Income from immovable property

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Article 6(1) – Income from immovable property

OECD Model	UN Model	US Model
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	Same as OECD model	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 Contracting State.

- Article 6(1) applies if the following conditions are satisfied:
  - A resident of Contracting State (Resident State) derives income
  - Such income is derived from immovable property or agriculture or forestry
  - Such immovable property is situated in other Contracting State (Source State Source)

- Article 6(1) does not apply to income from immovable property situated in Resident State or third state (UN & OECD commentaries, Andaman Sea Food Pvt ltd [2012] 148 TTJ 382

- Article 6(1) applies to income from any use of immovable property that leads to benefits, whether actual or notional, that is regarded as 'income' under the domestic law of source state IBFD Case No. 9/0329 (Supreme Court of Netherlands)

Distributive Rules – Certain Situations

- Income and capital may be classified into three classes, depending on the treatment applicable to each class in the State of source or situs:-
  (1) income and capital that may be taxed **without any limitation** in the State of source or situs (e.g. Article 6 and few other Articles)
  (2) income that may be **subjected to limited taxation** in the State of source, (e.g. dividend, interest, royalty, FTS etc)
  (3) income and capital that **may not be taxed in the State of source** or situs.

- The state of the Resident has an inherent right to tax the worldwide income of its residents. Unless the language of the tax treaty gives up the rights of taxation of the Resident State, the Resident will tax its residents.

- Greece - Income from immovable property may be taxed only in the territory in which the property is situated.

- Bangladesh and Egypt - Income from immovable property shall be taxable only in the Contracting State in which such property is situated.

Article 6(2) – Income from immovable property

OECD Model	UN Model	US Model
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.	Same as OECD model	The term "real property" or "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 real property (immovable property), livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of real property (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 and aircraft shall not be regarded as real property (immovable property).

Article 6(2) – Income from immovable property

Article 6(2) defines immovable property as follows:

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.

Whatever is affixed or attached to land becomes a part of the land –*Technical explanation to India-Australia tax treaty*

Article 6(2) – Income from immovable property - Scope

- **Is machinery embedded and treated as immovable property ?**

  It depends on facts and circumstances, the intention of the parties, and whether it is temporary or permanent. Duncans Industries Ltd. v. State of UP [2000] 87 AIR 355 (SC)

- **Are shares of a real estate company treated as a real estate company?**

  Definition of 'immovable property' u/s. 269UA(d) is not 'law of India', therefore, immovable property under Article 6 does not include shares of a real estate company Vanenburg Facilities BV v. ADIT [2013] (ITA Nos. 739 & 2118/ Hyd /2011 – What about definition under 194-IA of the Act?

- **Is investment in REIT's be treated as investment in immovable property?**

  Generally, the income earned from an REIT investment would be treated as dividend income. In the context of India-US DTAA, the income derived from REIT where the resident's investment exceeds 10% of the interest in such REIT will be treated as income derived from immovable property.

  Refer to the OECD Commentary on Article 10.

Article 6(3) and 6(4)– Income derived from immovable property

OECD Model	UN Model	US Model
(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. (4) The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.	(3) Same as OECD model (4) 4. 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	(3) The provisions of paragraph 1 of this Article shall apply to income derived from the direct use, letting, or use in any other form of real property (immovable property) (4) The provisions of paragraphs 1 and 3 of this Article shall also apply to the income from real property (immovable property) of an enterprise.

UN model also includes immovable property used for the performance of IPS. E.g. India-USA DTAA

Article 13(4) – Property Holding Company

<u>OECD MC 2014:</u>

- Gains derived by a resident of a Contracting State

from the alienation of shares deriving more than 50 per cent

of their value directly or indirectly

from immovable property situated in the other Contracting

State may be taxed in that other State

<u>OECD MC 2017:</u>

- Alienation of shares or comparable interest, such as interests in a partnership or trust
- At any time during the 365 days preceding the alienation ……..derived more than 50 per cent of their value……..

<u>UN</u>

Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property

situated in a Contracting State may be taxed in that State.

- Exclusion for immovable properties used in business activities
- 'Principally' – 50% of an aggregate value of all assets owned

Article 13(4) – Capital gains on shares of real estate company.

Characteristics of Article 13(4) are:

Property company or entity principally holding Immovable property (more than 50%)	Gains taxable in the state where Immovable property is situated	Designed to prevent avoidance of taxes on gains from sale of immovable property (para 8 of UN commentary)
Value of such immovable property to be computed without taking into account debts or other liabilities of the company	Can also include transfer of interest in Partnerships/ other entities (UN)	Does not include property in which business is carried on (UN)

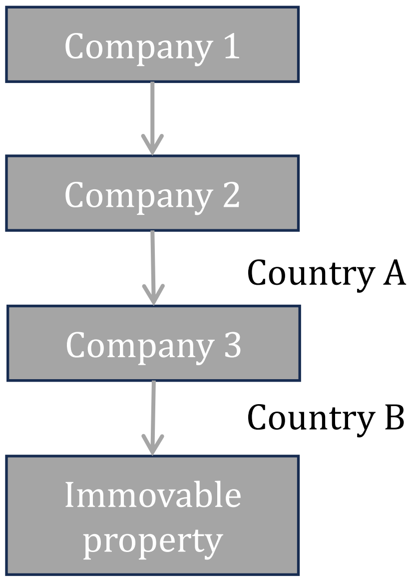
Article 13(4) – Capital gains on shares of real estate company.

Factors irrelevant for Article 13(4) are

Mode of alienation (reorganization)	Investor exempt from tax in a Resident State (Pension Fund)
Type of shares and % of holding (Para 8 of UN commentary)	Residential status of owner company in the state where Immovable Property is situated (Para 8 of UN commentary)

Example

- Co. 1 sells shares of Co. 2
- Only asset held by Co. 2 is shares of Co. 3, and only asset held by Co. 3 is the immovable property
- Is CG taxable in Country B under Art. 13(4)?



Article 13(4) – Property Holding Company

#	Scope	Sample Countries
1	of shares or interest in a company, the assets of which consist wholly or principally of real property	Australia
2	Shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable Property	Italy, Cyprus, Austria, Belgium, China, France, Denmark, Ireland, Italy, Luxembourg, Sweden
3	Shares deriving more than 50 per cent of their value directly or indirectly from immovable property	Malaysia, Indonesia
4	Shares or other corporate rights, of the capital stock of a company the property of which consists directly or indirectly principally (more than 50 percent of the aggregate value of assets owned by the company) of immovable property	Columbia
5	Shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property	Philippines, South Africa
6	Gains derived by a resident of a Contracting State from the alienation of : a) shares, deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other State (at the time of the alienation or at any time during the twelve preceding months); or b) an interest in a partnership, trust or other entity, deriving more than 50 per cent of its value directly or indirectly from immovable property situated in that other State (at the time of the alienation or at any time during the twelve preceding months); may be taxed in that other State	Israel
7	immovable property. Substantial interest exists when the resident owns $\geq$25%	Netherlands

Article 9 of MLI - Capital Gains from alienation of shares

Para 1: Provisions of a Covered Tax Agreement providing that gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or other rights of participation in an entity may be taxed in the other Contracting Jurisdiction provided that these shares or rights derived more than a certain part of their value from immovable property (real property) situated in that other Contracting Jurisdiction….shall apply,

- if the relevant value threshold is met at any time during the 365 days preceding the alienation; and
- to shares or comparable interests, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered) in addition to any shares or rights already covered by the provisions.

Para 2: Para 1 to apply 'in place of or in absence of'

Para 3: Option to choose Para 4

Para 4: ….. gains derived by a resident of a Contracting Jurisdiction from the alienation of shares or comparable interests,………if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property (real property) situated in that other Contracting Jurisdiction.

Para 6: Reservation (None by India)

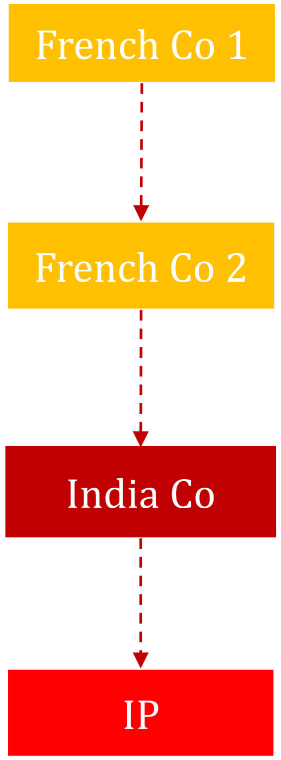
Para 7 and 8: Notifications

India has opted for Para 4 – chosen the value threshold of 50%

Case Study 1 – Implications of Art 9(4) of MLI

Example

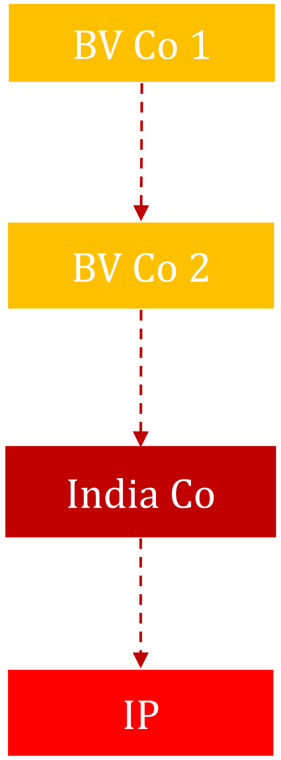
- French Co 1 holds 100% of French Co 2. French Co 2 holds 100% of the shares of India Co.
- French Co 2 assets are only shares of India Co.
- India Co. is engaged in the manufacturing of Nokia mobile phones. India Co holds significant land parcels, which were used in the business of manufacturing
- Due to a significant loss in demand for Nokia, French Co 1 decided to disinvest India operations.
- French Co 1 decided to sell shares of French Co 2 to another Non-Resident.
- Discuss the tax implications in the hands of French Co 2. Assume French Co 2 satisfies explanation 5 to Section 9(1)(i)



Case Study 2 – Implications of Art 9(4) of MLI

Example

- BV Co 1 holds 24% of BV Co 2. BV Co 2 holds 100% of the shares of India Co.
- BV Co 2 assets are only shares of India Co.
- India Co holds significant land parcels
- BV Co 1 decided to sell shares of BV Co 1 to another Non-Resident.
- Discuss the tax implications in the hands of BV Co 2. Assume BV Co 2 satisfies explanation 5 to Section 9(1)(i)



Thank You

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