



सत्यमेव जयते

संयुक्त राष्ट्र स्थित भारत का स्थायी मिशन  
न्यूयॉर्क

PERMANENT MISSION OF INDIA TO THE UNITED NATIONS

August 13, 2012

No.PMI/NY/DPR/2012

Excellency,

I have the honour to write to you in regard to the Model UN Convention on Double Taxation 2011. This Convention was launched in March this year at the Special Meeting of ECOSOC on International Cooperation in Tax Matters.

2. At the launch, while conveying our reservations on the Model Convention, we had stated that our Government was studying the Convention and we would forward our comments in due course. We strongly feel that the Model UN Convention must take into account the concerns of developing countries and should not be a mere replication of the OECD template. Our detailed comments on the Convention are enclosed.

3. I would request you to circulate our comments to all members of the Council. These we hope would inform and stimulate the ongoing discussion in the ECOSOC for a more equitable international cooperation in tax matters. India remains deeply committed to strengthening the role of ECOSOC in promoting an inclusive multilateral dialogue and cooperation on international taxation.

4. Please accept, Excellency, the assurances of my highest consideration.

[M.S. Puri]

Ambassador/Deputy Permanent Representative

H.E. Mr. Milos Koterec  
President of the Economic and Social Council  
United Nations, New York.

#77  
RECEIVED AUG 14 2012

Copy to: Mr. Alexander Trepelkov,  
Director, Financing for Development Office,  
UNDESA, New York.

## ANNEXURE

### COMMENTS ON THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

#### GENERAL COMMENTS

1. The Committee of Experts and its predecessor Ad Hoc Group of Experts have not been able to appropriately reflect all the concerns of developing countries, as the proceedings in the Committee and its sub-Committees tend to be dominated by experts from the OECD countries, low tax jurisdictions and non-governmental observer-representatives. An inter-Governmental Commission with balanced representation from countries at various stages of development would be a preferred organization to develop international standards for adoption by the countries. Only a commission of such nature can play a crucial role in fostering dialogue and cooperation between national tax authorities and ensure that the views of the developing countries do not get ignored, particularly when the positions of the developed countries on issues on which they have a consensus, are challenged.

2. United Nations should independently develop global standards in the field of international taxation, treaty policies and transfer pricing etc. after proper appreciation of the concerns of the developing countries, and not only of developed countries. The OECD standards should not be taken as internationally agreed 'standards'. UN work should focus on addressing challenges faced by tax administrations and policy makers in developing countries and give guidance rather than merely recognizing the OECD work and reacting thereto, primarily with a view to endorse that. The OECD principles have evolved from the perspective of only developed countries since they were prepared by the OECD countries, and many issues relating to developing countries have not been taken into consideration. This has resulted in serious curtailment of the taxing powers of the developing countries in relation to international transactions. Thus, UN should take an independent stand on tax standards instead of ratifying the standards prepared by the OECD.

3. The Commentary on UN Model Convention should detail its own view in tax related matters rather than making various OECD commentaries (from 2003 version to 2010 versions) as the primary base and then trying to show the differences. Extensive use of OECD Commentary has its own vulnerability, particularly in cases where the examples of OECD Commentary may be out of context due to different wording in the UN Model. To illustrate, the examples detailed in paragraphs 5.3 and 5.4 of OECD Commentary on Article 5 lose relevance in the UN context as the UN Model specifically provides for a service PE. Strangely, these examples are still extracted in the UN Commentary with a remark that these examples may be less significant for UN Model convention. If these examples are not relevant for UN model, why should these be included in the UN Commentary? This problem is bound to occur at many places due to UN Commentary being based on OECD Commentary even though UN Model convention is different from the OECD Model Convention.

4. Further, the UN Commentary should, wherever divergent views are recorded, state the rationale underlying both the views in a balanced and objective manner, which is not the case in the present Model Convention. For example at page 220, the

views of some of the members of the Committee have been summarized only in 2-3 sentences and no explanation of their views has been recorded in the Commentary.

5. Care needs to be taken to avoid factual inaccuracies. For example, in Para 2 of the Commentary on Article 8, it is mentioned that taxes in developing countries could be excessively high. These kinds of statements are avoidable as tax rates in many developed countries are much higher than the tax rates in developing countries. Further, using the rates of taxes in the developing countries as a reason for providing residence based taxation is inappropriate.

6. UN needs to work specifically on the following issues:

- (i) Developing international standards and guidance for Transfer Pricing under Article 9. Reliance on the guidelines stipulated by OECD is misplaced as those guidelines do not address the concerns of developing countries.
- (ii) Formulating a separate Article for taxing the 'Fees for Technical services' on gross basis in order to protect the tax base of developing countries.
- (iii) Providing guiding principles, for tax treatment of 'electronic commerce' transactions, which in the interest of developing countries should move away from the concept of fixed place of business used by OECD. Guidance may also be provided on emerging business trends and models like web-marketing, push mail services, interactive data information and analysis services, cloud computing, long distance consultancy services etc.
- (iv) Vesting taxation rights with source country for 'Re-insurance businesses' through a separate provision under Article 5.
- (v) Studying and creating standards and guidance on treaty issues regarding 'Environment related Taxes' from the perspective of developing countries.
- (vi) Formulating processes and procedures to be adopted by countries for giving foreign tax credit in order to bring consistency of approach amongst various countries.
- (vii) Establishing a robust system of exchange of information under Article 26 to bring true transparency as mandated by G20 and various other international bodies. In particular, there is a need to promote (among others):
  - automatic exchange (to go beyond the current practice of information exchange on request);
  - various types of cooperation like joint tax audits, tax examination abroad;
  - liberal interpretation of foreseeable relevance standard so as not to dilute effective exchange of information – examples may be considered to explain this;

- use of information for non tax purposes in accordance with domestic laws;
- free flow of information including past information.

## **ARTICLE WISE COMMENTS**

### **Article 1**

The introduction of the concept of treaty abuse in the update of the Commentary and the recognition of the menace of the Tax Avoidance Schemes in the form of treaty shopping, conduit companies etc., is a positive development.

### **Article 2**

No specific comments on Article 2 and on its Commentary.

### **Article 3**

Article 3 provides General Definitions for the purposes of the Convention. It is suggested that the Article be expanded to provide -

- (i) in the definition of the term "person", an option to include those entities which are treated as taxable units under the taxation laws in force in the respective contracting states;
- (ii) an option to include the definition of the term "fiscal year" as this period varies from country to country.
- (iii) an option to include the definition of the term "tax" in the treaty itself to avoid later disputes on the kind of taxes covered by the Convention.

### **Article 4**

- (i) UN Commentary at paragraph 6 clarifies the concept of "liable to tax" used in paragraph 1 of Article 4. The Commentary should spell out that the term "liable to tax" should be understood as "subject to tax". This clarity of interpretation is required as the entities which are tax exempt in the resident State should not be covered under the definition of "liable to tax" as tax treaty benefits extended to these entities would promote double non taxation, which tax treaties should generally aim to avoid.
- (ii) Paragraph 3 of Article 4 is a tie-breaker rule for non individuals. This rule needs to be supplemented by the option of denying the treaty benefit to the persons with dual residence to counter abusive situations.
- (iii) The Commentary on paragraph 3 of Article 4 states that circumstances which may, inter alia, be taken into account for establishing the "place of effective management", are the place where a company is actually managed and controlled, the place where the decision-making at the

highest level on the important policies essential for the management of the 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 most important accounting books are kept. In addition to these, the Commentary needs to clarify that the place where main and substantial activity of the entity is carried on, should also to be taken into account when determining the place of effective management.

## Article 5

- 1) Paragraph 2 of Article 5 which lists places which are included in the term “permanent establishment” does not list sales outlet, warehouse, farm, plantation etc. This paragraph needs modification to cover a sales outlet, a warehouse in relation to a person providing storage facility for others and a farm, plantation or other place where agriculture forestry, plantation or related activities are carried on.
- 2) Paragraph 3 of Article 5 on Service PE has a time threshold of 183 days. Due to advancement of technology in modern era, the work that used to be completed in 183 days two decades back can now be completed in less than 90 days. In fact, in paragraph 10 of the Commentary it has been stated that a few developing countries have advocated for reduction of this time limit, but the same has not been accepted as the purpose of tax treaty is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State. While we do not dispute this logic, the question, however, arises as to what preparatory or ancillary operation is. Two decades back, an activity that lasted for less than 183 days might have been an activity of preparatory or ancillary character. But with the advancement of technology, the same may not be the position now. Accordingly, the time threshold of 183 days in paragraph 3 of Article 5 for constituting a PE should be reduced to 90 days.
- 3) Paragraph 5 of Article 5 of UN Model on Agency PE does not specifically provide for creation of an agency PE where the agent habitually secures orders wholly or almost wholly for the principal. This paragraph should be amended to deem that if a person habitually secures orders in a Contracting State wholly or almost wholly for the enterprise of the other Contracting State, it would constitute an agency PE of the enterprise of the other Contracting State.
- 4) According to paragraph 7 of Article 5, an agent of an enterprise dealing at arm’s length basis is considered as an agent of independent status even if the activity of the agent is devoted wholly or almost wholly on behalf of that enterprise. This stipulation ignores the fact that FAR of an agent is different to

the FAR of the enterprise of the other Contracting State. Even if the agent is compensated at arm's length by the enterprise, there may still be some profit attributable to the enterprise on account of difference of FAR of the agent and the enterprise. Hence the exclusion of agents compensated on arm's length provided in the last sentence in paragraph 7 of Article 5, should be deleted and the last sentence of paragraph 7 should be redrafted to state:

*"... However, when the activities of such an agent are devoted wholly or almost wholly on behalf of the enterprise, he will not be considered an agent of independent status within the meaning of this paragraph."*

- 5) UN Commentary, relying on OECD Commentary or otherwise, has taken a position that following do not constitute PE:
- (i) Paragraph 5.3 of OECD Commentary (reproduced in paragraph 3 of UN Commentary): Where a painter works successively under a series of unrelated contracts for a number of unrelated clients in a large office building so that it cannot be said that there is one single project for repainting the building, the building should not be regarded as single place of business for the purpose of that work.
  - (ii) Paragraph 5.4 of OECD Commentary (reproduced in paragraph 3 of UN Commentary): Where a consultant works at different branches in separate locations pursuant to a single project for training the employees of a bank, each branch should be considered separately.
  - (iii) Paragraph 8 of OECD Model Commentary (reproduced in paragraph 3 of UN Commentary): If an enterprise of a state lets or leases facilities, ICS equipment, buildings or intangible property to an enterprise of the other state without maintaining for such letting or leasing activity, a fixed place of business in the other state, the leased facility, ICS equipment, building or intangible property, as such, will not constitute a PE of the lessor provided the contract is limited to mere leasing of the ICS equipments etc.
  - (iv) Paragraph 10 of OECD Model Commentary (reproduced in paragraph 3 of UN Commentary): A PE does not exist if the enterprise merely sets up the vending machines and then leases the machine to other enterprises.
  - (v) Paragraph 26 of the UN Commentary (relying on views of former Group of experts on International Cooperation in Tax Matters): If all the sales-related activities take place outside the host state and only

delivery, by an agent, takes place there, such a situation would not lead to PE.

- (vi) Paragraph 42.2 of OECD Model Commentary (reproduced in paragraph 36 of UN Commentary): An internet website does not itself constitute a tangible property. It does not have a location that can constitute a PE.
- (vii) Paragraph 42.2 of OECD Model Commentary (reproduced in paragraph 36 of UN Commentary): Website stored on a server is not at the disposal of the person using the website for its business (unless he owns or leases the server) and hence, the server cannot constitute PE of such person.

We do not agree with the interpretation that there cannot be any PE in the above examples.

In relation to examples at (i) and (ii) above, it may be noted that UN Commentary acknowledges that these examples could constitute service PE. However, we are of the view that UN Commentary should clarify that in cases where these examples do not constitute service PE; there could still be a possibility of fixed place PE.

In relation to examples at (iii) and (iv) above, we are of view that UN Commentary should clarify that at first it should be seen as to whether the lease rental in a dry lease is covered as equipment royalty. If yes, it must be taxed there. If not, one should see if there is fixed place PE or dependent agent PE. This is for the reason that tangible or intangible properties, ICS equipment or vending machine, etc. may constitute a permanent establishment of the lessor in certain circumstance.

In relation to example at (v) above, we are of the view that the example narrows the literal intent of subparagraph (b) of paragraph 5 of Article 5. Therefore, it is suggested that UN Commentary should actually clarify that if an agent delivers goods or merchandise on behalf of the enterprise of the other state, he will constitute an Agency PE of the enterprise, even if all the sales-related activities take place outside the host State.

In relation to example at (vi) above, we are of the view that the location of website per se does not determine whether there is PE or not, as it depends on facts and circumstances of the case. Hence, the UN Commentary should clarify that website may constitute a PE in certain circumstances.

In relation to example at (vii) above, we are of the view that UN Commentary should clarify that website stored on a server may be at the disposal of the person using the website for its business and, depending on the facts, an enterprise can be considered to have acquired a place of business by virtue of hosting its website on a particular server at a particular location.

- 6) Paragraph 4 of the UN Commentary states that even for the items listed in paragraph 2 of Article 5, the requirement of paragraph 1 of that Article is still to be met for constituting a PE. We are of the view that paragraph 1 of Article 5 defines PE exhaustively and then an inclusive definition is followed in paragraph 2. Under normal rule of interpretation, when inclusive definition follows exhaustive definition, the inclusive definition is in addition to the exhaustive definition and is not confined by it. Hence, UN Commentary should clarify that the examples listed in paragraph 2 can always be regarded as constituting *a priori* permanent establishment.
- 7) In paragraph 18 of OECD Model Commentary, which is reproduced in paragraph 11 of UN Commentary, it is stated that the six month (12 months in OECD) test applies to each individual site or project for constituting construction PE. We are of the view that this interpretation would encourage tax avoidance schemes by splitting of contract in order to avoid constituting a construction PE. Therefore, UN Commentary should instead clarify that a series of consecutive short term sites or projects operated by a contractor would give rise to the existence of a permanent establishment in the country concerned.
- 8) In paragraph 23 of OECD Model Commentary, which is reproduced in paragraph 18 of UN Commentary, examples are given of activities that may be in general of preparatory or auxiliary character. This includes fixed place of business solely for the purpose of scientific research. We are of the view that UN Commentary should clarify that scientific research cannot be an activity of preparatory or auxiliary nature.

#### **Article 6**

No specific comments on Article 6 as well as on its Commentary.

#### **Article 7**

No specific comments on Article 7 as well as on its Commentary.

#### **Article 8**

(1) The UN Model Convention, like OECD Model Convention, includes profits from Inland Waterways Transport within the scope of Article 8. We are of the view that



UN Model should exclude inland waterways from the scope of Article 8 as the activities of transport carried out in inland waters or within two places situated in the territorial waters (e.g. transport of goods from Mumbai to Kandla) cannot be considered international transport and thus the taxing powers should be given exclusively to the source country in which such activities are carried out.

(2) In paragraphs 8 to 11 of the UN Commentary (quoting from 2003 OECD Commentary), it has been explained as to how some ancillary activities are part of the shipping/airlines activities and are entitled to benefits under Article 8. We are of the view that income from ancillary activities may not form part of the shipping/airlines activities and, therefore, UN Commentary should exclude these activities from the scope of Article 8.

### **Article 9**

We reiterate our views stated under General Comments and Recommendations that UN should take the lead in developing standards and guidance on Transfer Pricing issues. The advice of the former Group of Experts to follow OECD principles set out in OECD Transfer Pricing Guidelines should be ignored and the current Commentary on Article 9 be substituted by guidance worked out afresh through UN work.

### **Article 10 of UN Convention**

1) In paragraph 2 of Article 10, the rate of tax in the source country has not been prescribed and has been left to be decided by mutual agreement. However, the threshold limit of holdings for treating an investment as a direct investment is 10% as against 25% in the OECD Model Convention. The reason for such a reduction stated is that many of the developing countries do not allow foreign direction investment beyond 50% ownership in a company and hence even a 10% stake constitutes a significant portion of such permitted ownership. The reduction of the threshold limit of holding from 25% to 10% for being treated as direct investment reduces the source country's tax revenues particularly if the rate of taxation under clause (a) is significantly less than the rate provided in clause (b). We recognize that the Commentary in paragraph 6 does state that the 10% threshold, which determines the level of shareholding qualifying as a direct investment, is illustrative only. However, we suggest that Article 10 should clearly specifically provide an option to settle the rate of tax as well as the threshold limit for direct investment through bilateral negotiation.

2) Paragraph 3 of Article 10 enumerates the various payments which are to be treated as dividend. Further, paragraph 14 in the Commentary reproduces paragraphs 23 to 30 of the OECD Commentary to explain the concept of dividend.

We are of the view that the UN Convention should clarify that domestic laws of contracting states may allow certain distributions to be recognized as dividend.

### **Article 11**

In paragraph 13 of the UN Commentary it has been stated that for a person selling equipment on credit, the interest is more an element of the sales price than income from invested capital. We are of the view UN Commentary should give an option to treat the interest element of sales as interest in accordance with paragraph 2 of the Article 11.

### **Article 12**

(1) In General comments we had suggested that a separate Article needs to be developed for taxing the 'Fees for Technical services' on gross basis in order to preserve the tax base of developing countries.

(2) Paragraph 3 of Article 12 defines royalty. We are of the view that UN Commentary on paragraph 3 should clarify that Royalty includes payments for the "use of and right to use" computer software irrespective of the medium through which such right is transferred.

### **Article 13**

Paragraphs 4 of Article 13 provides source based taxation on gains from alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, where the property of such entities consists, directly or indirectly of immovable property. Paragraph 5 of Article 13 gives source country right on gains from alienation of shares of a company not covered by paragraph 4 (ibid), if the alienator held a specified % (bilaterally negotiated %) of the capital of that company. We are of the view that the application of paragraph 4 raises numerous issues like finding out how and when the value of immovable property exceeds 50% value of all assets. The UN may work towards evolving a common methodology for all countries for easy implementation of paragraph 4. The threshold % in paragraph 5 can be manipulated (including by splitting the shareholding) through tax avoidance schemes, thereby eroding the source country tax base. Therefore, UN Model should provide for complete source based taxation on gains from alienation of shares in paragraph 5.

### **Article 14**

No specific comments on Article 14 and its Commentary. Once UN provides for a separate Article on "Fees for Technical Services", as suggested in the General Recommendations and Comments, necessary amendments would be needed in this Article to avoid overlapping.

## **Article 15**

In Article 8, we had recommended that UN Model should exclude inland waterways from the scope of Article 8 as the activities of transport carried out in inland waters or within two places situated in the territorial waters (e.g. transport of goods from Mumbai to Kandla) cannot be considered international transport. Accordingly, we are of the view that UN Commentary should clarify that the taxing rights in respect of the remuneration of the crew aboard a boat engaged in inland waterways belongs exclusively to the source country in which the activities are carried out.

## **Articles 16, 17 and 18**

No specific comments on Articles 16, 17 and 18 as well as on their Commentary.

## **Article 19**

Paragraph 2 of UN Commentary reproduces paragraph 6 of the OECD Commentary. According to this paragraph salary, wages and pension paid by certain public bodies like State Railways and the Post Office carrying out business activities are not covered under Article 19 and if the Contracting States wish to bring them under this Article may either omit paragraph 3 of the Article 19 or else bring them specifically under paragraphs 1 and 2. We are of the view that UN Commentary should clarify that public bodies like State Railways and Post Offices are not performing business activities and even without special wordings in paragraphs 1 and 2, wages, salaries and pension paid by these bodies are covered by Article 19.

## **Article 20**

We are of the view that Article 20 should be amended to minimize abusive practices. There is evidence to show that tax due on services rendered is evaded by designating the persons rendering services as apprentices or trainees. The Article should be amended as follows:

- (i) "business apprentice" should be excluded from the scope of this Article;
- (ii) remuneration for services rendered by a student in the other Contracting State should be exempt from taxation in the source country provided that such services are directly related to his education or training;
- (iii) the exemption provided for in the Article should be restricted to a maximum period of six years.

## **Articles 21, 22, 23A and 23B**

No specific comments on Articles 21, 22, 23A and 23B and their Commentary.

## **Article 24**

- (i) Paragraph 3 of Article 24 deals with non-discrimination of PEs. It states that PE of the non-resident should not be less favourably taxed than the resident enterprises carrying on the same activities. We are of the view

that if a Contracting State adopts a higher rate of taxation of a PE where the PE is not subjected to branch profit tax, the same should not be treated as discriminatory.

- (ii) Paragraph 44 of the OECD Commentary reproduced in paragraph 5 of the UN Commentary states that the tax incentives/exemptions provided for promoting investments for development of economically backward regions, or the promotion of new activities necessary for the expansion of the economy etc. should be extended to PEs, once they have been accorded the right to engage in business activity. Paragraph 6 of the UN Commentary records that some members from developing countries indicated that States may wish to grant tax preferences conditional on given percentage of local ownership of the enterprise involved. UN Commentary advises that such special situations be resolved in bilateral negotiations. We are of the view that the current Article itself can be interpreted to granting of tax preferences to resident enterprises and specific resolution is not required.

#### **Article 25**

No specific comments on Article 25 and its Commentary.

#### **Article 26**

We recommend development of a more effective system for exchange of information based on suggestions detailed in General Comments and Recommendations.

#### **Article 27**

We are of the view that UN may include the following paragraph in Article 27 in order to allow contracting steps assistance in taking interim measures of conservancy:

*“5. When a Contracting State may, under its law, take interim measures of conservancy by freezing the assets before a tax claim is raised against a person, the competent authority of the other Contracting State, if requested by the competent authority of the first mentioned State, shall take measures for freezing the assets of that person in that Contracting State in accordance with the provisions of its law.”*