, tax, fiscal year, etc.
- Article 3(2) states that any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of DTAA.
- It may happen that as a consequence of reference to domestic law, in many instances the two contracting states may attach different meanings to terms in applying the tax treaty.
- Some commentators says that if each treaty partner applies its own respective definition, it could lead to double taxation or non-taxation of income for both countries.
- It was held by the Hon'ble Mumbai Tribunal in the case of Hindalco Industries Ltd. v. Asstt. CIT [2005] 94 ITD 242 (Mumbai) that the provisions of the tax treaty are to be given effect to in their context and in the light of the object and purpose of the tax treaty. Even when connotations of a treaty term are to be adopted as per the domestic law in the country of taxability, it cannot be done so as a thoughtless and mechanical process. The meaning of the undefined terms in a tax treaty should be determined by reference to all of the relevant information and all of the relevant context. There cannot, however, be any residual presumption in favour of a domestic law meaning of a tax treaty term.

# ARTICLE 4 – FISCAL DOMICILE/RESIDENCE

- The permanence of the home, which can be an apartment or merely a rented furnished room, is essential. The individual must have access to the home at all times continuously and not occasionally for e.g. travel for pleasure, business travel, educational travel, attending a course at a school, etc.
- A house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there.
- Centre of vital interest will be deemed to be in a state where personal and economic interests are closer. For e.g. his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc. The circumstances must be examined as a whole. For example - If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State.
- “Habitual abode” refers to a three-fold test: frequency, duration, and regularity of stay. These are to be assessed in view of an individual’s facts and circumstances. While more complex, it may nevertheless lead to a more accurate determination of tax residency.



# ARTICLE 4 – Place of Effective Management (POEM) of a Company

- Section 6(3) of the Income-tax Act, 1961 (the Act), prior to its amendment by the Finance Act, 2015, provided that a company is said to be resident in India in any previous year, if it is an Indian company or if during that year, the control and management of its affairs is situated wholly in India. This allowed tax avoidance opportunities for companies to artificially escape the residential status under these provisions by shifting insignificant or isolated events related with control and management outside India.
- To address these concerns, the existing provisions of section 6(3) of the Act were amended vide Finance Act, 2015, with effect from 1st April, 2016 to provide that a company is said to be resident in India in any previous year, if its place of effective management in that year is in India .
- "Place of effective management" is defined in the Act to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.
- The guiding principles to be followed for determination of POEM are enumerated in Circular No. 06 of 2017 dated 24th January, 2017 .

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# ARTICLE 4 – Place of Effective Management (POEM) of a Company

- Any determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since “residence” is to be determined for each year, POEM will also be required to be determined on year to year basis.
- The process of determination of POEM would be primarily based on the fact as to whether or not the company is engaged in active business outside India.
- The place of effective management in case of a company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India.
- However, if on the basis of facts and circumstances it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India, then the place of effective management shall be considered to be in India. For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Pay roll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

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- For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.
- In cases of companies other than those that are engaged in active business outside India, the determination of POEM would be a two stage process, namely:-
  - ❖ First stage would be identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole.
  - ❖ Second stage would be determination of place where these decisions are in fact being made.
- The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM it is the substance which would be conclusive rather than the form.

# ARTICLE 4 – Place of Effective Management (POEM) of a Company

- The location where a company's Board regularly meets and makes decisions may be the company's place of effective management provided, the Board-
  - ❖ (i) retains and exercises its authority to govern the company; and
  - ❖ (ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.
- Mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.
- If a board has de facto delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

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- A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.
- The delegation of authority may be either de jure (by means of a formal resolution or Shareholder Agreement) or de facto (based upon the actual conduct of the board and the executive committee).
- The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made.
- The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

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- In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered.
- The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. However, the shareholder's involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct.
- It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM.
- If the above factors do not lead to clear identification of POEM then the following secondary factors can be considered :-
  - ❖ Place where main and substantial activity of the company is carried out; or
  - ❖ Place where the accounting records of the company are kept.

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- The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.
- The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- POEM provisions will not apply to a company having turnover or gross receipts of Rs. 50 crores or less in a financial year.