

# Sudit K. Parekh & Co.

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Chartered  
Accountants

**Taxation of Immovable  
Property, Capital Gains and  
Other Income (Article 6, 13,  
21)**

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**5 March 2016**

Mumbai | Pune | Hyderabad | New Delhi | Bangalore

| Abbreviation | Full-form                                              |
|--------------|--------------------------------------------------------|
| AAR          | Authority for Advance Rulings                          |
| Act          | Income-tax Act, 1961                                   |
| CA           | Capital Asset                                          |
| CG           | Capital Gains                                          |
| COR          | Country of Residence                                   |
| COS          | Country of Source                                      |
| DTAA         | Double Taxation Avoidance Agreement                    |
| IP           | Immovable Property                                     |
| LTCA         | Long Term Capital Asset                                |
| NR           | Non-resident                                           |
| OECD         | Organisation for Economic Co-operation and Development |
| PE           | Permanent Establishment                                |
| STCA         | Short Term Capital Asset                               |
| TOPA         | Transfer of Property Act, 1882                         |
| UN           | United Nations                                         |



## **Article 6 – Income From Immovable Property**

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### Taxability as per the Income Tax Act, 1961 -

- Taxable in India if property is situated in India u/s 9(1)(i).
- The expression “income” has to be interpreted in accordance with its definition in Sec 2(24) of Act.

### Taxability as per the International Tax Laws –

- Taxability as per the Article 6 of the OECD, U.N and U.S Model conventions deal with income from Immovable Property.
- The paragraphs of Article in all three conventions are similar with a minor difference.
- **Exception** - DTAA between India - Greece is an exception, income from immovable property falls under Article 10.

## OECD, UN and US

| Article | OECD Model                                                                                                                                                                                                               | UN Model                                                                                                                                                                                              | US Model                                                                                                                                                                                                              |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6(1)    | Income derived by a <b>resident</b> of a Contracting state from immovable property (including income from agriculture or forestry) situated in the other Contracting state may be taxed in that Other Contracting state. | Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State. | Income derived by a resident of a Contracting State from real property (immovable property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other State. |

## OECD, UN and US

| Article | OECD Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | UN Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | US Model                                                                                                                                                                       |
|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6(2)    | <p>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 not be regarded as immovable property</p> | <p>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 not be regarded as immovable property.</p> | <p>The term "real property (immovable property)" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated.</p> |

## OECD, UN and US

| Article | OECD Model                                                                                                                                | UN Model                                                                                                                                                                                                      | US Model                                                                                                                                                                                  |
|---------|-------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6(3)    | The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property. | The provisions of paragraph 1 shall also apply to income derived from the direct use, letting or use in any other form of immovable property                                                                  | The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of real property.                                                      |
| 6(4)    | The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.                             | The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services. | The provisions of paragraphs 1 and 3 shall also apply to the income from real property of an enterprise and to income from real property used for the performance of independent personal |

## OECD, UN and US

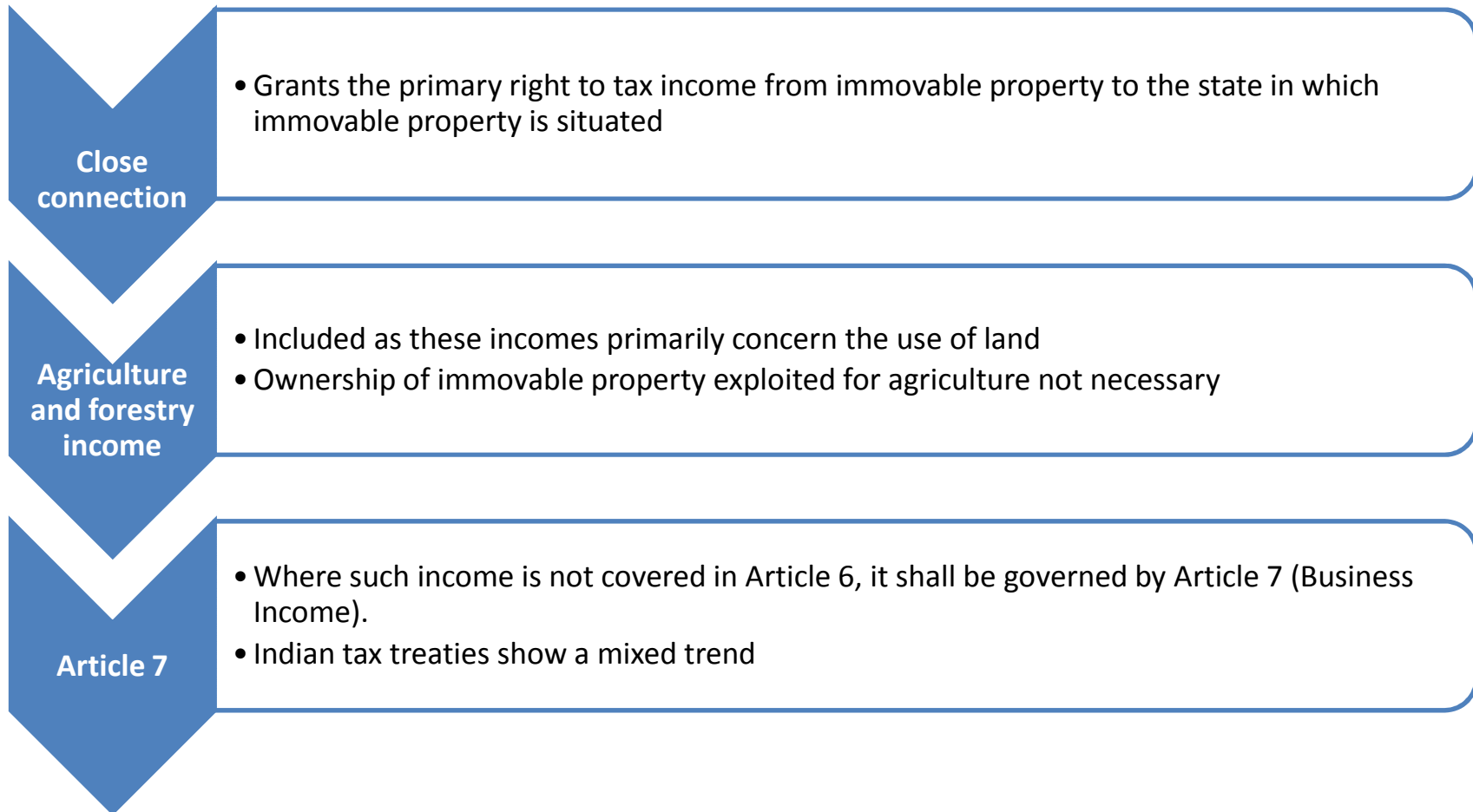
| Article | OECD Model               | UN Model               | US Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|---------|--------------------------|------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 6(5)    | Not there in OECD Model. | Not there in UN Model. | A resident of a Contracting State who is liable to tax in the other Contracting State on income from real property situated in the other Contracting State may elect for any taxable year to compute the tax on such income on a net basis as if such income were business profits attributable to a permanent establishment in such other State. Any such election shall be binding for the taxable year of the election and all subsequent taxable years unless the competent authority of the Contracting State in which the property is situated agrees to terminate the election. |



## Overview

| Article | Overview of Provisions                                                       |
|---------|------------------------------------------------------------------------------|
| 6(1)    | Grants rights of taxation to country where the property is situated          |
| 6(2)    | Meaning of Immovable Property                                                |
| 6(3)    | Explains forms of exploitation of property                                   |
| 6(4)    | Explains treatment of property of an enterprise/used for performing services |

## Paragraph 1



## Paragraph 1

### Alienation/sale

- Governed by Article 13(Capital Gains).
- Tax treaties with Armenia, Austria, France, Indonesia include such capital gains in Article 6 whereas treaty with Australia, China, Denmark, Japan do not include this income in Article 6

### Controversy in interpretation of "May be taxed in "

- State of source gets primary right but not the exclusive right as the paragraph uses the words '*may be taxed in*'
- SC held in CIT v. P.V.A.L. Kulandagan Chettiar 267 ITR 654 that income from rubber estate in Malaysia was not taxable in India although Article 6 uses the words 'may be taxed in'. Madras and MP High Courts and Chennai ITAT have taken the same view.
- Notification No. 91/2008 dt. 28-8-2008 clarifies that where the treaty provides 'may be taxed in', such income shall be included in the income of resident in India.

## Applicability of Article 6(1)

### Applicability

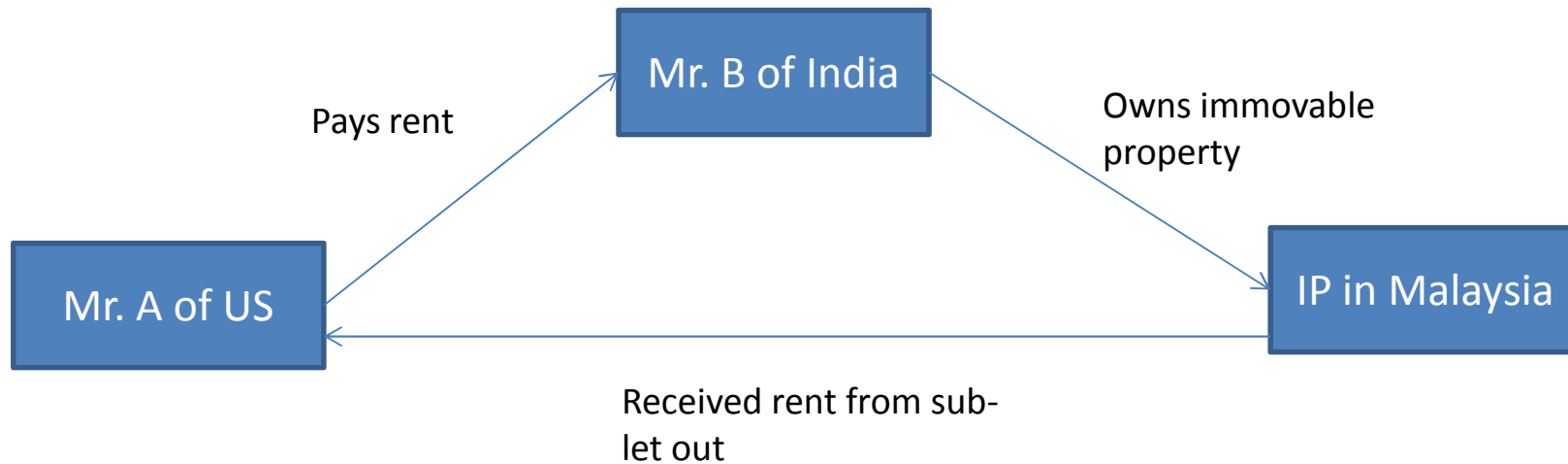
- Income derived from the **direct use, letting or use in any other form** of IP.
- **Capital gains** derived from **transfer** of IP (**in the absence of Article 13(1)**)
- **Deemed annual appreciation** of **owned** IP (if there is no indication whatsoever to suggest that the capital appreciation might fall under any other articles that would have prevented other contracting state from taxing it, had it not applied the deeming provision in its domestic law)
- Payments for **grant of licence to extract natural resources** (such payments are not 'royalties' under Article 12)
- **Scope of income to be covered within Art 6 or otherwise depends upon negotiation between contracting states.**

### Non Applicability

- **Interest** earned on **debt secured by IP** (such interest is **covered by Article 11**)
- **Interest** earned on **temporarily invested funds** which are **set aside for acquiring IP or for capital expenditure** (such interest is covered by **Article 11**)
- **Interest** earned on **bank deposits** placed out of **rent and security deposits** from IP (such interest is **covered by Art 11**)
- Distribution of **dividends** by a company referred to in **Article 13(14)**.
- **Deemed rental income** from IP in situations where the income recipient (Say, X), instead of owning the IP itself. Owns shares of a company owning the IP and such shares entitle X to use the property.

## Illustration

- Income from property situated in third state not covered



**Income from subletting received by Mr. A cannot be taxed under India – US treaty rather it will be taxable under US-Malaysia treaty.**

### Definition as per Section 269UA of IT Act

- Land or building or part thereof and includes
- Plant & Machinery, furniture, fittings and other things transferred along with land or building
- Including right therein

### Inclusions as per Treaty

- Property accessory to IP
- Livestock and equipment used in agriculture and fores
- Rights to which the provisions of general law respecting landed property apply
- Usufruct of IP
- Rights attached to extraction of natural resources

### Exclusions as per Treaty

- Ships, boats and aircrafts
- Indebtedness secured by immovable property

### Forms of exploitation

- Direct use
- Letting out
- Use in any other form

### No specific definition of term 'letting out'

- Can also include sub-letting?

### No specific definition of term 'used in any other form'

- Governed by the local laws of the country where the property is Situated.

- 
- **Extends scope of situs based taxation -**
    - Income earned by an enterprise (PE of non- resident in source country) from immovable property
      - E.g. relinquishment of property for use by a third party
  - **Income from immovable property used for the purpose of IPS**
  - **Consequences on computation of income**
    - Principles laid down in Article 7 do not apply
  - **Silent on the modalities of determining income. In the absence of specification, the computation shall be as per the domestic law.**





**Article 13**

## Relevant Sections

### Definitions

- Section 2(14) – ‘Capital asset’
- Section 2(29A) – ‘Long term capital asset’ (LTCA)
- Section 2(42A) – ‘Short term capital asset’ (STCA)
- Section 2(47) – ‘Transfer’ (akin to alienation)
- Section 269UA(d) – ‘Immovable property’

### Charging provisions

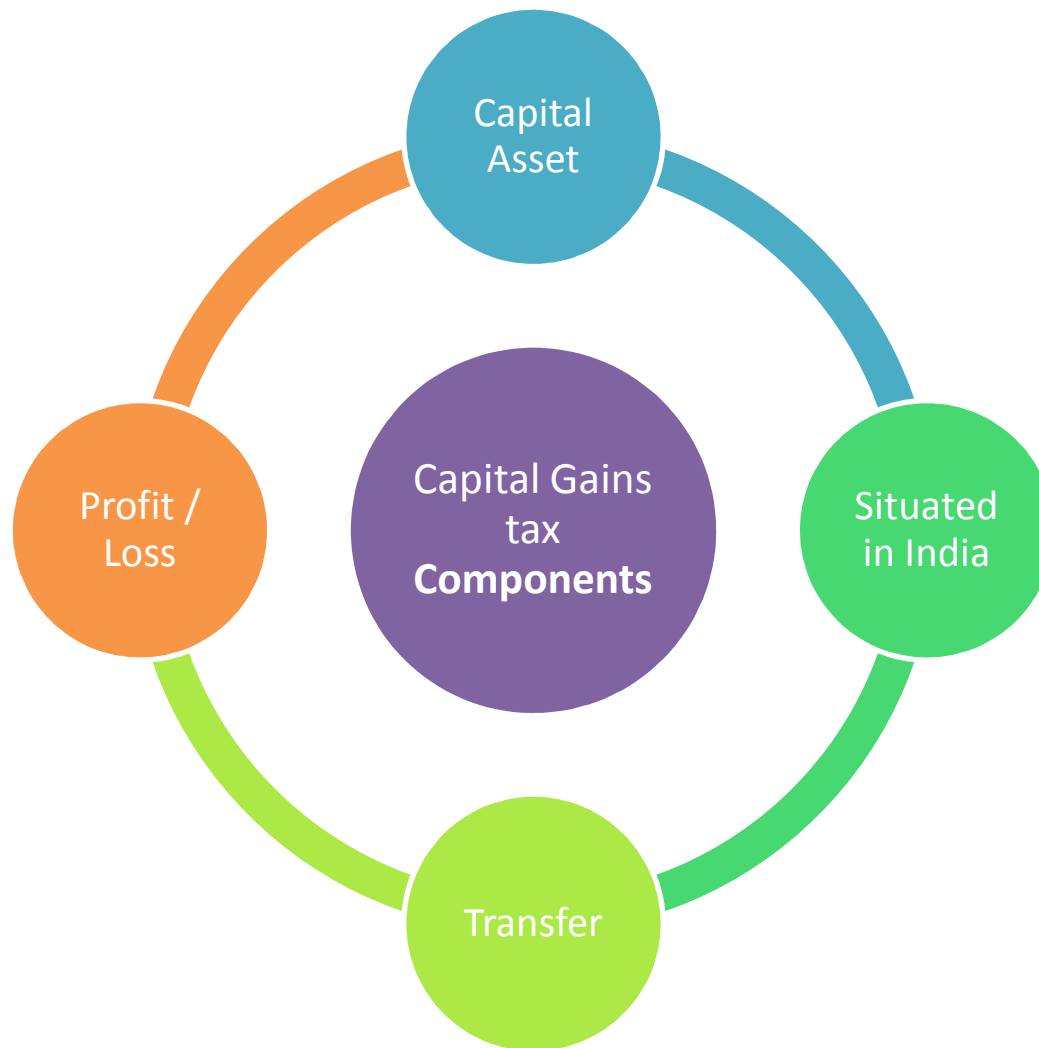
- Section 9(1)(i) – Income deemed to accrue or arise in India
- Section 45 – Chargeability of ‘income from capital gains’ to tax
- Section 46 – Distribution of assets in liquidation
- Section 46A – Buy back of shares
- Section 47 – Certain transactions not to be treated as ‘transfer’

### Computation and withholding

- Section 48 – Mode of computation of capital gains
- Section 50 – Computation of capital gains in case of depreciable assets
- Section 50B – Computation of capital gains in case of slump sale
- Section 50C – Anti-avoidance provision relating to undervaluation of immovable property
- Section 50D – Fair market value deemed to be full value of consideration in certain cases
- Section 111A, 112
- Section 195 – Deduction of tax at source for payment in case to NR

## Components for Capital Gains Tax

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## Specific provisions

### **CAPITAL ASSET [Section 2(14)]**

- Defined to mean property of any kind (whether or not connected with business or profession)
- Property may be tangible or intangible
- Examples = Land, buildings, vehicles, goodwill, tenancy rights, leasehold rights, licenses, patents, trade marks, etc.
- Stock in trade, agricultural land, personal affects, etc. are certain exclusions of capital assets subject to certain conditions

### **SITUATED IN INDIA [Section 9]**

- Gains from 'transfer' of capital asset is deemed to accrue or arise in India, if the capital asset is 'situated in India'
- Situated in India not defined
- However, clarified that share / interest of a foreign company shall be deemed to have always been situated in India if such share / interest derives its value substantially from assets located in India (i.e. Indirect Transfer provisions – explained in next slide)

### **UNDERSTANDING THE PROVISIONS**

### **TRANSFER OF CAPITAL ASSET [Section 2(47)]**

- The sale, exchange or relinquishment of an asset;
- The extinguishment of any rights therein;
- The compulsory acquisition of any capital asset by the government;
- Conversion of capital asset in to stock in trade.
- Transaction involving allowing of possession of any immovable property to be taken or retained in part performance of contract under TOP Act, 1882

### **GAIN / LOSS**

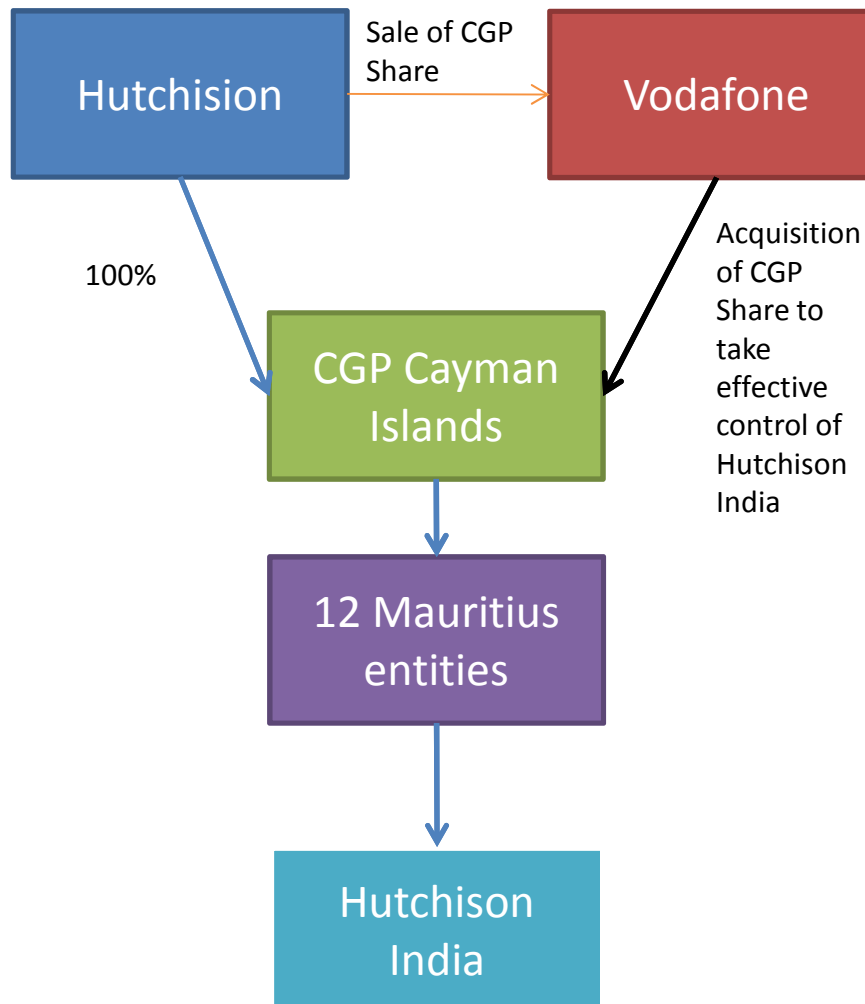
- Any gain / loss arising from 'transfer' of 'capital asset' 'situated in India', will be taxable in India
- Mode of computation of gain / loss varies depending on type of capital asset and period of holding i.e. Long term or Short term
- Even rate of tax varies depending on type of capital asset

## Provisions and history

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- Share / interest of a foreign company deemed to always have been situated in India if such share / interest derives its value substantially from assets located in India
- Share / Interest of foreign company deemed to derive substantial value from Indian assets if the value of Indian assets
  - Exceed INR 100 million and
  - Said value  $\geq$  50% of the value of all assets owned by foreign company
- Amount to be taxed in India to be proportional to value of Indian assets to global assets
- Exemption provided from indirect transfers to
  - Small shareholders holding less than 5% voting power/share capital and not having management control
  - Foreign amalgamations and demergers, subject to certain conditions
- These provisions were introduced retrospectively from 1 April 1962 to negate the favorable order of the Hon'ble Supreme Court decision in the case of **Vodafone International B.V. (17 taxmann.com 202 (SC) [2012])**

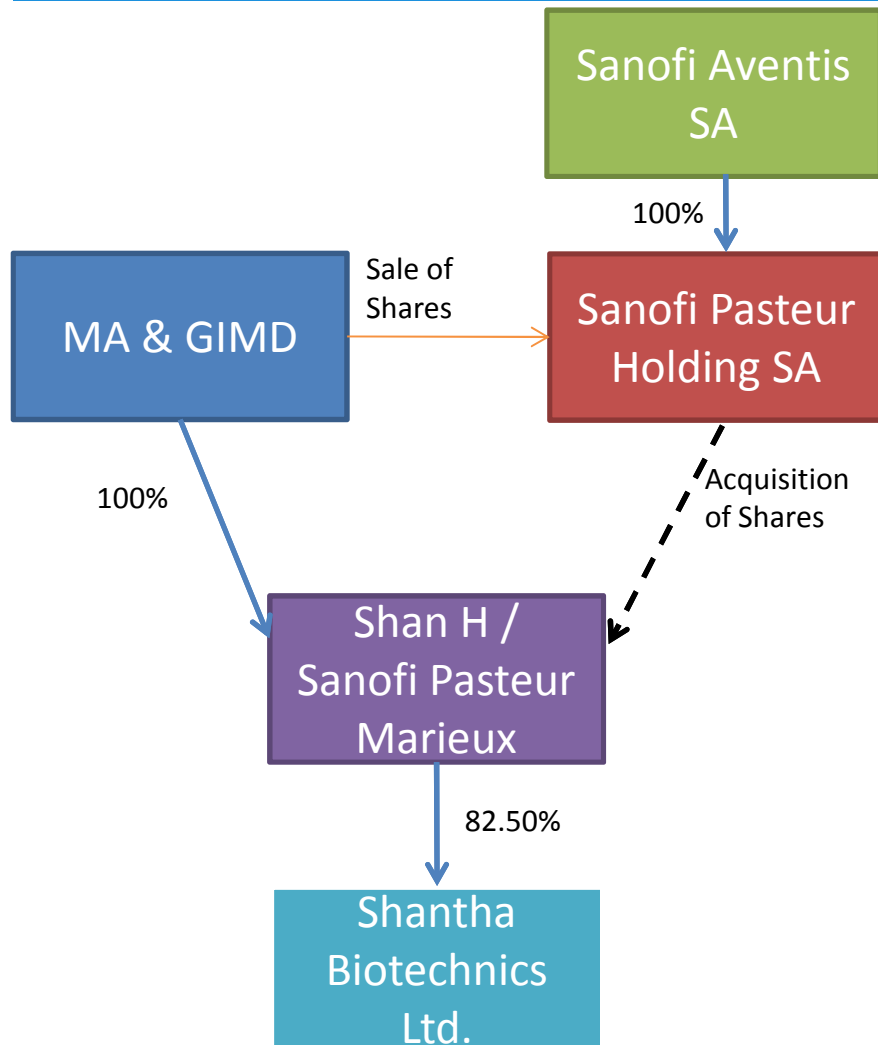
## Vodafone ruling – Supreme Court



### Supreme Court's ruling:

- Section 9(1) a legal fiction, and cannot be expanded by giving purposive interpretation - It does not envisage “look through” provisions
- Word “indirectly” used only with ‘income’; not “capital asset”
- Source of income is where the transaction of sale takes place; and not where the value lies
- A share is situated where the company is registered and the register of members is kept; and not where the ‘underlying assets’ are situated
- Controlling interest in the management of the company - not an identifiable or distinct capital asset independent of the holding of shares
- Tax is to be levied on the transaction i.e. share sale and not on its effect
- Vodafone case an eye-opener of what India lacks in regulatory laws and what measures India has to take to meet the various unprecedented situations without sacrificing national interest

## Sanofi ruling – Andhra Pradesh High Court



### High Court's ruling:

- ShanH is an independent corporate entity, registered and resident in France. It has a commercial substance and a purpose (FDI in SBL); and is neither a mere nominee of MA and/or MA/GIMD, nor is a contrivance/device for tax avoidance;
- Since inception (in 2006) till date, ShanH (not MA or MA/GIMD) had acquired and continued to hold SBL shares;
- There is no warrant for lifting corporate veil of ShanH; and even on looking through the ShanH corporate persona there is no material to conclude that there is a design or stratagem to avoid tax.
- The capital gain arising as a consequence of the transaction in issue is chargeable to tax; and the resultant tax is allocated to France (not to India) under the DTAA;
- The retrospective amendments to the Income-tax Act, 1961 (vide the Finance Act, 2012) have no impact on interpretation of the DTAA; the transaction in issue falls within Article 14(5) of the DTAA; and the tax resulting therefrom is allocated exclusively to France;
- The ruling of the Authority for Advance Rulings is unsustainable; and
- The order of assessment (determining Sanofi to be an assessee in default, under section 201 of the Act) is unsustainable

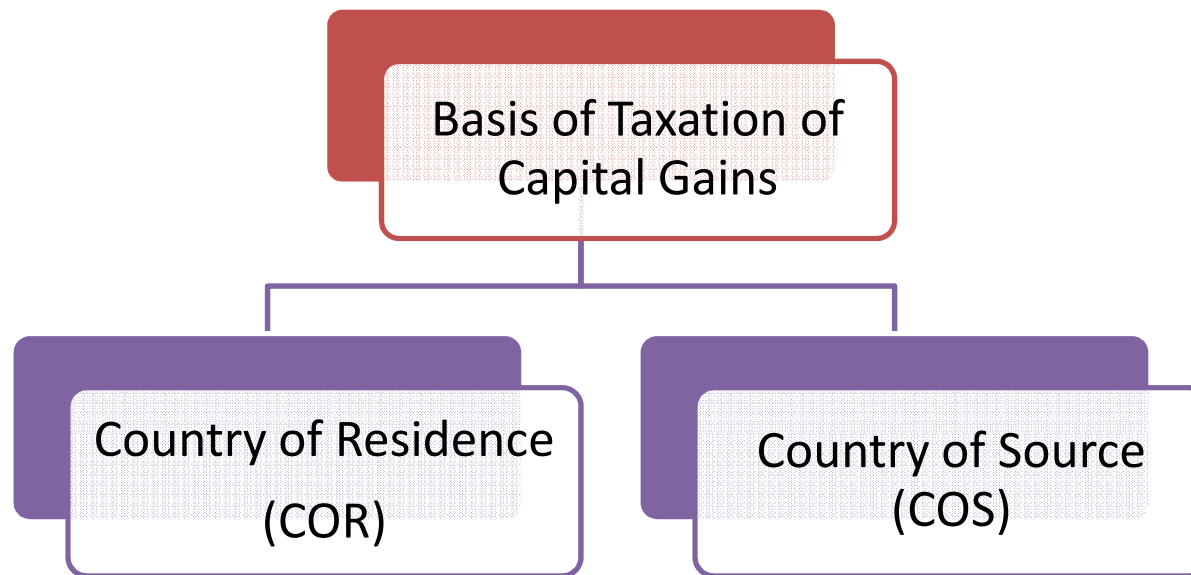
# Taxability under DTAA

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- India has entered into DTAA with several countries
- As per Section 90(2) of the Act, taxability for NRs is determined as per the provisions of the **Act** or the applicable **DTAA, whichever is more beneficial.**
- Capital gains under the DTAA are generally taxed in a different manner than other incomes
- Provisions of taxability of capital gains vary from treaty to treaty
- Depending on the provisions of specific treaties, tax planning can be done
- The rights of taxation of capital gains as per Article 13 of OECD and UN Model Conventions are explained in the next slide



## Taxability under DTAA – Diagrammatic representation

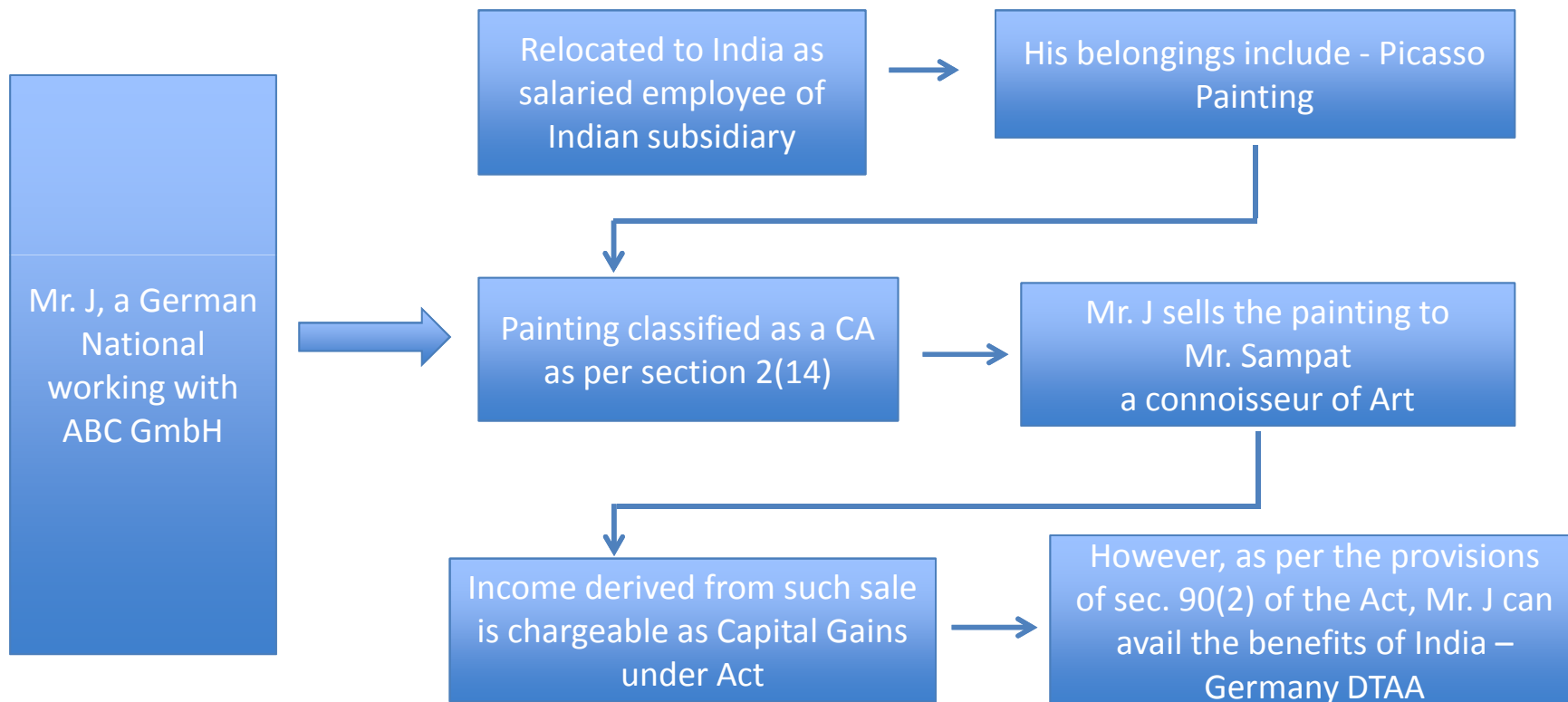


- Features of Article 13 of OECD and UN Model Conventions
  - As per the basic principle of International taxation, COR always has the right to tax income. The COS may be given full / partial / or no rights to tax
  - From capital gains tax perspective, gains from alienation of assets are as such always taxable in the COR, i.e. where the seller is a resident. For some assets, COS is also given the right to tax, i.e. where the asset is situated (situs of asset)
  - Generally, the country which has the right to tax income derived *from* the asset, is given the right to tax gains arising *from alienation (sale/ transfer)* of such assets

## Classic example of how DTAA is more favorable than Act

### Illustration

A tax resident of Germany selling assets situated in India:



As per the provisions of India – Germany DTAA, position can be taken **capital gains** arising in India from sale of painting will be **taxable in Germany only as not covered specifically in Article 13**

## OECD vs UN

| Article | OECD Model                                                                                                                                                                                                                                                                                                                                               | UN Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13(1)   | Gains derived by a resident of a Contracting State from <b>alienation of immovable property</b> referred to in Article 6 and situated in the other Contracting state may be <b>taxed in that other State</b>                                                                                                                                             | Gains derived by a resident of a Contracting State from <b>alienation of immovable property</b> referred to in Article 6 and situated in the other Contracting state may be <b>taxed in that other State</b>                                                                                                                                                                                                                                                                                                           |
| 13(2)   | Gains from <b>alienation of movable property</b> forming part of the <b>business property</b> of a <b>permanent establishment (PE)</b> which an enterprise of a Contracting State has in the other Contracting State, including gains from alienation of such PE (alone or with the whole enterprise) may be <b>taxed in the other Contracting State</b> | Gains from <b>alienation of movable property</b> forming part of <b>business property</b> of a <b>PE</b> which an enterprise of a Contracting State has in the Other Contracting State or <b>movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services</b> , including such gains from alienation of such PE (alone or with the whole enterprise), may be <b>taxed in that other State</b> |

\*US Model convention is typical – Even capital gains article under India-USA tax treaty is not as per US convention. Hence, it has not been explained in this presentation

## OECD vs UN

| Article | OECD Model                                                                                                                                                                                                                                                                                                                                                                                                                                          | UN Model                                                                                                                                                                                                                                                                                                                                                                                                           |
|---------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13(3)   | <p>Gains from <b>alienation of</b></p> <ul style="list-style-type: none"> <li>▪ ships or,</li> <li>▪ aircrafts operated in international traffic,</li> <li>▪ boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircrafts or boats,</li> </ul> <p>shall be <b>taxable only in the Contracting State in which the Place of Effective Management (POEM) of the enterprise is situated</b></p> | <p>Gains from <b>alienation of</b></p> <ul style="list-style-type: none"> <li>▪ ships or</li> <li>▪ aircrafts operated in international traffic,</li> <li>▪ boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircrafts or boats,</li> </ul> <p>shall be <b>taxable only in the Contracting State in which the POEM of the enterprise is situated</b></p> |

## OECD vs UN

| Article | OECD Model                                                                                                                                                                                                                                                      | UN Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|---------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13(4)   | <p>Gains derived by a resident of a Contracting State from <b>alienation of shares deriving more than 50% of their value directly or indirectly</b> from immovable property situated in the other Contracting State may be <b>taxed in that other State</b></p> | <p>Gains from <b>alienation of shares</b> of the capital stock of a company, or <b>of an interest in a partnership, trust or estate</b>, the property of which consists <b>directly or indirectly principally</b> of immovable property situated in a Contracting State may be <b>taxed in that state</b>.</p> <p><i>Exception provided to Company, partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, etc. in its business activities (not being business of management of immovable property).</i></p> <p><i>“Principally” means 50% or more of the aggregate value of all assets owned by such company, partnership, etc.</i></p> |

## OECD vs UN

| Article | OECD Model                                                                                                                                                                                 | UN Model                                                                                                                                                                                                                                                                              |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 13(5)   | Gains from alienation of any property, other than that referred to in paragraph 1, 2, 3, and 4 shall be <b>taxable only in the Contracting State of which the alienator is a resident.</b> | Gains from <b>alienation of shares other than those mentioned in paragraph 4</b> representing participation of a percentage (which is established by way of <b>bilateral negotiation</b> ) in a company which is a resident of a Contracting State may be <b>taxed in that State.</b> |
| 13(6)   | Not there in OECD Model.<br><br>Effectively Para 13(5) applies                                                                                                                             | Gains from the <b>alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5</b> shall be taxable in the Contracting State in which the alienator is a <b>resident.</b>                                                                                    |

## Overview

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- OECD Model Commentary is exhaustive and well-explained
  - UN Model Commentary is broadly said to be in line with OECD Model Commentary and a view adopted for OECD Model commentary can be similarly adopted for UN Model Commentary
- Renowned authors such as Klaus Vogel and Philip Baker have given their views on OECD Model
- Instances when OECD Commentary has been relied on by judicial authorities for interpreting tax treaties (in addition to **Telecommunications Consultants India Limited - [2012] 20 taxmann.com 31 (Delhi)**)
- **Asia Satellite Telecommunications Co. Ltd., v. (2011) 332 ITR 0340 (Delhi HC):**  
*“The Tribunal has discarded the aforesaid commentary of OECD as well as Klaus Vogel only on the ground that it is not safe to rely upon the same. However, what is ignored is that when the technical terms used in the DTAA are the same which appear in Section 9(1)(vi), for better understanding all these very terms, OECD commentary can always be relied upon. The Apex Court has emphasized so in number of judgments clearly holding that the well-settled internationally accepted meaning and interpretation placed on identical or similar terms employed in various DTAAs should be followed by the Courts in India when it comes to construing similar terms occurring in the Indian Income Tax Act.”*

## Overview


| Sr. No | Type of capital asset                                                                                                                                     | OECD Model                                     | UN Model                                                         |
|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------|------------------------------------------------------------------|
| 1      | Alienation of immovable property                                                                                                                          | Taxable in COS                                 | Taxable in COS                                                   |
| 2      | Movable property forming part of business property of a PE, including gains from alienation of PE itself either alone or along with the entire enterprise | Taxable in COS                                 | Taxable in COS                                                   |
| 3      | Gains from alienation of ships, aircrafts, or boats or movable property relating to operations in international traffic                                   | Taxable in country of POEM                     | Taxable in country of POEM                                       |
| 4      | Gains from <b>alienation of shares</b> of company resident in source country, deriving their value mainly from immovable property in source country       | Taxable in COS                                 | Taxable in COS                                                   |
| 5      | Gains from alienation of any other property not included in the Article                                                                                   | Taxable in COR                                 | Taxable in COR                                                   |
| 6      | <b>Gains from sale of shares of a company resident in source country, other than discussion in point 4 above</b>                                          | <b>Not found in OECD Model, taxable in COR</b> | <b>Found in UN Model, taxable in COS, subject to negotiation</b> |




## Immovable property [Article 13(1)]




- Paragraph 1 preserves the right of the COS to tax gains from alienation of immovable property situated in that Country




- The term ‘immovable property’ means property as explained in Article 6



- It is immaterial whether property is residential or commercial, capital asset, the COS can levy tax.




- The treatment of income as capital gains or business income or other income depends on the domestic law. For example – sale of capital assets is taxed under capital gains tax and sale of stock-in-trade is taxed under business income




- Most of the DTAA's entered into by India provide that the gains ‘may also be taxed’ in the source state and thus grant taxing rights to both the states (examples India-Belarus DTAA, India-Czech Republic DTAA, India-Ireland DTAA, India-Israel DTAA, India-Jordan DTAA, India-Qatar DTAA, India-Russia DTAA etc.)

## Movable property [Article 13(2)]




- Paragraph 2 of Article 13 deals with allocation of taxing rights to the Source State in respect of gains from alienation of movable property, subject to the following conditions;

- There must be an alienation of movable property
- The movable property must form a part of business property
- The business must have a PE in the Source State
- Such PE must be of the enterprise of the Residence State
- The gain must arise on alienation of such movable property or
- The gains must arise on alienation of such PE independently or as along with the enterprise as a whole
- The Source State may tax such gains




- Since IPS article is not covered in the OECD convention, there is no specific mentioning of gains from movable property to a fixed base available to IPS.

## Ships and Aircrafts [Article 13(3)]


- 
- If a non- resident earns Capital Gains from sale of:
    - ships or aircraft operated in international traffic,
    - boats engaged in inland waterways transport, or
    - movable property pertaining to the operation of such ships, aircraft or boats.
  - The same can be taxed ONLY in the Contracting State in which the POEM of the enterprise is situated.
  - Any movable property relating to operation of ships and aircrafts in international traffic can be taxed only where the POEM is situated.
  - It is immaterial whether there is a PE or not or whether the asset is a part of the PE or not.

Article 13(3) being a specific article takes precedence over article 13(2)


## Shares deriving value from immovable property [Article 13(4)]




- Alienation of shares deriving more than 50 percent of its value, directly or indirectly from immovable property situated in a contracting state, may be taxed in the contracting state.




- Many states prefer to either broaden or narrow the scope of this paragraph through bilateral negotiations



- UN Model further extends the scope of this Article by including interest in partnerships or trust etc. and provides for property which consists 'principally' of immovable property situated in a contracting state





- The expression 'principally' has been defined to mean the value of such immovable property exceeding 50% of the aggregate value of all assets owned by the company, partnership, trust or estate

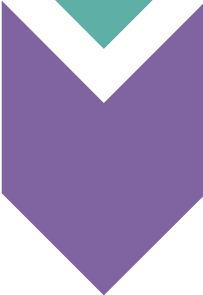


- Hence, if the property is in India and it is owned by an Indian entity or a foreign entity, on sale of shares or interest in the entity, India can tax the income if the value of the shares is principally derived from the value of immovable property other than used for the purpose of business

## Residuary Assets [Article 13(5)] [UN Model 13(6)]

- 
- Residuary assets include:
    - Shares other than ones covered in Article 13(4)
    - Bonds;
    - Debentures;
    - Other financial instruments;
    - Stock options, stock futures, stock indices etc.

- 
- Residence country has exclusive taxation rights

- 
- Taxability in Residence country depends on domestic law  
e.g. Mauritius / Singapore does not tax capital gains

As can be seen from above, Article 13(5) provides for taxation in COR even in case of shares of company resident in COS if they are not covered by Article 13(4) – This is a point of difference with UN Model Article 13(5)

## UN Model [Article 13(5)]

- Gains from alienation of shares other than those mentioned in paragraph 4 representing participation of a percentage (which is established by way of bilateral negotiation) in a company which is a resident of a Contracting State may be taxed in that State i.e. COS

- Generally, Indian treaties provide that gains from alienation of shares of Indian company will be taxable in India and do not provide for any percentage of holding

- Exceptions to the above are as under:

- Gains from alienation of shares of Indian company not taxable in India – Mauritius, Singapore, Cyprus, Korea

- Gains from alienation of shares of Indian company not taxable in India unless certain percentage of holding satisfied – Netherlands, France

- Other than above, most of the tax treaties alienation of shares of Indian company will be taxable in India

- Treaties with US and UK provide for taxation as per law of respective countries

## India – Singapore and India - Mauritius DTAA

| India – Singapore DTAA                                                                                                                                                                                                                            | India - Mauritius DTAA                                                                                                                               |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| Capital Gains on sale of shares of an Indian company are not taxable in India in the hands of a resident of Singapore<br>– Article 13(4) of the DTAA                                                                                              | Capital Gains on sale of shares of an Indian company are not taxable in India in the hands of a resident of Mauritius<br>– Article 13(4) of the DTAA |
| However, as per protocol, the benefit of exemption of tax in India will not be available if the affairs of the Singapore resident are “arranged with the primary purpose to take advantage of the benefits” provided in Article 13(4) of the DTAA | There is no such protocol                                                                                                                            |
| Also, as per the protocol, the benefit of Article 13(4) of the DTAA is not available to a shell / conduit company – Criteria provided for determining shell / conduit company                                                                     | There is no such protocol                                                                                                                            |
| There is no capital gains tax in Singapore                                                                                                                                                                                                        | There is no capital gains tax in Mauritius                                                                                                           |

This explains why Singapore and Mauritius are more favoured jurisdictions for inbound investment into Indian companies

## Litigation

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- Unlike India-Singapore DTAA, as India-Mauritius DTAA does not have a protocol for limiting the benefits of Article 13(4) of the DTAA, there has been considerable litigation on this issue
  - The tax authorities have alleged that investors using the India - Mauritius DTAA are indulging in treaty shopping as they lack commercial substance in Mauritius
- However, the Supreme Court in **Azadi Bachao Andolan [2003] 132 taxman 373 SC** held that benefit of India-Mauritius DTAA had to be granted to every Mauritius resident which furnished a valid Tax Residency Certificate (TRC)
- Supreme Court also upheld the validity of CBDT Circular **No. 789 which** stated that:  
*wherever a TRC is issued by the Mauritian Revenue Authorities, it will be sufficient evidence for residence and beneficial ownership for applying the provisions of the India-Mauritius DTAA*



## India – Cyprus DTAA and India – Korea DTAA

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- India - Cyprus DTAA and India-Korea DTAA also provide for similar benefits on capital gains as the India - Mauritius DTAA i.e. no tax is payable in India on sale of shares in an Indian company by a tax resident of Cyprus / Korea and there is no protocol in this regard
- However, these are not as preferred as Mauritius due to the following reasons:

### Cyprus

- CBDT has notified Cyprus as a “Notified Jurisdictional Area” under Section 94A i.e. Cyprus has been listed as a non-cooperative jurisdiction from 1<sup>st</sup> November 2013 for all transactions with Cyprus
- Accordingly:
  - For transactions with a person in Cyprus, concerned parties shall be treated as AEs and transfer pricing provisions will accordingly apply - additional documentation as prescribed will be required to be maintained
  - Any payment on which tax is deductible at source and made to a person located in Cyprus, will be liable for deduction of tax at source as per the rates under the Act or 30%, **whichever is higher**.
- While this does not impact the tax exemption provided under India-Cyprus DTAA, transactions with Cyprus have come under intense scrutiny

### Korea

- Korea is not generally preferred due to language barriers

## India – Netherlands DTAA and India – France DTAA

| Netherlands - Article 13(5)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | France - Article 14(5)                                                                                                                                                                                                                    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Gains from alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in COR</p> <p>However, gains from alienation of shares of a company resident in the other State (COS) which shares form part of at least a 10% interest in the capital stock of that company, may be taxed in that other State if the alienation takes place to a resident of that other State</p> <p>However, exception is provided to the above for corporate organisation, reorganization, amalgamation, division or similar transaction and buyer or seller owns at least 10% of capital of the other</p> | <p>Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of at least 10 per cent in a company which is a resident of a Contracting State may be taxed in that Contracting State.</p> |

**What is to be checked is the total holding percentage and not the actual percentage sold i.e. if Netherlands / France company holds atleast 10% in Indian company, then gain will be taxable in India even if 1 share is sold**

## India – USA and India - UK DTAA

| India – USA DTAA                                                                                                                                                                     | India - UK DTAA                                                                                                                                                                                  |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Except as provided in Article 8 (Shipping and Air transport) of this Convention, each contracting state may tax capital gains in accordance with the provisions of its domestic law. | Except as provided in Article 8 (Air transport) and Article 9 (Shipping) of this Convention, each contracting state may tax capital gains in accordance with the provisions of its domestic law. |

Treaties with US and UK provide for taxation as per law of respective countries



## **Article 21 – Other Sources**

## Introduction and Scope

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**Article 21 – ‘Other Income ‘ covers the income which is not specifically covered under any other Article of the DTAA. Thus, Article 21 is a residuary Article.**

### Scope

- Does not cover income which is covered by Article 2 or any other Article of the DTAA (e.g. incomes which are subject to Indirect tax)
- Limited in Scope, mere non-inclusion of any income in any other specific Article does not imply the inclusion of the same under the preview of this Article - DCIT vs Andaman Sea Foods Pvt. Ltd. **[ITA No. 1412/Kol/2011]**

### Overview

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#### Elements of Income

- Distribution from partnership firms, trusts, do not constitute income and thus not covered

#### Income Includes

- 'Income' includes income from gambling, punitive (but not compensatory) damages, non-compete covenants, income from activities other than business or profession, alimony, winnings from lottery, rent from immovable property etc.

#### Income Excludes

- Business Profits (Article 7)
- Royalty income arising from COS owned by a resident of the other contracting state (Article 12)
- Dividend and interest sourced in and received by the trustee in COS on behalf of the beneficiary of COR (Article 10/11).

## OECD vs UN vs US

| Article | OECD Model                                                                                                                                                               | UN Model                                                                                                                                                                  | US Model                                                                                                                                                                                           |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 21(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. | 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. | Items of income <b>Beneficially Owned</b> by 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. |

## OECD vs UN vs US

| Article | OECD Model                                                                                                                                                                                                                                                                                                                                                                                                                                                               | UN Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | US Model                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|---------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 21(2)   | <p>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 State through a PE situated therein and the right or property in respect of which the income is paid is effectively connected with such PE. In such cases provisions of Article 7 shall apply.</p> | <p>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 State through a PE situated therein or performs in the other State IPS from a fixed base situated therein and the right or property in respect of which the income is paid is effectively connected with such PE or fixed base. In such cases provisions of Article 7 or Article 14, as the case may be, shall apply.</p> | <p>The provisions of paragraph shall not apply to income, other than income from <b>real property</b> as defined in paragraph 2 of Article 6 [income from real property (immovable property)], if the <b>beneficial owner</b> of the income, being a resident of a Contracting State, carries on business in the other Contracting State through PE situated there in, or performs in that other State IPS from a fixed base situated therein, and the income is attributable to such PE or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (IPS), as the case may be, shall apply.</p> |



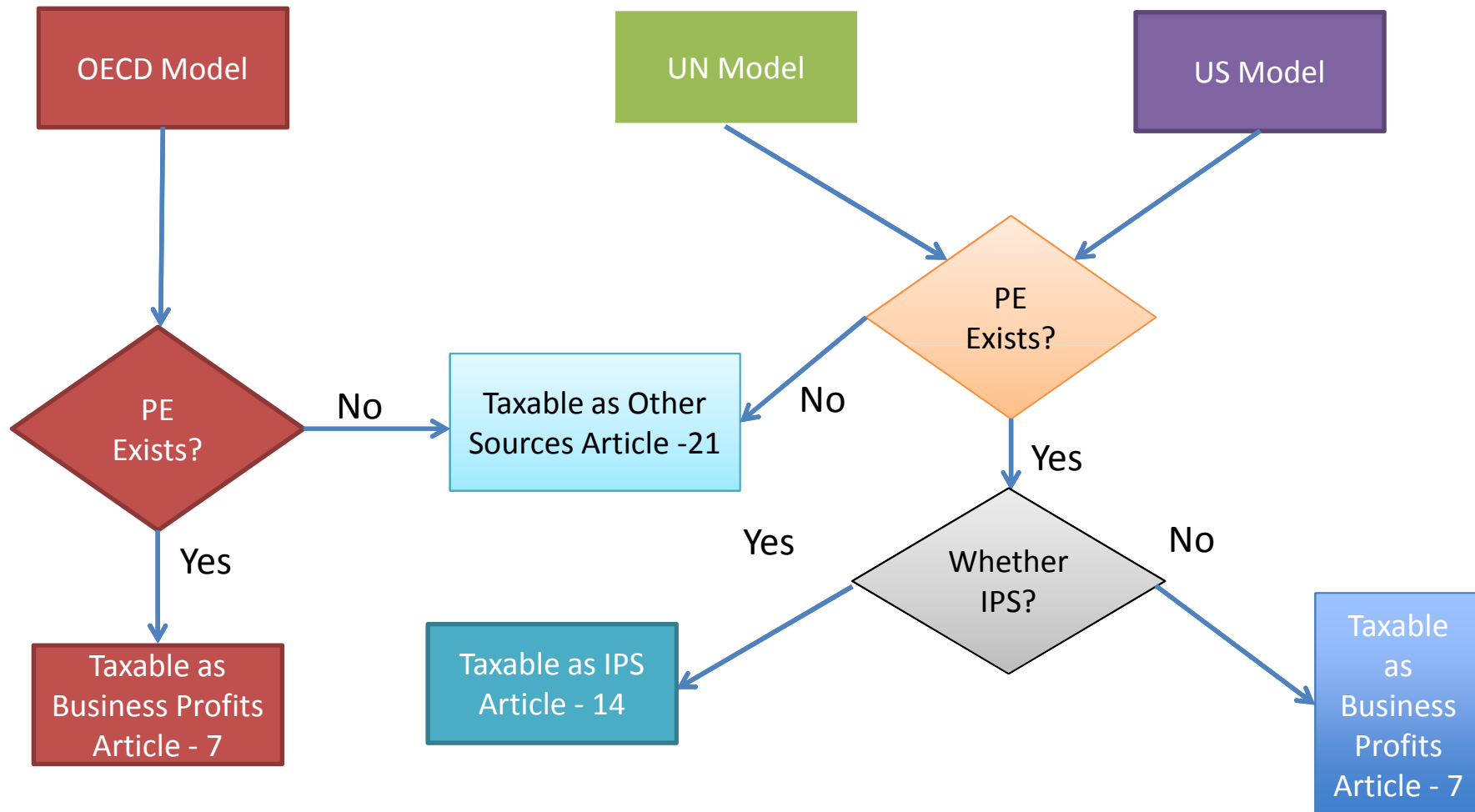
## OECD vs UN vs US

| Article | OECD Model              | UN Model                                                                                                                                                                                                                                                      | US Model              |
|---------|-------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|
| 21(3)   | Not there in OECD Model | Notwithstanding the provisions of paragraph 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 <b>may also be taxed in that other state</b> | Not there in US Model |

## Overview

| Article Number | OECD Model                                               | UN Model                | US Model                |
|----------------|----------------------------------------------------------|-------------------------|-------------------------|
| 21(1)          | Taxable in COR                                           | Taxable in COR          | Taxable in COR          |
| 21(2)          | Taxable under Article 7 or Article 14 as the case may be | Taxable under Article 7 | Taxable under Article 7 |
| 21(3)          | Not found in OECD Model                                  | Taxable in COR          | Not found in US Model   |

## Income associated with PE/FB[Article 21(2)]



## [Article 21(3)]

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- Article 21(3) **only** makes an appearance in the **UN MC** and has been excluded from the OECD and US MC.
- Income becomes taxable in COS as per domestic law in case it is not expressly dealt within the foregoing Articles. However, Article 21(1) states that COR has the right to tax such income. This may result in double taxation. To combat this occurrence provisions of Article 23S or 23B may be applied as required.
- The UN MC offers three options on inclusion of a new clause which deals with financial instruments.
  1. The Contracting state may adopt Article 21 of the US model with all three paragraphs.
  2. The Contracting State may adopt Article 21(3) with a reduced tax rate.
  3. The Contracting state may Adopt only Article 21(1) and Article 21(2)
- The said clause observes the domestic laws of both states to determine the source of income for the purpose of income which is deemed to have arisen in a given Contracting State.
- In case countries want to avoid the issue of double taxation they may insert a clause stating that Income will have been deemed to arise in a contracting state where the payer is a resident or where the person paying the income whether a resident or not has a PE/FB in the contracting state, in connection of which the income has been incurred and borne by such PE/FB then such income will have been deemed to arise in the state in which the PE/FB is situated.

## Issues

- May be taxed as per the provisions of Article 17 based on the judgment passed by AAR or as per the provisions of Article 21 as per the opinion provided by CBDT.

**Guarantee Commission**



- 'Business Income' Article – AAR ruling in case of Tekniskil (Sendirian) Berhad (88 taxman 435)
- 'Other Income' Article – XYZ. In re (20 taxman.com 88)
- Ambiguity in this matter and the approach would depend upon facts to facts

**Absence of article -  
'Fees for technical  
Services'**



| Issues                                                                                                                                                        | Countries                                                                                                              |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| No provision of this Article                                                                                                                                  | Greece, Libya, Malaysia and Netherlands                                                                                |
| Restricting right to tax to lotteries, crossword puzzles, races, gambling, betting etc                                                                        | Germany, Hungary, Ireland, Israel, Jordan, Portugal, Russia, Sweden, Switzerland, Kazakhstan and Czech Republic.       |
| Clause 3 not adopted                                                                                                                                          | Mauritius, Nepal and UAE                                                                                               |
| Adopting partly UN and partly OECD model by deleting Fixed Base in clause 3                                                                                   | Turkey                                                                                                                 |
| Right to tax in COS                                                                                                                                           | Namibia                                                                                                                |
| Right to tax in COR                                                                                                                                           | Korea, Philippines and Syria                                                                                           |
| Treaties adopting single clause- tax shall be levied in the state of residence except where express provision to the contrary has been made in the convention | Bangladesh, Brazil, Egypt, Finland, Italy, Kenya, Malaysia, New Zealand, Singapore, South Africa, Thailand and Zambia. |

| Treaty         | Extension in clauses                                                                                                                                                                                                                                                                           |
|----------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Canada         | <b><u>Extension to clause 3:</u></b> Where <b>income chargeable to tax in COR</b> is derived from an <b>estate of trust</b> (other than a trust to which contribution is eligible for tax deduction), the <b>tax</b> on such income <b>shall not exceed 15%</b> of the gross amount of income. |
| United Kingdom | <b><u>Extension to clause 1:</u></b> Income <b>beneficially owned by a resident</b> of one state, not being income paid out of <b>trusts</b> or the estate of deceased person and not being taxed under any other Article shall be <b>taxed in COR.</b>                                        |
| Poland         | <b><u>Extension to clause 1:</u></b> Income derived from the other contracting state, may also be taxed as per the provisions of the domestic laws of that other state.                                                                                                                        |

Questions?



THANK YOU!

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