



# INTRODUCTION TO TAX TREATIES

PRESENTATION BY  
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**Your global tax partner**

# CONTENTS PAGE

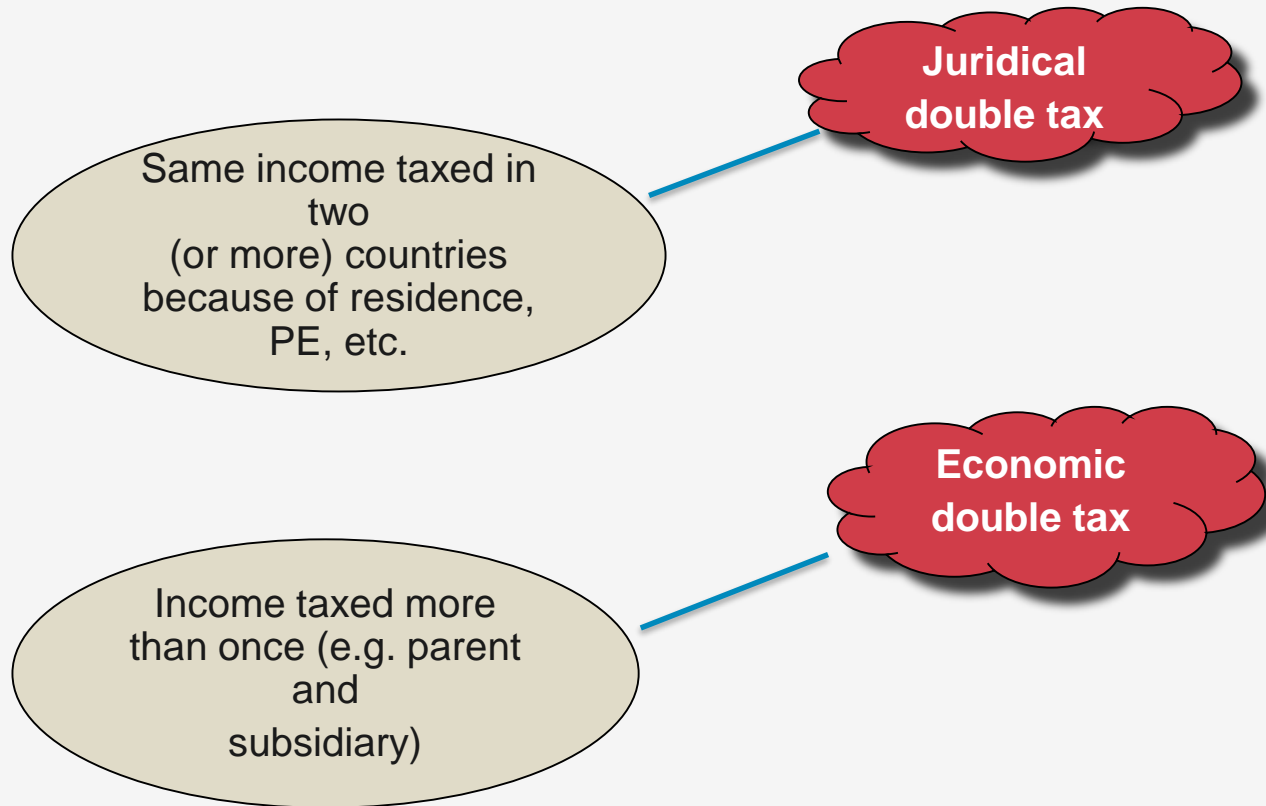
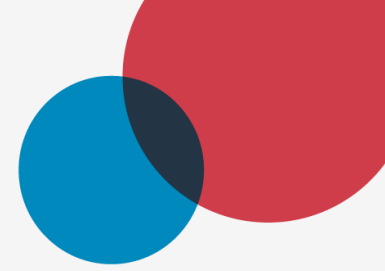



1. Double taxation
2. Double taxation relief
3. Tax treaty
4. Purpose of tax treaties
5. Tax treaty vs domestic law
6. Model Conventions
7. Structure of a tax treaty
8. Interpretation of a tax treaty
9. Applying the tax treaties
10. Evolving treaty landscape



**DOUBLE  
TAXATION**

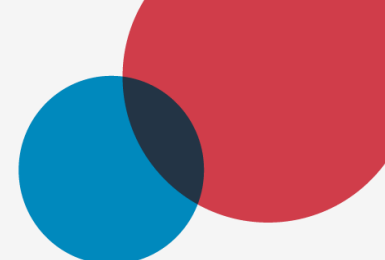
# DOUBLE TAXATION





**DOUBLE  
TAXATION  
RELIEF**

# DOUBLE TAXATION RELIEF



**Unilateral relief**

Domestic laws of one country e.g. Section 91 of (Indian) Income-tax Act, 1961

**Bilateral relief**



Double Taxation Avoidance Agreement

Elimination of double taxation imperative for fostering cross border transactions



**TAX TREATIES –  
WHAT ARE  
THESE ?**

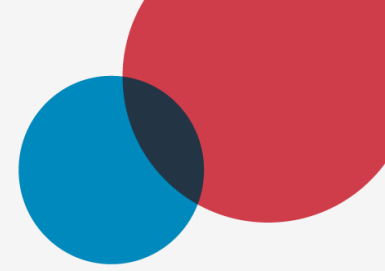
# TAX TREATIES



- ❖ In International law, treaty means a contract between two states
- ❖ International tax law refers to
  - rules that deal with tax conflicts
  - involving cross border transactions, and is
  - derived primarily from public international law



# TAX TREATIES



What is International law?

- ❖ Body of law that governs legal relations between / amongst sovereign states or nations
- ❖ Rules and principles of general application dealing with the conduct of states and of international organizations with their relations *inter se*

Is international law really a law?

- ❖ Why do states comply with international law?
- ❖ 3 R's compliance principle – Reputation, Reciprocity and Retaliation

❖ TAXAND

# TAX TREATIES



- ❖ Vienna Convention on law of treaties (VCLT) 1969 defines a Treaty as *an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument and whatever its particular designation*
- ❖ Provide certainty as to when and how tax is to be imposed in a country where:
  - Income-producing activity is conducted (i.e. source country), or
  - Payment is made by one country to another
- ❖ **Main aim:** to avoid double taxation; relief from double taxation
- ❖ OECD BEPS AP6: Preamble of tax treaties to be updated to contain instances of 'double non-taxation' as well [**ARTICLE 6(1) of MLI**]

## ❖ TAXAND

# TAX TREATIES



## **Purpose:**

- ❖ Allocation of taxing rights
- ❖ Allow sharing of taxing rights between two countries on a fair basis
- ❖ Eliminating double taxation
- ❖ Mitigate instances of non-taxation, or reduced taxation through tax evasion or avoidance
- ❖ Spur economic ties and development – tax sparing relief



**TAX TREATY  
VS  
DOMESTIC LAW**

# TAX TREATY vs DOMESTIC LAW



- ❖ Treaty – a formal agreement between two or more states
- ❖ Question arises – which takes precedence ? Treaty or domestic law ?
  - this may depend on the country's view on international law
- ❖ Most countries – treaty precedes domestic law - this would generally require a provision in the domestic legislation
- ❖ Some countries (e.g. US): treaty equals domestic law

# TAX TREATY vs DOMESTIC LAW



## Tax treaty

- ❖ Agreement between two States
- ❖ Involves negotiation process
- ❖ Relief from double tax
- ❖ Sharing of tax revenue
- ❖ No frequent amendments
- ❖ International law
- ❖ Dispute settled by appellate forum /Court /Competent Authority

## Domestic Law

- ❖ Act of Legislation
- ❖ No negotiation
- ❖ Charge of tax
- ❖ Earning of tax revenue
- ❖ Frequent amendments
- ❖ National Legislation
- ❖ Dispute settled by appellate forum /Court



**MODEL  
CONVENTIONS**

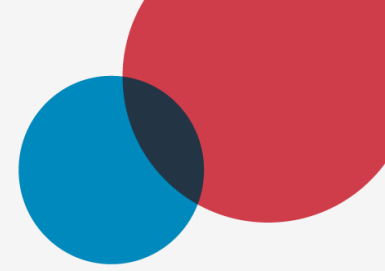
# MODEL CONVENTIONS



- ❖ League of Nations – Models 1928 – 1946
- ❖ Organization for Economic Co-operation and Development (OECD) Model - 1963, 1977, 1992, 2008, 2010, 2014 and 2017
- ❖ United Nations (UN) Model – 1980, 2001, 2011 and 2017
- ❖ CIAT Model
- ❖ ASEAN Model
- ❖ National models (e.g. USA and Netherlands)



# OECD MODEL



- ❖ Established in 1961 with developed countries as its members
- ❖ Essentially a model treaty between two developed nations with comparable tax systems and tax objectives
- ❖ Advocates residence principle and lays emphasis on the right of state of residence to tax
- ❖ Also addresses right of source country

# OECD CLUB – LIMITED MEMBERS, GLOBAL REACH



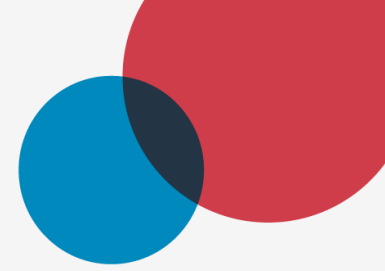
# UN MODEL



- ❖ Tax treaties between countries with unequal economic status :
  - Developed and developing countries, or
  - Between developing countries
- ❖ Drafted in 1980, designed to encourage flow of investments from the developed to developing countries
- ❖ Compromise between source principle and residence principle
- ❖ Gives more weightage to source principle – i.e. income should be taxed where it arises

## ❖ TAXAND

# THE ISSUE IN PRACTICE



- ❖ To what extent can the Commentary on the OECD Model tax Convention on Income and on capital be used to give an interpretation of tax treaties ?
- ❖ Is the Commentary part of 'context' of Article 3(2) ?

# OECD MODEL



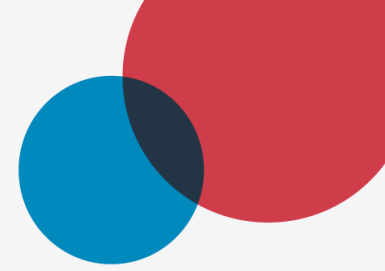
- ❖ What does the OECD Commentary say about itself ?
  - "Commentaries ... are of special importance in the development of international fiscal law"
  - "not designed to be annexed ... to the conventions signed by Member countries ..."
  - "... can ... be of great assistance in the application and interpretation ..."

# PRACTICAL OBSERVATIONS



- ❖ OECD Model Tax Convention and Commentary form the basis for hundreds of tax treaties (hence somewhat difficult to disregard)
- ❖ Often the only material available to shed light on meaning
- ❖ Can help develop a common body of international tax law
- ❖ Can help avoiding double taxation and double non-taxation
- ❖ Gives a degree of certainty for taxpayers

# PRACTICAL OBSERVATIONS



## ❖ Conditions for relying on commentary

- Same wording (or meaning) of treaty and OECD Model Tax Convention
- No observations by States in question
- Statement in commentary clear enough
- Other factors must not indicate that another meaning was intended

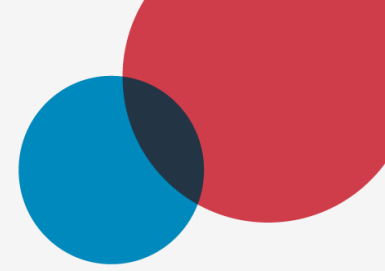
# HOW DO MODEL TAX TREATIES WORK ?



- ❖ Model treaties contain classification and assignment rules (collectively known as distributive rules) for income subject to tax under domestic tax laws of both countries
- ❖ Distributive rules contain more than fourteen categories of income to cover entire tax base; standard articles may be amended by negotiation
- ❖ Model treaties distinguish income under each article and specify which State has the right to tax



# HOW DO MODEL TAX TREATIES WORK ?

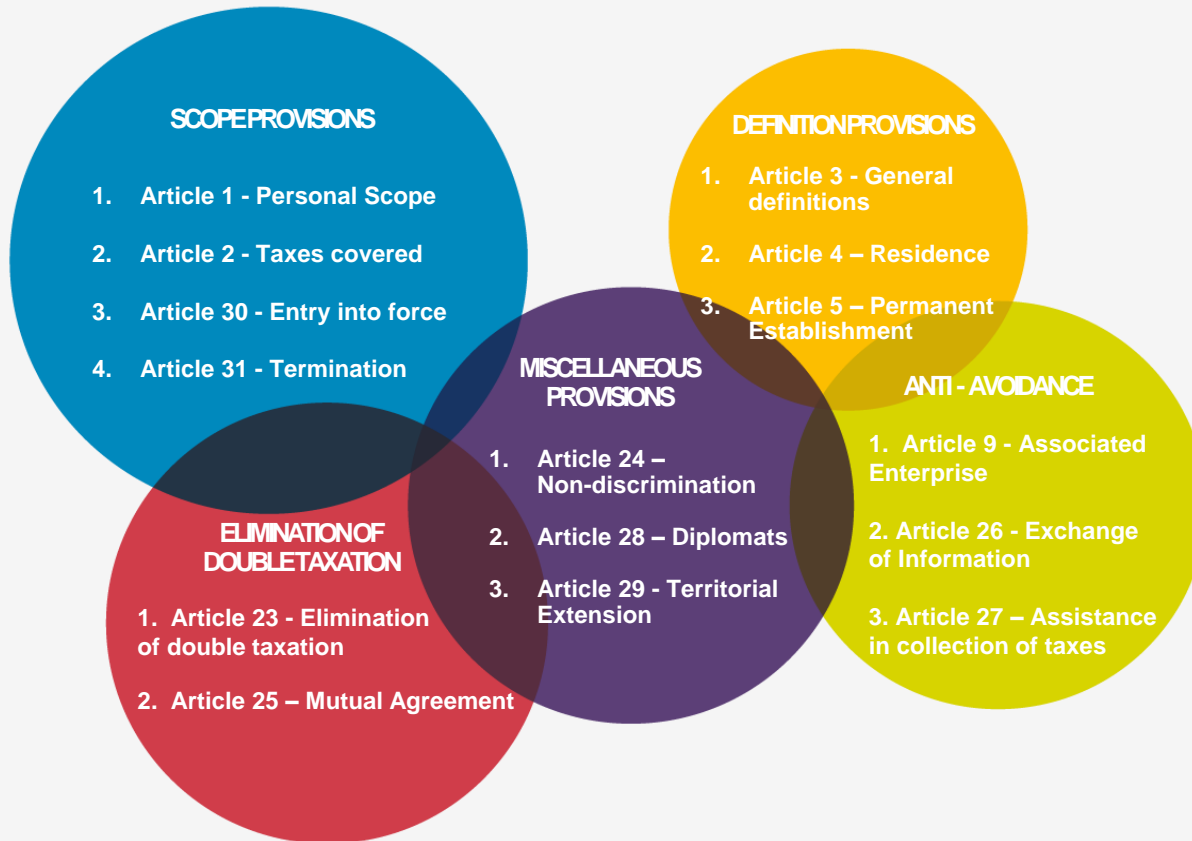


- ❖ Either Source State or Residence State get exclusive or limited right to tax
- ❖ If states share taxing rights they share cost of eliminating double taxation
- ❖ Model treaties allocate taxing rights but do not make tax rules



**STRUCTURE  
OF A TAX  
TREATY**

# STRUCTURE OF A TAX TREATY



## SUBSTANTIVE PROVISIONS

1. Article 6 - Immovable property
2. Article 7 - Business Profits
3. Article 8 - Shipping
4. Article 10 - Dividends
5. Article 11 - Interest
6. Article 12 - Royalties & FTS
7. Article 13 - Capital gains
8. Article 14 - Independent Personal Services
9. Article 15 - Dependent Personal Services
10. Article 16 - Directors
11. Article 17 - Artistes & Sports persons
12. Article 18 - Pensions
13. Article 19 - Government service
14. Article 20 - Students
15. Article 21 - Other income
16. Article 22 - Capital



**INTERPRETATION  
OF  
TAX TREATIES**

# INTERPRETATION OF TAX TREATIES



- ❖ The VCLT was codified in 1969 and entered into force in 1980
- ❖ Limited scope
- ❖ Applicable to both past and future treaties
- ❖ Due weightage is given by non signatories and its rules are referred to in growing number of decisions in international courts
- ❖ Article 3(2) is a rule on interpretation
  - Undefined terms to be given meaning under domestic law unless 'context otherwise requires'

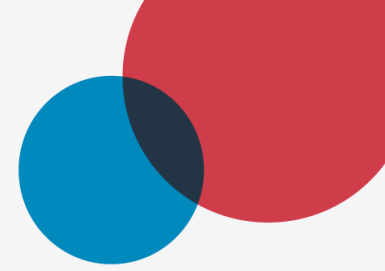
# INTERPRETATION OF TAX TREATIES



## ❖ Static vs dynamic interpretation

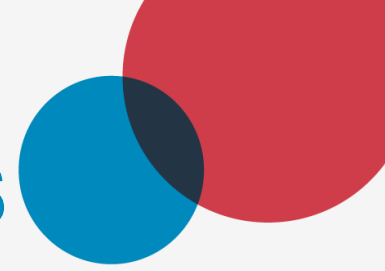
- Static interpretation: reference in tax treaties refers to legal situation at the moment of conclusion of treaty
- Dynamic interpretation: reference in tax treaties refers to legal situation when treaty is applied
- OECD Commentary: dynamic interpretation unless difference in substance (Introduction, para 35)

# AIDS TO INTERPRETATION



- ❖ OECD /UN model conventions and commentary
- ❖ Protocols
- ❖ Technical memorandum
- ❖ Parallel treaties
- ❖ International case laws

# PERSONAL SCOPE OF TAX TREATIES



Who is covered by a tax treaty ?

- ❖ Article 1

This convention shall apply to persons who are residents of one or both the contracting states

- ❖ Article 3

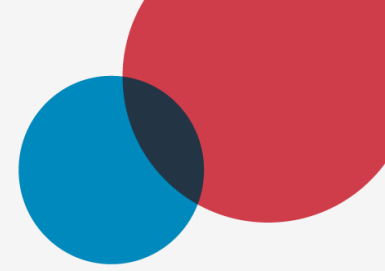
Person includes an individual, a company and any other body of persons

- ❖ Article 4 - Resident

Person taxable “by reason of his domicile, residence, place of incorporation...”



# TERRITORIAL SCOPE OF TAX TREATIES



- ❖ Provided in Article 3 - required for application of tax treaty
- ❖ Generally 'Country X' is defined to mean territory of Country X and includes territorial sea and air space above it, as well as any other maritime zone in which Country X has sovereign rights, other rights and jurisdictions, according to the law of Country X and in accordance with international law
- ❖ In most treaties, there will be a territorial scope

# TAXES COVERED BY TAX TREATIES



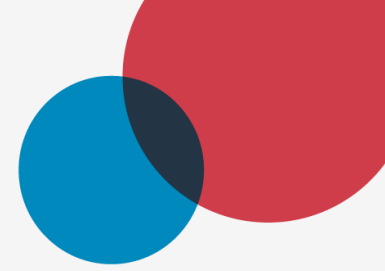
- ❖ Article 2 – Income and Capital taxes (usually listed specifically in paragraph 3)
  
- ❖ Interpretative issues
  - What is income or capital tax ?
  - Can a tax based on estimated income qualify ?
  - Taxes levied by political subdivisions covered ?
  - Many states do not accept, partly for constitutional reasons
  
- ❖ Future ‘identical or substantially similar’ taxes covered

# SPECIFIC TAXES COVERED BY TAX TREATIES



- ❖ There are some taxes which are specifically mentioned in Article 2 and hence get covered
- ❖ Australia – New Zealand treaty
  - resource rent tax in respect of offshore projects relating to exploration for or exploitation of petroleum resources and
  - the fringe benefits tax imposed under the Federal Laws of Australia

# SPECIFIC TAXES COVERED BY TAX TREATIES



## ❖ India – Denmark treaty

- the seamen's tax, the church tax and the hydrocarbon tax

## ❖ Malaysia – Canada treaty

- tin profit tax, development tax, timber profits tax and petroleum income tax

# ALLOCATION OF TAXING RIGHTS

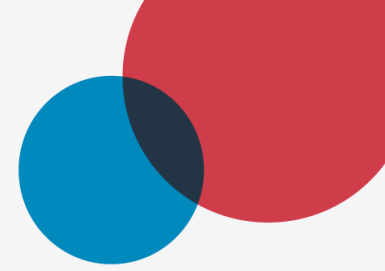


- ❖ Income and capital can be classified into 3 classes:
  - Full taxing rights to source state
  - Limited taxing rights to source state
  - No taxing rights to source state
  
- ❖ As a rule, exclusive right to tax conferred on State of residence
  
- ❖ Generally State of Residence has taxing rights on all incomes
  
- ❖ However, where State of Source given full / limited rights, State of residence to provide relief to avoid double taxation either by exemption method or by credit method



**APPLYING A  
TAX TREATY**

# CHECK – LIST



- ❖ Check residence and ensure that you are using the right treaty
- ❖ Latest version? - check if in effect /not terminated? – e.g. tax treaties with East Germany – non existent now – use West German treaty
- ❖ How would you know if a treaty has been amended ?
  - Check if there is a Protocol /exchange of notes, etc.
- ❖ Treaty languages - Take note of whether the version used is an official /unofficial translation
- ❖ Are you dealing with a provision of law introduced after treaty came into effect? What is the treaty impact on this?

# SCENARIO



Singapore



Deposit

A light grey rectangular box containing the word "Deposit", positioned between the Investor and Bank boxes.

Interest

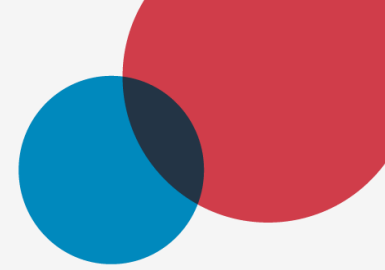
A light grey rectangular box containing the word "Interest", positioned between the Bank and Investor boxes.



Indonesia



# THE FIVE - STEP APPROACH



## Step 1

A tax treaty generally only applies if the taxpayer who is resident in one country receives income from sources from another country.

For example, a Singapore resident receives interest income from an Indonesian bank account.

# THE FIVE - STEP APPROACH



## Step 2

It has to be checked whether the taxpayer is covered by the treaty. Usually he has to be a resident of one or both of the treaty countries. The term 'resident' is often specifically defined in one of the articles of the treaty (Article 4 of the OECD Model)

For example, is the taxpayer a Singapore resident under the treaty?

# THE FIVE - STEP APPROACH

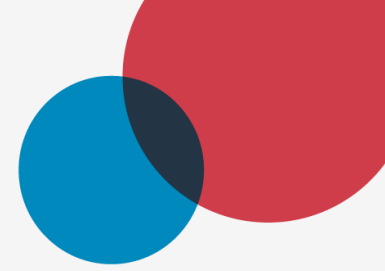


## Step 3

Next, the type of income which the taxpayer receives must be determined. The relevant article will determine which country has the right to tax the income. Articles 6 to 22 cover the allocation of the right to tax income.

For example, the article on interest income determines that the right of taxation is allocated to the country of residence, which is Singapore. However, the source country Indonesia is entitled to levy a withholding tax

# THE FIVE - STEP APPROACH



## Step 4

If the allocation article provides that the country of source has the right to tax the income, this does not mean that the country of residence may not tax the income. Article 23 of the OECD Model determines how double taxation is avoided in the country of residence: (i) either the country of residence grants a tax credit for the taxes paid in the country of source; (ii) or it exempts the foreign source income from tax

For example, on interest income taxed in Indonesia, Singapore would grant a tax credit

# THE FIVE - STEP APPROACH



## Step 5

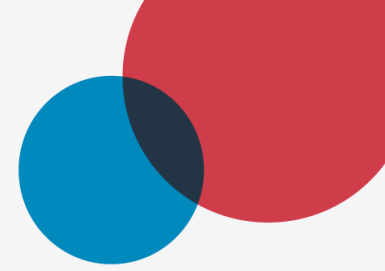
Although it may be clear what happens under the articles of the tax treaty. However, this does not necessarily mean that the respective country actually levies tax on this income. National law must be examined to see if and how the income is taxed

For example, Indonesia may establish an exemption on all interest income under its domestic law and such exemption will apply irrespective of the allocation of the taxing right under the treaty



**EVOLVING  
TREATY  
LANDSCAPE**

# BEPS ACTION PLAN 15



- ❖ BEPS Action Plan 15 deals with development of a Multilateral Instrument (MLI) to implement tax treaty related BEPS measures *inter-alia* including:
  - Action 2 – Neutralizing the effects of hybrid mismatch arrangements
  - Action 6 – Prevention of treaty abuse
  - Action 7 – Preventing the artificial avoidance of permanent establishment status
  - Action 14 – Improving Dispute Resolution
  
- ❖ MLI to modify more than 3000 existing bilateral tax treaties to enable countries to meet treaty-related minimum common standards agreed as a part of BEPS initiative

# BEPS ACTION PLAN 15



- ❖ OECD released text of the MLI and accompanying Explanatory Statement in November 2016
- ❖ First joint signing ceremony held in Paris on June 7, 2017
- ❖ 88 countries have come forth to sign the MLI as on 18 June 2019 – India and China are first
- ❖ 6 countries have expressed their intent to sign the MLI



# THANK YOU

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