



# Study course on DTAA

## Article 4 – Residence

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Where Passion Delivers Value

# Importance of Art 4 - Residence

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- Article 1 of OECD MC
  - This convention shall apply to persons who are **residents** of one or more contracting states”
- Residence is considered as gateway to DTAA
- Allocation of taxing rights amongst contracting state
- Key in determining jurisdiction which jurisdiction has primary right and obligation to grant tax credit
- Establish/limit right of source tax to tax business income/fees for technical services/royalty, salary income
- Exception: Non-discrimination article under treaty

# Text of Article 4(1) of OECD MC

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For the **purposes of this Convention**, the term “resident of a Contracting State” means any person who, **under the laws of that State**, is **liable to tax** therein **by reason of** his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State.....[First sentence]

This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.....[Second sentence]

# Paraphrasing Article 4(1)

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- Entity is a person as defined in Article 3
  - Person includes an individual, a company or any other body of person
- Such person is liable to tax by reason of following connecting factors:
  - Domicile
  - Residence
  - Place of management or
  - Place of incorporation [UN Model treaties]
  - any other criterion of a similar nature
- Such liability to tax is under domestic laws of State
- Such liability is not covered by second sentence

# Country practice – residence of individual


Country	Residency Rule
India	<ul style="list-style-type: none"><li>• Number of days presence in tax year</li></ul>
USA	<ul style="list-style-type: none"><li>• Green card holders</li><li>• Substantial presence test<ul style="list-style-type: none"><li>• Present in USA for at least 31 days in CY and</li><li>• Atleast 183 days during consecutive three year period by assigning weights</li></ul></li></ul>
UK	<ul style="list-style-type: none"><li>• Physical presence plus other connective factors</li></ul>
France	<ul style="list-style-type: none"><li>• Resident if person home, principal place of abode, professional activity or center of economic interest is located in France</li></ul>
Germany	<ul style="list-style-type: none"><li>• Domicile in Germany for their personal use</li><li>• They have customary place of abode in Germany</li></ul>

# Liable to tax


## Liable to tax – different scenario




1  
Particular source of  
income not taxable in  
State R



2  
Entity is exempt in  
State R



3  
Entity is not covered  
by tax law in State R



4  
Entity not required  
to pay tax

# Liable to tax

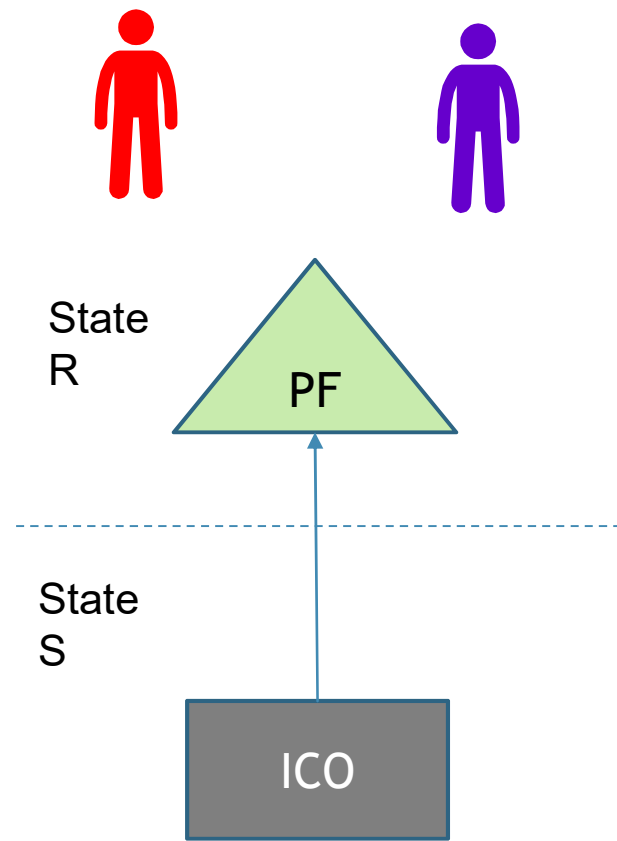
## Ratio of ABA (263 ITR 0706)\*

- Merely because exemption has been granted in respect of taxability of a particular source of income, it cannot be postulated that the entity is not 'liable to tax'
- Liability to taxation is a legal situation; payment of tax is a fiscal fact
- For the purpose of application of art. 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax

## Peculiar cases

- Fiscally transparent entity
- Trust
- Collective Investment Vehicle
- US LLC

# Fiscally transparent entity



- ICO makes FTS payment to PF
- State R treats PF as pass through entity and taxes income in hands of partners
- Issue: Whether PF is entitled to treaty benefit
- Judicial views:

## Favourable

- Linklaters LLP (Tribunal)
- Chiron Bearing GMBH (Bom HC)
- The Firm AP Moller

## Negative

- Schellenberg Wittmer (AAR)



# Liable to tax

## India - UAE

an individual who is present in the UAE for a period or periods totalling in the aggregate at least 183 days in the calendar year concerned, and a company which is incorporated in the UAE and which is managed and controlled **wholly** in UAE

## India - UK

In the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust **is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.**

## TRC

- Person shall not be entitled to claim treaty benefit unless TRC is obtained along with Form 10 F
- SKAPS Industries (Ahm Trib) – Treaty benefit cannot be denied in absence of TRC

# Tie breaker rule - Individual

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- Article 4(2) provides various test which needs to be applied in sequence

R in state in which he has Permanent Home available (PH)

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graph TD; A[R in state in which he has Permanent Home available (PH)] --> B[If PH in both states, R in state in which his personal and economic relations are closer (centre of vital interests)]; B --> C[If centre of vital interest cannot be determined, or he has no PH, R in which he has habitual abode]; C --> D[If habitual abode in both states or neither, R of which he is national]; D --> E[If national in both states or neither, question to be settled under MAP];
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If PH in both states, R in state in which his personal and economic relations are closer (centre of vital interests)

If centre of vital interest cannot be determined, or he has no PH, R in which he has habitual abode

If habitual abode in both states or neither, R of which he is national

If national in both states or neither, question to be settled under MAP

# Permanent Home test

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- Key ingredients
  - Permanent
  - Home
  - Availability
- Time element required for permanence
- Position of secondary home
- Distinction between 'home' and 'house' – requires personal attachment
- Such home should be available for use (rented accommodation, vacation home, weekend house)

# Centre of vital interest

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- Indicia of personal interest
  - family and social relationship
  - Communication address
  - Spiritual affiliation
  - Recreation, club, political and cultural affiliation
- Indicia of economic interest
  - Place of business or profession
  - Occupation
  - Investment
  - Pension and social security scheme
- Preference of one over other (i.e. whether personal interest supersede economic interest?)

# Other test

## Habitual abode

- Denotes concept of residing in State as against concept of home
- Habitual refers regular or repeated use of place over period of time in contrast to something which is temporary
- Should 'number of days test' be applied to determine Habitual Abode

## Nationality

- Article 3 of OECD MC defines national in relation to contracting state to mean any individual possessing nationality or citizenship of Contracting State

# Case Study: India calling

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- PC is renowned Bollywood actress and global star. PC married NJ a US citizen and a popular singer
- Post marriage
  - Producer and actor in 'Sky is Pink'
  - Appeared in promotional event
  - Most of the future movies signed with Indian producers or OTT providers
  - Visited India on brother engagement and celebrity weddings
  - Stays with husband in US
  - Appeared on US talk shows and interviews
- PC qualifies as resident in India as per domestic law and resident of US
- Determine treaty residence of PC

# Tie breaker rule - company

## Pre BEPS

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated

## Post BEPS

.....the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States

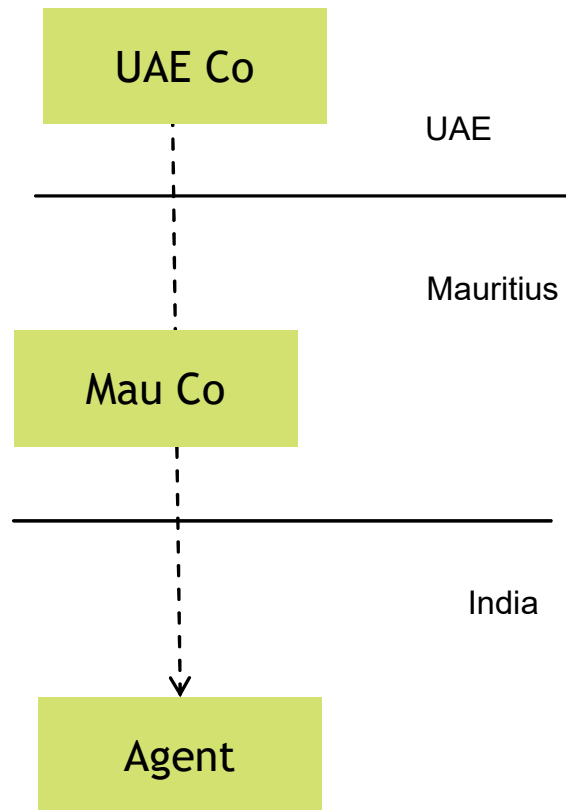
# POEM and tax treaty

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- Accepted test for treaty tie breaker rule in case of dual resident company
- OECD Commentary provides for consideration of following factors to determine POEM
  - Where meetings of the persons board of directors or equivalent body are usually held
  - Where chief executive office and other senior executives usually carry on their activities
  - Where the senior day to day management of the person is carried on
  - Where the persons headquarters are located
  - Which country laws govern the legal status of the person
  - Where its accounting records are kept

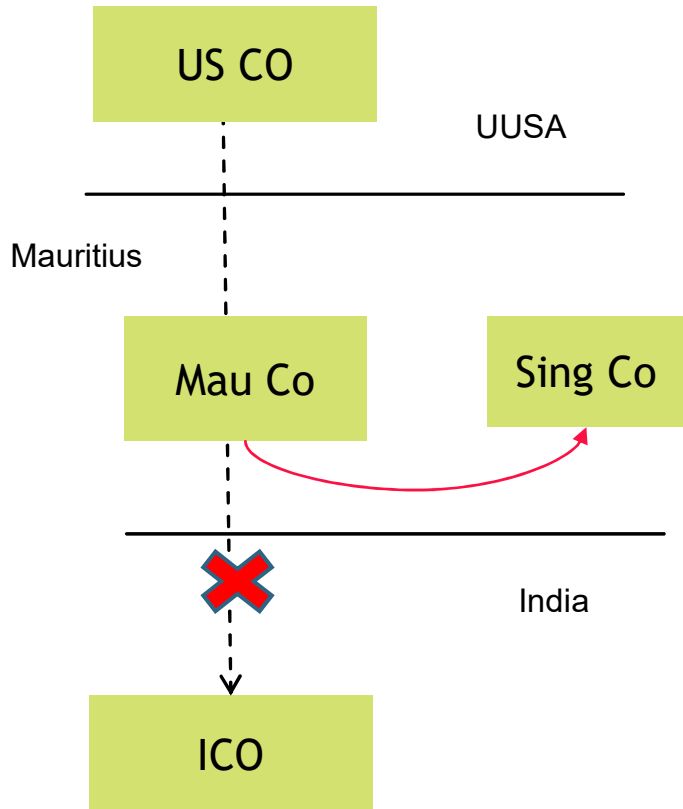


# Bay Lines (Mauritius)



- Taxpayer is shipping company incorporated in Mauritius. It contended that shipping profit can be taxed only in Mauritius under Article 8 of treaty since its POEM lies in Mauritius
- Tribunal affirming following facts that that POEM of Taxpayer is in UAE
  - POEM is place where key commercial decision that is necessary for the business is taken or in substance the POEM will originally be a place where the most senior person or a group of person make its decision
  - Shareholders of taxpayer are UAE resident and other directors are on board only to satisfy conditions of Mauritius government
  - Indian agent was appointed on letter head showing UAE address. Letter from AO also originated from UAE
  - Aforesaid indicates though company was registered in Mauritius, but major policy decisions were taken at UAE

# AB Holdings – Mauritius II\*



- IRA alleged that POEM of Mau Co is in US and it is not eligible for treaty benefits
- AAR held that holding company could have a role to play in affairs of the subsidiary. The C&M was not in US but in Mauritius
  - Movements of the directors in and out of Mauritius could not alone conclude that control and management was not in Mauritius
  - Physical absence of one director in board meeting and his attendance through telephone or video conference from US was a valid communication
  - The other two directors of M1 were well qualified to engage in meaningful discussions and were involved in the decision making process
  - Investment holding companies such as M1, did not require huge offices/staff or incur multiple account expenses as opposed to manufacturing or trading companies

\* 90 taxmann.com 177

# POEM under ITA

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## Prior to amendment

A company is said to be resident in India if:

- It is an Indian company
- During that year, the control and management of its affairs is situated wholly in India

## Post amendment

A company is said to be resident in India if:

- It is an Indian company
- Its place of effective management in that year is in India

Place of effective management means a place where key management and commercial decisions that are necessary for conduct of the business of an entity as a whole are in substance made

# Guiding principles of Circular 8/2017

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- Determination of POEM depends upon facts and circumstances of each case
- POEM concept is one of substance over form
- Entity may have more than one place of management, but it can have only one place of effective management at any point of time
- POEM will be required to be determined on year to year basis
- Guiding principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time during the previous year needs to be considered

- FA 2018 introduced Explanation 4 which provides that where the term is not defined in agreement but defined in Act, it shall have same meaning as assigned to it in the Act and explanation if any given to it by Central Government
- Should POEM be interpreted autonomously de hors ITA definition?

# Approach to POEM

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## Determination of POEM

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graph TD; A[Determination of POEM] --> B[Companies engaged in Active Business Outside India (ABOI)]; A --> C[Companies other than those engaged in Active Business Outside India]; B --> D[POEM outside India if majority BOD Meetings outside India]; B --> E[However, if de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India]; C --> F[Stage 1: Identify the persons who actually make the key management and commercial decision]; C --> G[Stage 2: Determine the place where these decisions are in fact being made – important than the place where implemented];
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### Companies engaged in Active Business Outside India (ABOI)

- POEM outside India if majority BOD Meetings outside India
- However, if de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India

### Companies other than those engaged in Active Business Outside India

**Stage 1:** Identify the persons who actually make the key management and commercial decision

**Stage 2:** Determine the place where these decisions are in fact being made – important than the place where implemented

# India tax treaty

## India - USA

Where, by reason of paragraph 1, a company is a resident of both Contracting States, **such company shall be considered to be outside the scope of this Convention** except for purposes of paragraph 2 of Article 10 (Dividends), Article 26 (Non-Discrimination), Article 27 (Mutual Agreement Procedure), Article 28 (Exchange of Information and Administrative Assistance) and Article 30 (Entry into Force).

## India Belarus protocol

With reference to Article 4, it is understood that when establishing the "place of effective management" as used in paragraph 3 of Article 4, circumstances which may, *inter alia*, be taken into account are the place where a company is actually managed and controlled, the place where the decision making at the highest level on important policies essential for the management of a company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the relevant accounting books are kept.

*Thank You*

# Our Offices

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