

TAX TREATY - SAVING CLAUSE AND ITS APPLICATION

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WHAT IS A SAVING CLAUSE?

- THE TAXATION LAWS (AMENDMENT) ACT, 2019

“10. (1) The Taxation Laws (Amendment) Ordinance, 2019 is hereby repealed.

(2) Notwithstanding such repeal, anything done or any action taken under the said Ordinance, shall be deemed to have been done or taken under the corresponding provisions of this Act.”

- Generally present in US Tax Treaties
- Tax Policy behind the US saving clause: Capital Export Neutrality?

WHAT IS A SAVING CLAUSE?

- Saving clause in the India-USA tax treaty [Article 1 - General Scope]:

Paragraph 2:

“The Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded:

(a) by the laws of either Contracting State; or

(b) by any other agreement between the Contracting States.”

Paragraph 3:

*“Notwithstanding any provision of the Convention except paragraph 4, a Contracting State may tax its residents [as determined under Article 4 (Residence)], and by reason of citizenship may tax its citizens, **as if the Convention had not come into effect**. For this purpose, the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss.”*

SAVING CLAUSE, INCLUSION IN MODELS

OECD MC 2017:

□ Article 1(3) reads as follows:

“This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 [A] [B], 24, 25 and 28.”

□ Introduced in the 2017 Update to the MC

□ Result of Action 6 of the BEPS Report

□ Similar inclusion in the 2017 UN MC

SAVING CLAUSE, INCLUSION IN MODELS

Paragraph 18 in OECD commentary to Paragraph 1(3):

“Paragraph 3 confirms the general principle that the Convention does not restrict a Contracting State’s right to tax its own residents except where this is intended and lists the provisions with respect to which the principle is not applicable.”

- India has not expressed any position on the above in the section containing non-OECD economies’ positions on the OECD MC

SAVING CLAUSE, RELEVANCE FOR INDIA

- P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC): Interpretation of “may be taxed”
- Notification 91 of 2008: “may be taxed” to be interpreted in a manner, where the subject income, would be included, in the total income of a resident
- Article 11 of the MLI stands as a bilateral alteration of the Treaty, relative to the said Notification, which may be construed as a unilateral alteration

CHANGES TO EXISTING TAX TREATIES

MLI:

- Article 11: Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents
- Based on Action 6 of BEPS Report
- Paragraph 1 provides for a saving clause - similar in nature to the OECD MC 2017
- Not a minimum standard
- India's position: No express reservation, so automatic inclusion unless the other party reserves the right to include!
 - Cyprus, Netherlands, Singapore, Japan reserved the right to apply. No inclusion
 - Gets included in India's tax treaties with Australia, Denmark, Belgium, Norway, New Zealand, Poland, Russia, Slovak Republic, UK

APPLICATION TO INDIA'S TAX TREATIES

MLI - synthesized text of India-UK tax treaty

□ Article 1- Scope of the Convention now reads as follows:

“1. This Convention shall apply to persons who are residents of one or both of the Contracting States.

2. This Convention extends to the territory of each Contracting State, including its territorial ...

The following paragraph 1 of Article 11 of the MLI applies and supersedes the provision of this Convention:

ARTICLE 11 OF THE MLI - APPLICATION OF TAX AGREEMENTS TO RESTRICT A PARTY'S RIGHT TO TAX ITS OWN RESIDENTS

[This Convention] shall not affect the taxation by a [Contracting State] of its residents, except with respect to the benefits granted [under paragraph 2 of Article 10 and Articles 19, 21, 22, 24, 26, 27 and 29] of [this Convention].

LINKAGE TO FTC ARTICLE, EXISTING TAX TREATY

- India-Philippines tax treaty signed on 12 February 1990 [Article 1 - Personal Scope]:

This Convention shall apply to persons who are residents of one or both of the Contracting States.

- **Protocol:**

For purposes of Article 1, nothing in this Convention shall be construed as preventing either Contracting State from taxing its citizens, in accordance with its domestic legislation, who may be residing in the other Contracting State. However, no credit shall be given under this Convention for taxes paid/payable in pursuance of such domestic legislation.

LINKAGE TO FTC ARTICLE, IMPACT OF MLI

MLI:

- Article 5: Application of Methods for Elimination of Double Taxation
- Based on Action 2 of BEPS Report
- Not a minimum standard
- India's position: Adopted Option C - Replacement of exemption method by credit method (para 6, 7 of Article 5)
 - Applies to residents of India? [Bulgaria, Egypt, Greece]
 - Slovak Republic [applies to residents of both countries]

SAVING CLAUSE PLUS FTC ARTICLE, MLI IMPACT

MLI - synthesized text of India: Slovak Republic DTAA:

□ Article 1- Personal Scope will read as follows:

“This agreement shall apply to persons who are residents of one or both of the Contracting States.

The following paragraph 1 of Article 11 of the MLI applies and supersedes the provisions of this Agreement:

ARTICLE 11 OF THE MLI- APPLICATION OF TAX AGREEMENTS TO RESTRICT A PARTY’S RIGHT TO TAX ITS OWN RESIDENTS :

The Agreement shall not affect the taxation by a Contracting State of its residents, except with respect to the benefits granted under Article 9 as modified by paragraph 1 of Article 17 of MLI, Article 18, 20, 21, 23, 24, 25 and 27 of the Agreement.”

SAVING CLAUSE PLUS FTC ARTICLE, MLI IMPACT

MLI - synthesized text of India: Slovak Republic tax treaty

Interplay between saving clause and tax credit relief - Article 5(6) of MLI:

□ Article 23 [Elimination of double taxation] will now read as follows :

“Where a resident of a Contracting State derives income which may be taxed in the other Contracting State in accordance with the provisions of the Agreement (except to the extent that these provisions allow taxation by that other Contracting State solely because the income is also income derived by a resident of that other Contracting State), the first-mentioned Contracting State shall allow as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other Contracting State;”

CASE STUDY 1

Facts:

- Mr. A is a US Citizen;
- He is ROR in India [and tie-breaks as a Resident in India];
- He has earned dividend income from us securities

Issue:

Is India obliged to give credit for taxes suffered in the US by a US citizen [cum Indian Resident] on US sourced dividend? If so to what extent?

Particulars	Amount (in INR)
Dividend	100
US tax [based on citizenship]	37
Restriction on US tax under Article 10(2)	25
India tax (assume income > 2 crores)	39

CASE STUDY 1 (CONT'D)

- Article 10 of the India-USA tax treaty

“Dividends

1. Dividends paid by a company which is a resident of a Contracting State [US] to a resident of the other Contracting State [India] may be taxed in that other State [India].

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident [US], and according to the laws of the State, but if the beneficial owner of the dividends is a resident of the other Contracting State [India], the tax so charged shall not exceed:

(a) 15 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 per cent of the voting stock of the company paying the dividends;

(b) 25 per cent of the gross amount of the dividends in all other cases.

...”

CASE STUDY 1 (CONT'D)

□ Saving clause in the India-USA tax treaty [Article 1 - General Scope]:

Paragraph 3:

“Notwithstanding any provision of the Convention except paragraph 4, a Contracting State may tax its residents [as determined under Article 4 (Residence)], and by reason of citizenship may tax its citizens, as if the Convention had not come into effect. ...”

Paragraph 4:

“The provisions of paragraph 3 shall not affect—

(a) the benefits conferred by a Contracting State under paragraph 2 of Article 9 (Associated Enterprises), under paragraphs 2 and 6 of Article 20 (Private Pensions, Annuities, Alimony, and Child Support), and under Articles 25 (Relief from Double Taxation), 26 (Non-Discrimination), and 27 (Mutual Agreement Procedure) ;and

(b) the benefits conferred by a Contracting State under Articles 19 (Remuneration and Pensions in respect of Government Service), 21 (Payment received by Students and Apprentices), 22 (Payments received by Professors, Teachers and Research Scholars) and 29 (Diplomatic Agents and Consular Officers), upon individuals who are neither citizens of, nor have immigrant status in, that State.”

CASE STUDY 1 (CONT'D)

“Article 25 - Relief From Double Taxation

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income

(a) the income tax paid to India by or on behalf of such citizen or resident; and

(b) in the case of a United States company owning at least 10 percent...

*2. (a) **Where a resident of India derives income** which, **in accordance with the provisions of this Convention**, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.”*

CASE STUDY 1 (CONT'D)

Key points for consideration:

- Article 1(3) grants the US a right to tax its citizen as if the treaty had not come into effect (saving clause)
- Article 1(4) states that Article 1(3) shall not affect the benefits conferred by a Contracting State under Article 25
- Article 10(2) of the India-US treaty restricts the US tax to 25% of the gross amount of dividend
- Article 25(2)(a) - Credit available in India - “Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States....”

CASE STUDY 1 (CONT'D)

US Australia tax treaty signed on 6 August 1982

Article 22 - Relief From Double Taxation

*“...Subject to paragraph (4), United States tax paid under the law of the United States and in accordance with this Convention, **other than United States tax imposed in accordance with paragraph (3) of Article 1 (Personal Scope) solely by reason of citizenship** or by reason of an election by an individual under United States domestic law to be taxed as a resident of the United States, in respect of income derived from sources in the United States by a person who, under Australian law relating to Australian tax, is a resident of Australia shall be allowed as a credit against Australian tax payable in respect of the income. The credit shall not exceed ...*

*4. For the purposes of computing United States tax, **where a United States citizen is a resident of Australia, the United States shall allow as a credit against United States tax the income tax paid to Australia after the credit referred to in paragraph (2).** The credit so allowed against United States tax shall not reduce that portion of the United States tax that is creditable against Australian tax in accordance with paragraph (2).”*

CASE STUDY 1 (CONT'D)

US New Zealand tax treaty signed on 23 July 1982

Article 23 - Relief from Double Taxation

*“...In the case of New Zealand, double taxation shall be avoided as follows: In accordance with, and subject to any provisions of, the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax for tax paid in a country outside New Zealand (which shall not affect the general principle hereof), United States tax paid under the law of the United States and consistently with this Convention, whether directly or by deduction, in respect of income derived by a resident of New Zealand arising in the United States (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) shall be allowed as a credit against New Zealand tax payable in respect of that income; **except that such credit shall not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen or a United States company.** ...*

*3. For the purposes of computing United States tax, **where a citizen of the United States or a United States company is a resident of New Zealand, the United States shall allow as a credit against United States tax the income tax paid to New Zealand after the credit referred to in paragraph 2.** The credit so allowed against United States tax shall not reduce that portion of the United States tax that is creditable against New Zealand tax in accordance with paragraph 2..”*

CASE STUDY 1 (CONT'D)

US Italy tax treaty signed on 17 April 1984

Article 23 - Relief from Double Taxation

“..3. If a resident of Italy derives items of income which are taxable in the United States under the Convention (*without regard to paragraph 2 (b) of Article 1 (Personal Scope)*), Italy may, in determining its income taxes specified in Article 2 of this Convention, include in the basis upon which such taxes are imposed the said items of income (unless specified provisions of this Convention otherwise provide). In such case, Italy shall deduct from the taxes so calculated, the tax on income paid to the United States, *but in an amount not exceeding the tax that would be due to the United States if the resident of Italy were not a citizen of the United States*, and not exceeding that proportion of the aforesaid Italian tax which such items of income bear to the entire income. ..

4. For purposes of the United States obligation to avoid double taxation with respect to Italian tax under the preceding paragraphs of this Article:

b) in the case of an individual who is a resident of Italy, *income or profits which may be taxed by the United States by reason of citizenship in accordance with paragraph 2 (b) of Article 1 (Personal Scope)* shall be deemed to arise in Italy to the extent necessary to avoid double taxation, provided that in no event will the tax paid to the United States be less than the tax that would be paid if the individual were not a citizen of the United States.”

CASE STUDY 2

Situation:

Mrs A is also a US citizen who is a ROR in India. She performs independent personal services in the United States. She is present in the United States for less than 90 days in a taxable year and income from services is not attributable to a fixed base in the United States.

- Article 15 (Independent Personal Services) would normally prevent the United States from taxing income.
- The saving clause permits the United States to include the remuneration in the worldwide income of the citizen and subject it to tax under normal rules

Question:

Should Mrs A be allowed a tax credit in India on taxes paid in the US?

CASE STUDY 2 (CONT'D)

“Article 15 - Independent Personal Services

1. Income derived by a person who is an individual or firm of individuals (other than a company) who is a resident of a Contracting State [India] from the performance in the other Contracting State [US] of professional services or other independent activities of a similar character shall be taxable only in the first-mentioned State [India] except in the following circumstances when such income may also be taxed in the other Contracting State [US]:

(a)if such person has a fixed base regularly available to him in the other Contracting State [US] for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other State [US]; or

(b)if the person's stay in the other Contracting State [US] is for a period or periods amounting to or exceeding in the aggregate 90 days in the relevant taxable year.

...”

QUESTIONS?

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