Scope of Tax Treaties
‘Liable to Tax’ Clause
&
Limitation Of Benefits Clause

Harshal Bhuta
M.Com., F.C.A., A.D.I.T., LL.M. (Hons.)
in International Tax Law [WU]

Liable to Tax Clause

Liable to Tax clause under DTAA

OECD Model Treaty 2017

ARTICLE 4
RESIDENT

1. 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. 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.

ARTICLE 3
GENERAL DEFINITIONS

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Liable to tax vs. Subject to tax

❑ Liable to tax *vs*. Subject to tax:

❖ Commentary on Article 4 of OECD MTC 2017 :

- (Para 8.11) *Paragraph 1 refers to persons who are "liable to tax" in a Contracting State under its laws by reason of various criteria.* ***In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax.*** *For example, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).*
- (Para 8.12) ***In some States, however, these entities are not considered liable to tax if they are exempt from tax under domestic tax laws.*** *These States may not regard such entities as residents for purposes of a convention unless these entities are expressly covered by the convention. Contracting States taking this view are free to address the issue in their bilateral negotiations.*

Residency Provision under the ITA, 1961

❖ **<u>Section 6 of the Income Tax Act as amended by Finance Act, 2020.</u>**

6. For the purpose of this Act, -

(1) An individual is said to be resident in India in any previous year, if he-

…

*1A) Notwithstanding anything contained in clause (1), an individual, being a citizen of India , having total income, other than income from foreign sources, exceeding Rs. Fifteen lakh during the previous year, shall be deemed to be resident in India in that previous year, if he is **<u>not liable to tax</u>** in any other country or territory by reason of his domicile or residence or any other criteria of similar nature;*

Section 2(29A): *"liable to tax", in relation to a person and with reference to a country, means that there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Azadi Bachao Andolan [2003] 263 ITR 703 (SC)**

  - (Para 79) *We are inclined to agree with the submission of the appellants that, 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' as contended by the respondents.*

  - (Para 85) *In our view, the contention of the respondents proceeds on the fallacious premise that liability to taxation is the same as payment of tax.* ***Liability to taxation is a legal situation; payment of tax is a fiscal fact.*** *For the purpose of application of Article 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. If this were not so, the DTAC would not have used the words 'liable to taxation', but would have used some appropriate words like 'pays tax'.*

Residency Provision

- **<u>Treaty access for Indian nationals living in GCC after Sec. 6(1A) enactment:</u>**

GCC Country	Whether liable to tax under domestic tax law?	Article 4(1) provision	Impact
UAE	No	Number of days stay condition	Can still access UAE DTAA if crossing 183 days stay in UAE
Saudi Arabia	Yes	Number of days stay condition	No impact
Kuwait	No	Number of days stay condition	Can still access Kuwait DTAA if crossing 183 days stay in Kuwait
Bahrain	No	NA	May become RNOR automatically
Oman	No*	Liable to tax condition	May become RNOR automatically
Qatar	Yes	Liable to tax condition	No impact

*Taxpayer does not include individual but only enterprise of such individual.

Implications: Tie -Breaker Test Provision - DTAA

❖ **Tie-Breaker Test**

Permanent Home	• Resident of country in which he has a permanent home available
Centre of Vital Interest	• If permanent home available in both countries, resident of country in which his personal or economic relations are closer
Habitual Abode	• If his centre of vital interest cannot be determined, resident of the country in which he has an habitual abode
National	• If he has an habitual abode in both countries, resident of country of which he is a national
Competent Authorities	• If he is a national of both the countries, competent authorities of both countries shall settle by mutual agreement

Implications

Sr. No.	Source of Income	Ordinarily Resident (ROR)	Not-Ordinarily Resident (RNOR)	Non-Resident
1	Indian Sourced Income	Taxable	Taxable	Taxable
2	Foreign Sourced Income	Taxable	Not-taxable*	Not-taxable

****Income accruing outside India but derived from a business controlled in or a profession set up in India is taxable in India.***

Residency Provision under the ITA, 1961

❖ **<u>Section 6 of the Income Tax Act as amended by Finance Act, 2020.</u>**

6. For the purpose of this Act, -

(6) A person is said to be "not ordinarily resident" in India in any previous year if such person is—

(a) an individual who has been a non-resident in India in 9 out of 10 previous years preceding that year, or has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to, 729 days or less; or

(b) ----- ; *or*

(c) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, as referred to in clause (b) of Explanation 1 to clause (1), who has been in India for a period or periods amounting in all to one hundred and twenty days or more but less than one hundred and eighty-two days; or

(d) a citizen of India who is deemed to be resident in India under clause (1A).

Implications – Impact on Indian & Foreign Income

- **Impact on Indian sourced income**

Nature of income	**If obtained TRC**	**If TRC not obtained**
Dividend from an Indian company	No Impact	Impacted. Taxable at higher rate.
Interest from NRO bank a/c in India	No Impact	Impacted. Taxable at higher rate.
Interest from NRE bank a/c in India	No Impact	No Impact
Interest from FCNR deposit	No Impact	No Impact
Capital gain on sale of assets in India	No Impact	Exemption accorded under DTAA for certain class of assets not available. (e.g. sale of units of MF under India – UAE DTAA)
Rental income from property situated in India	No Impact	No Impact

- **No impact on foreign sourced income whether TRC obtained or not.**

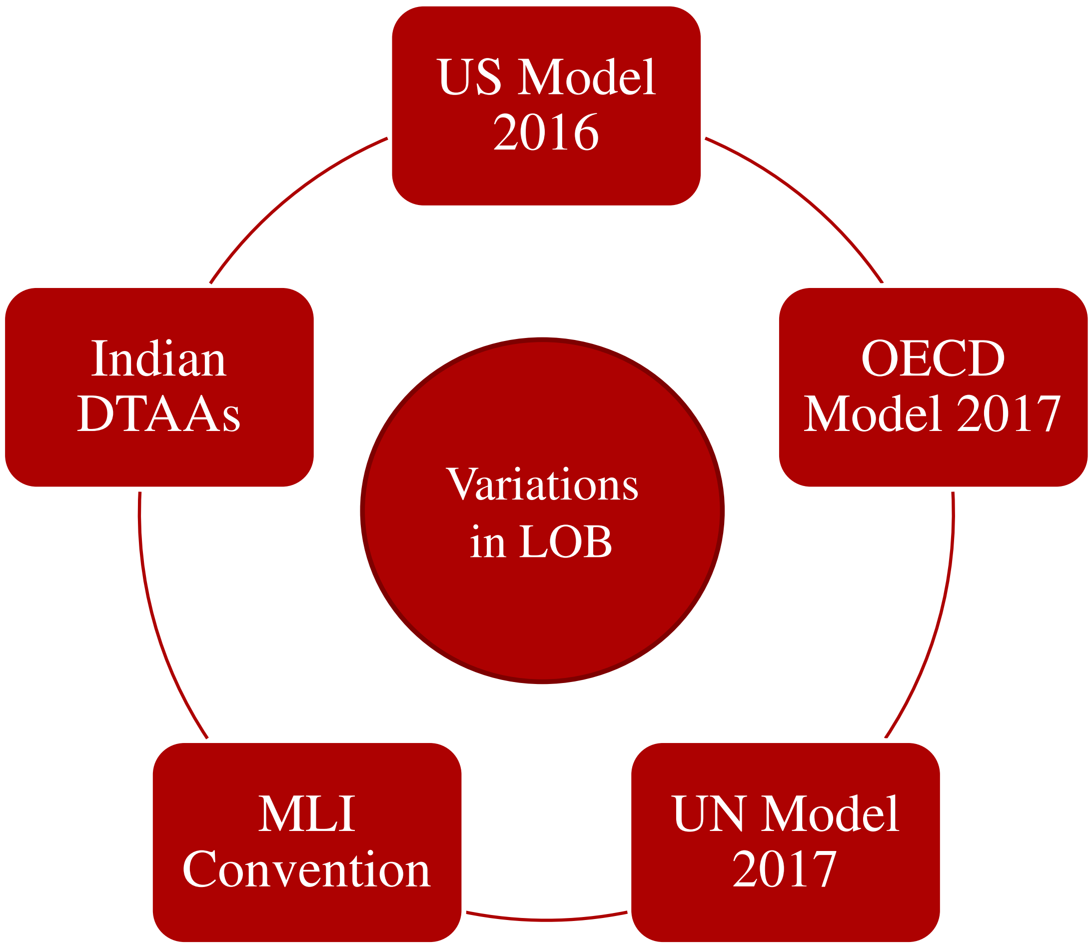
Implications: Under other laws

- **<u>Collateral impact of becoming RNOR from erstwhile NR:</u>**

Coverage under Legislation / Disclosure norms / Provision	**Impact Analysis**
Schedule FA	No change. RNOR exempt from disclosure.
Schedule AL	No change. Disclosure of Indian assets to continue.
Black Money Act	Change. Source of investment can be questioned for purchase of foreign assets.
Transfer Pricing	No change. Sec. 2(30) – NR includes RNOR.
Treaty Benefit	Can access Indian DTAA since brought under comprehensive liability to tax.

Limitation of Benefits Clause

LOB Variations



Need to study LOB clause under Indian DTAAs apart from SLOB insertions

Other Contracting State may not be a signatory to MLI

- India-USA DTAA, Sri Lanka, Tajiskistan, Tanzania etc

Existing DTAA may not become CTA

- India-Mauritius DTAA

Other party may have made a reservation

- India-Mexico DTAA

Existing LOB clause to continue even after insertion

- India-Singapore DTAA

Replacement of only a part of LOB Clause

- India-Israel, Korea

India – Russia Treaty

The following paragraphs 8 through 13 of Article 7 of the MLI applies and supersedes the provisions of this Agreement:

ARTICLE 7 OF THE MLI - PREVENTION OF TREATY ABUSE

(Simplified Limitation on Benefits Provision)

Paragraph 8 of Article 7 of the MLI

Except as otherwise provided in the Simplified Limitation on Benefits Provision, a resident of a [Contracting State] shall not be entitled to a benefit that would otherwise be accorded by [this Agreement], other than a benefit under [paragraph 3 of Article 4 of this Agreement as modified by paragraph 1 of Article 4 of the MLI, Article 9 of this Agreement as modified by Paragraph 1 of Article 17 of the MLI or Article 25 of this Agreement], unless such resident is a "qualified person", as defined in paragraph 9 [of Article 7 of the MLI] at the time that the benefit would be accorded.

Paragraph 9 of Article 7 of the MLI

A resident of a [Contracting State] to [the Agreement] shall be a qualified person at a time when a benefit would otherwise be accorded by [the Agreement] if, at that time, the resident is:

a) an individual;

b) that [Contracting State], or a political subdivision or local authority thereof, or an agency or instrumentality of any such [Contracting State], political subdivision or local authority;

India – Russia Treaty

c) a company or other entity, if the principal class of its shares is regularly traded on one or more recognised stock exchanges;

d) a person, other than an individual, that:

   i. is a non-profit organisation of a type that is agreed to by the [Contracting States] through an exchange of diplomatic notes; or

   ii. is an entity or arrangement established in that [Contracting State] that is treated as a separate person under the taxation laws of that [Contracting State] and:

      A. that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that [Contracting State] or one of its political subdivisions or local authorities; or

      B. that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision A);

e) a person other than an individual, if, on at least half the days of a twelve-month period that includes the time when the benefit would otherwise be accorded, persons who are residents of that [Contracting State] and that are entitled to benefits of the Agreement under subparagraphs a) to d) own, directly or indirectly, at least 50 per cent of the shares of the person.

India – Russia Treaty

Paragraph 10 of Article 7 of the MLI

a) A resident of a [Contracting State] will be entitled to benefits of [the Agreement] with respect to an item of income derived from the other [Contracting State], regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned [Contracting State], and the income derived from the other [Contracting State] emanates from, or is incidental to, that business. For purposes of the Simplified Limitation on Benefits Provision, the term "active conduct of a business" shall not include the following activities or any combination thereof:

   i. operating as a holding company;

   ii. providing overall supervision or administration of a group of companies;

   iii. providing group financing (including cash pooling); or

   iv. making or managing investments, unless these activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such.

b) If a resident of a [Contracting State] derives an item of income from a business activity conducted by that resident in the other [Contracting State], or derives an item of income arising in the other [Contracting State] from a connected person, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned [Contracting State] to..

India – Russia Treaty

b) which the item is related is substantial in relation to the same activity or a complementary business activity carried on by the resident or such connected person in the other [Contracting State]. Whether a business activity is substantial for the purposes of this subparagraph shall be determined based on all the facts and circumstances.

c) For purposes of applying this paragraph, activities conducted by connected persons with respect to a resident of a [Contracting State] shall be deemed to be conducted by such resident.

Paragraph 11 of Article 7 of the MLI

A resident of a [Contracting State] that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded by [the Agreement] with respect to an item of income if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least 75 per cent of the beneficial interests of the resident.

Paragraph 12 of Article 7 of the MLI

If a resident of a [Contracting State] is neither a qualified person pursuant to the provisions of paragraph 9 [of Article 7 of the MLI], nor entitled to benefits under paragraph 10 or 11 [of Article 7 of the MLI], the competent authority of the other [Contracting State] may, nevertheless, grant the benefits of [the Agreement], or benefits with respect to a specific item of income, taking into account the object and purpose of [the Agreement], but only if such resident demonstrates..

India – Russia Treaty

to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under [the Agreement]. Before either granting or denying a request made under this paragraph by a resident of a [Contracting State], the competent authority of the other [Contracting State] to which the request has been made shall consult with the competent authority of the first-mentioned [Contracting State].

Paragraph 13 of Article 7 of the MLI

For the purposes of the Simplified Limitation on Benefits Provision:

a) the term "recognised stock exchange" means:

   i. any stock exchange established and regulated as such under the laws of either [Contracting State]; and

   ii. any other stock exchange agreed upon by the competent authorities of the [Contracting States];

b) the term "principal class of shares" means the class or classes of shares of a company which represents the majority of the aggregate vote and value of the company or the class or classes of beneficial interests of an entity which represents in the aggregate a majority of the aggregate vote and value of the entity;

India – Russia Treaty

c) the term "equivalent beneficiary" means any person who would be entitled to benefits with respect to an item of income accorded by a [Contracting State] under the domestic law of that [Contracting State], [the Agreement] or any other international instrument which are equivalent to, or more favourable than, benefits to be accorded to that item of income under [the Agreement]; for the purposes of determining whether a person is an equivalent beneficiary with respect to dividends, the person shall be deemed to hold the same capital of the company paying the dividends as such capital the company claiming the benefit with respect to the dividends holds;

d) with respect to entities that are not companies, the term "shares" means interests that are comparable to shares;

two persons shall be "connected persons" if one owns, directly or indirectly, at least 50 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares) in each person; in any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

India – USA Treaty

ARTICLE 24

LIMITATION ON BENEFITS

1. A person (other than an individual) which is a resident of a Contracting State and derives income from the other Contracting State shall be entitled under this Convention to relief from taxation in that other Contracting State only if :
   a) more than 50 per cent of the beneficial interest in such person (or in the case of a company, more than 50 per cent of the number of shares of each class of the company's shares) is owned, directly or indirectly, by one or more individual residents of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or other individuals subject to tax in either Contracting State on their worldwide incomes, or citizens of the United States ; and
   b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not resident of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or citizens of the United States.
2. The provisions of paragraph 1 shall not apply if the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct by such person of a trade or business in the first-mentioned State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company).

India – USA Treaty

3. The provisions of paragraph 1 shall not apply if the person deriving the income is a company which is a resident of a Contracting State in whose principal class of shares there is substantial and regular trading on a recognized stock exchange. For purposes of the preceding sentence, the term "recognized stock exchange" means :
   a) in the case of United States, the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Act of 1934 ;
   b) in the case of India, any stock exchange which is recognized by the Central Government under the Securities Contracts Regulation Act, 1956 ; and
   c) any other stock exchange agreed upon by the competent authorities of the Contracting States.
4. A person that is not entitled to the benefits of this Convention pursuant to the provisions of the preceding paragraphs of this Article may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income in question arises so determines.

India – Mauritius Treaty

ARTICLE 27A - LIMITATION OF BENEFITS

1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.
2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
3. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian Rs.1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.
4. A resident of a Contracting State is deemed not to be a shell/conduit company if:
   a) it is listed on a recognized stock exchange of the Contracting State; or
   b) its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

   Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention.]

India – United Mexican States Treaty

ARTICLE 28

LIMITATION OF BENEFITS

1. Except as otherwise provided in this Article, a person (other than an individual), which is a resident of a Contracting State and which derives income from the other Contracting State shall be entitled to all the benefits of this Agreement otherwise accorded to residents of a Contracting State only if such a person has the qualifications as defined in paragraph 2 and meets the other conditions of this Agreement for the obtaining of any such benefits.
2. A person of a Contracting State is a qualified person for a fiscal year only if such person is either :
   a) Government entity; or
   b) a company incorporated in either of the Contracting States, if
      i. the principal class of its shares is listed on a recognized stock exchange as defined in paragraph 5 of this Article and is regularly traded on one or more recognized stock exchanges, or
      ii. at least 50 per cent of the aggregate vote or value of the shares in the company is owned directly or indirectly by one or more individuals residents of either of the Contracting States or/and by other persons incorporated in either of the Contracting States, at least 50 per cent of the aggregate vote or value of the shares or beneficial interest of which is owned directly or indirectly by one or more individuals residents of either of the Contracting States; or

India – United Mexican States Treaty

c) a partnership or association of persons, at least 50 per cent or more of whose beneficial interests is owned by one or more individuals residents of either of the Contracting States or/and by other persons incorporated in either of the Contracting States, at least 50 per cent of the aggregate vote or value of the shares or beneficial interest of which is owned directly or indirectly by one or more individuals residents of either of the Contracting States; or

d) a charitable institution or other tax exempt entity whose main activities are carried on in either of the Contracting States :

Provided that the persons mentioned above will not be entitled to the benefits of the Agreement if more than 50 per cent of the person's gross income for the taxable year is paid or payable directly or indirectly to persons who are not residents of either of the Contracting States in the form of payments that are deductible for the purpose of computation of tax covered by this Agreement in the person's state of residence (but not including arm's length payment in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank incurred in connection with a transaction entered into with the permanent establishment of the bank situated in either of the Contracting States).

India – United Mexican States Treaty

3. A resident of a Contracting State shall nevertheless be granted the benefits of the Agreement if the Competent Authority of the other Contracting State determines that the said resident actively carries out business in the other State and that the establishment or acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Agreement.
4. Before a resident of a Contracting State is denied relief from taxation in the other Contracting State by reason of paragraph 1, 2 or 3, the competent authorities of the Contracting States shall consult each other.
5. For the purposes of this Article the term 'recognised stock exchange' means—
   a) in India, any stock exchange which is recognized by the Central Government under the Securities Contracts (Regulation) Act, 1956;
   b) in Mexico, the Mexican Stock Exchange Market (Bolsa Mexicana de Valores); and
   c) any other stock exchange which the competent authorities agree to recognise for the purposes of this Article.
6. Notwithstanding anything contained in paragraphs 2 to 5 above, any person shall not be entitled to the benefits of this Agreement, if its affairs were arranged in such a manner as if it was the main purpose or one of the main purposes to avoid taxes to which this Agreement applies.

India – Singapore Treaty

ARTICLE 24A

1. A resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement if its affairs were arranged with the primary purpose to take advantage of the benefits in the said paragraph 4A or paragraph 4C of Article 13 of this Agreement, as the case may be.
2. A shell or conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement. A shell or conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.
3. A resident of a Contracting State is deemed to be a shell or conduit company if its annual expenditure on operations in that Contracting State is less than S$ 200,000 in Singapore or Indian Rs. 5,000,000 in India, as the case may be:
   a) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12 month periods in the immediately preceding period of 24 months from the date on which the gains arise;
   b) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.

India – Singapore Treaty

4. A resident of a Contracting State is deemed not to be a shell or conduit company if:
   a) it is listed on a recognised stock exchange of the Contracting State; or
   b) its annual expenditure on operations in that Contracting State is equal to or more than S$ 200,000 in Singapore or Indian Rs. 5,000,000 in India, as the case may be:
      i. in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;
      ii. in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.
5. For the purpose of paragraph 4(a) of this Article, a recognised stock exchange means:
   a) in the case of Singapore, the securities market operated by the Singapore Exchange Limited, Singapore Exchange Securities Trading Limited and The Central Depository (Pte) Limited; and
   b) in the case of India, a stock exchange recognised by the Securities and Exchange Board of India.

Explanation: The cases of legal entities not having bona fide business activities shall be covered by paragraph 1 of this Article.

India – Singapore Treaty

The following paragraph 1 of Article 7 of the MLI applies to the provisions of this Agreement:

ARTICLE 7 OF THE MLI - PREVENTION OF TREATY ABUSE (Principal purposes test provision)

Notwithstanding any provisions of the Agreement, a benefit under the Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Agreement.

India – Korea Treaty

ARTICLE 28

LIMITATION OF BENEFITS

1. Nothing in this Agreement shall be construed as restricting, in any manner, the application of any provisions of the laws or regulations of a Contracting State which are designed to prevent the avoidance or evasion of taxes, whether or not described as such.
2. ~~No person shall be entitled to the benefits of the Agreement, if its affairs were arranged in such a manner that the main purpose or one of the main purposes was to avoid taxes to which this Agreement applies.~~

The following paragraph 1 of Article 7 of the MLI applies to the provisions of this Agreement:

ARTICLE 7 OF THE MLI - PREVENTION OF TREATY ABUSE (Principal purposes test provision)

Notwithstanding any provisions of the Agreement, a benefit under the Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Agreement.

India – Korea Treaty

3. In respect of Articles 10, 11, 12, 13 and 22, a resident of a Contracting State shall not be entitled to benefits otherwise accorded to residents of a Contracting State by the Agreement, if:
   a) the resident is controlled directly or indirectly by one or more persons that are not residents of that Contracting State; or
   b) the main purpose or one of the main purposes of any person concerned with the creation or assignment of a share, a debt-claim, or a right in respect of which the income is paid is to take advantage of these Articles by means of that creation or assignment.

Jurisprudence on ‘Liable to Tax’ Clause

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Mohsinally Alimohammed Rafik [1995] 213 ITR 317 (AAR)**

  - *Several articles in the DTAA which specifically concern individuals would make no sense at all, if individuals living in the UAE were treated as excluded from the benefits of the agreement because they were not currently subjected to any tax in the UAE.*

  - *In this situation, the authority was of the opinion that the second interpretation was the preferable one and that an individual like the applicant though, at present not actually liable to pay any income-tax in Dubai, should also be considered to be a resident of Dubai for the purposes of the DTAA as, being a person living in Dubai and having sources of income there, he was certainly liable to be called upon to pay income-tax under the tax laws of that country.*

  - It was held that even though there was no tax on the personal income of UAE resident, they would be entitled to treaty benefit because the word liable to tax are followed by the words 'by reason of his domicile, residence, place of management or any other criterion of a similar nature" and these words cannot be ignored while interpreting the treaty.

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Cyril Eugene Pereira [1999] 239 ITR 650 (AAR)**

  - *These provisions cannot be given effect to until and unless the UAE imposes a tax on income earned by individuals. In other words, these provisions will become effective as soon as tax laws corresponding to the Indian taxes come in force in the UAE.*

  - *No relief from double taxation can be given unless the petitioner is in a position to allege that he is liable to be taxed twice in respect of the same income in the same year in two different countries and as such, he is entitled to invoke the protection of the Double Taxation Agreement.*

  - *In the premises, an individual who is not liable to pay tax under the UAE law cannot claim any relief from the only tax on income which is payable in India under the agreement. The provision of DTAA does not apply to any case where the same income is not liable to be taxed twice by the existing laws of both the Contracting States.*

Liable to tax vs. Subject to tax

❑ <u>Liable to tax *vs.* Subject to tax:</u>

❖ **Abdul Razak A. Meman [2005] 276 ITR 206 (AAR)**

- *The Taxation Law in force in UAE is the UAE Tax Decree of 1969 (UAE Decree), which came into force on 1-1-1969 wherein an 'individual' is excluded from the definition of 'person' under the UAE Decree.*
- *Parties proceeded on the assumption that a new law bringing individual within the income-tax net of UAE was in the pipeline and That explains as to why the definition of the expression 'resident of a Contracting State' was adopted as in article 4(1) of the OECD Model without any modification unlike in the case of French Republic-UAE; Canada-UAE Treaty; Federal Republic of Germany-UAE which specifically cover individuals.*
- *Once it is accepted that there is no provision in UAE Decree to tax the income of individuals, as a necessary corollary it follows that individuals could not be residents in UAE within the meaning of para (1) of article 4. The applicant who is not a tax entity under the UAE Decree cannot under the guise of liberal interpretation of article 4(1), be enabled to avail the benefit of articles 10, 11 and 13 of the Treaty.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Emmerich Jaegar [2005] 274 ITR 125 (Gujarat)**

  - *Being liable to tax and being actually taxed are two different things, and in a given situation, it is always possible that a person may be liable to pay tax under a statute, but may not be actually taxed by virtue of, may be, some other provision under the same statute. Therefore, the approach of the authorities below to treat the liability to pay tax as being actually taxed was not warranted by the language of the provision.*

  - *The view taken by the lower authorities that unless and until the assessee produced proof of payment of tax, he would not be entitled to claim relief under the Agreement did not accord with the terms of the Agreement and the language employed in article 14(2)(c) of the Agreement.*

  - *As the assessee was claiming benefit under an exception (exemption) provision, it would be upon the assessee to discharge the onus to show that it was subject to Austrian tax.*

Liable to tax vs. Subject to tax

❑ **Liable to tax *vs.* Subject to tax:**

❖ **Green Emirates Shipping and Travels [2006] 100 ITD 203**

➢ *There is no meeting ground between the ruling given by the Authority for Advance Rulings in Cyril Eugene Pereira's case (supra) and the judgment delivered by the Hon'ble Supreme Court in Azadi Bachao Andolan's case (supra). The choice, however, poses no difficulty in the light of the elementary legal position that the judgments of Hon'ble Supreme Court have binding force on all of us. Much as we respect the Hon'ble Authority for Advance Rulings, we regret our inability to follow the ruling which, in our humble understanding, has been clearly disapproved by the Hon'ble Supreme Court. It is not even open to us, even in a case in which our understanding of the issue on merits concurs with that of the Hon'ble Authority for Advance Rulings in Cyril Eugene Pereira's case, to follow that school of thought.*

➢ *Learned, Departmental Representative has invited our attention to the ruling given by the Authority for Advance Rulings in the case of Abdul Razak A. Meman, In re which supports the case of the Revenue and is said to be on exactly the same material facts. We are, however, unable to accept this plea.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Meera Bhatia [2010] 38 SOT 95 (Mumbai)**

  - *The issue involved in the instant case was covered by the Tribunal's decision in the case of Asstt. DIT v. Green Emirate Shipping & Travels [2006] 100 ITD 203 (Mum.) wherein the Tribunal has held that actual payment of tax in one of the Contracting States is not a condition precedent to avail the benefits of the DTAA in the other Contracting States because the tax treaty prevents not only 'current' taxation but also 'potential' double taxation. Once the right to tax the UAE residents in specified circumstances vests only in Principal State of the UAE under a tax treaty, that right, whether that right is exercised or not, continues to remain exclusive right of that State.*

  - *That amendment in the definition of resident of the UAE, thus, accepts the broad proposition that the taxability in one of Contracting States is not a sine qua non to avail treaty benefits in the other Contracting State.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Rameshkumar Goenka [2010] 39 SOT 132 (Mumbai)**

  - *We have heard the submissions of learned Departmental Representative who relied on the order of the Assessing Officer. In our view, decision in the case of Green Emirate Shipping & Travels (supra) is squarely applicable to the facts of the present case. As held in the aforesaid case, expression 'liable to tax' in the contracting State as used in article 4(1) of Indo-UAE DTAA does not necessarily imply that the person should actually be liable to tax in that contracting State and that it is enough if other contracting State has right to tax such person, whether or not such a right is exercised.*

  - *In the light of the ratio laid down in the aforesaid decision, which has been followed by CIT(A), we find no grounds to interfere with the order of CIT(A). We, therefore, confirm the order of CIT(A) and dismiss the appeal by the revenue.*

Liable to tax vs. Subject to tax

❑ Liable to tax *vs.* Subject to tax:

❖ **Resource Connections FZE [2010] 42 SOT 23 (Mumbai) (URO)**

- *It is thus clear that a tax treaty not only prevents 'current' but also 'potential' double taxation. Therefore, irrespective of whether or not the UAE actually levies taxes on non-corporate entities, once the right to tax UAE residents in specified circumstances vests only with the Government of UAE, that right, whether exercised or not, continues to remain exclusive right of the Government of UAE.*

- *It is thus clear that taxability in one country is not sine qua non for availing relief under the treaty from taxability in the other country.*

- *In our view decision in the case of Green Emirate Shipping & Travels is squarely applicable to the facts of the present case. As held in the aforesaid case, expression 'liable to tax' in the contracting state as used in Article 4(1)of Indo-UAE-DTAA does not necessarily imply that the person should actually be liable to tax in that contracting state and that it is enough if other contracting state has right to tax such person, whether or not such a right is exercised.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Smt. Manu Mahavirchand Mehta [2010] 3 taxmann.com 754 (Mumbai)**

  - *The revenue is in appeal to contend, relying on the decision of AAR in the case of Cyril Eugene Pereira v. CIT [1999] 239 ITR 650/105 Taxman 273, that the provisions of the treaty do not apply to a case where the same income is not liable to be taxed twice by the existing laws of both the contracting States.*

  - *This decision has been considered by the Tribunal in its order cited supra and in paragraph 5 of its order, after referring to the judgment of the Supreme Court cited above, the Tribunal has observed that since the Supreme Court was not persuaded by the decision of the AAR, it would not be proper to follow the decision of the AAR. We are also informed that the 'L' Bench of the Mumbai Tribunal has taken the same view in its order dated 29.10.2010 in Meera Bhatia v. ITO [2010] 38 SOT 95 (Mum.) and in the case of ITO v. Ramesh Kumar Goenka [2010] 39 SOT 132 (Mum.).*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Birla Sunlife Management Co. Ltd. [2010] 3 taxmann.com 782 (Mumbai)**

  - *We have heard the submissions of learned Departmental Representative who relied on the order of the Assessing Officer.*

  - *In our view decision in the case of Green Emirate Shipping & Travels (supra) is squarely applicable to the facts of the present case. As held in the aforesaid case, expression 'liable to tax' in the contracting state as used in Article 4(1) of Indo-UAE-DTAA does not necessarily imply that the person should actually be liable to tax in that contracting state and that it is enough if other contracting state has right to tax such person, whether or not such a right is exercised.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Frate Line, Dubai [2010] 3 taxmann.com 769 (Mumbai- Trib.)**

  - *We have heard the rival contentions and perused the material on record. We find that, as rightly noted by the CIT (A), the issue is covered in favour of the assessee by the decision of the Tribunal in the case of Green Emirate Shipping & Travels (supra), wherein, on identical facts, the Tribunal has held that the assessee is entitled to the benefits of Indo UAE DTAA.*

  - *In view of the above discussions, and following the view taken by the coordinate benches in a large number of decisions including in the cases of Green Emirate Shipping & Travels (supra) and Meera Bhatia (supra), we approve the conclusions arrived at by the CIT (A) and decline to interfere in the matter.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Mustaq Ahmad Vakil [2011] 47 SOT 454 (Delhi)**

  - *We have heard the submissions of learned Departmental Representative who relied on the order of the Assessing Officer. In our view, decision in the case of Green Emirate Shipping & Travels (supra) is squarely applicable to the facts of the present case. As held in the aforesaid case, expression 'liable to tax' in the contracting State as used in article 4(1) of Indo-UAE DTAA does not necessarily imply that the person should actually be liable to tax in that contracting State and that it is enough if other contracting State has right to tax such person, whether or not such a right is exercised.*

  - *In the light of the ratio laid down in the aforesaid decision, which has been followed by CIT(A), we find no grounds to interfere with the order of CIT(A). We, therefore, confirm the order of CIT(A) and dismiss the appeal by the revenue.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Mahavirchand Mehta [2011] 45 SOT 137 (Mumbai) (URO)**

  - *It is thus clear that a tax treaty not only prevents 'current' but also 'potential' double taxation. Therefore, irrespective of whether or not the UAE actually levies taxes on non-corporate entities, once the right to tax UAE residents in specified circumstances vests only with the Government of UAE, that right, whether exercised or not, continues to remain exclusive right of the Government of UAE.*

  - *In our view decision in the case of Green Emirate Shipping & Travels is squarely applicable to the facts of the present case. As held in the aforesaid case, expression 'liable to tax' in the contracting state as used in Article 4(1)of Indo-UAE-DTAA does not necessarily imply that the person should actually be liable to tax in that contracting state and that it is enough if other contracting state has right to tax such person, whether or not such a right is exercised.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Emirates Shipping Line, FZE [2012] 349 ITR 493 (Delhi)**

  - *The test for liability for taxation is not determined on the basis of an exemption granted in respect of any particular source of income but by taking into consideration the totality of provisions of income tax law. Merely because at the given time there is an exemption from income tax in respect of any particular head, it cannot be contended or held that the assessee is not liable to tax. The Supreme Court referred to the concept of 'fiscal residence of a company' after making reference to OECD and UNO Model Conventions and interpretations placed by Courts in different countries and manuals of international taxation. It was observed that 'liable to taxation' does not refer to current but also potential double taxation.*

  - *Lastly, and more importantly, it was to be found that one was bound by the ratio and the decision of the Supreme Court in Azadi Bacho Andolan's case.*

Liable to tax vs. Subject to tax

❑ Liable to tax *vs.* Subject to tax:

❖ **Bhagwan T. Shivlani [2012] 53 SOT 233 (Mumbai) (URO)**

- *There is no dispute that the assessee would be liable to tax in UAE though he may not have actually be taxed in that country because income of individuals are not liable to taxation in UAE.*

- *As held in the case of Asstt. DIT v. Green Emirate Shipping & Travels [2006] 100 ITD 203 (Mum.) expression 'liable to tax' in the contracting state as used in Article 4(1) of Indo-UAE-DTAA does not necessarily imply that the person should actually be liable to tax in that contracting state and it is enough if other contracting state has right to tax such person, whether or not such a right is exercised. Thus, the assessee has to be treated as 'resident of UAE' and the provisions of the DTAA between India-UAE have to be examined by treating him as a resident of UAE.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs*. Subject to tax:</u>**

- **Vinod Arora [2012] 139 ITD 205 (Delhi)**

  - *The identical facts were considered by the ITAT in the case of Mustaq Ahmed Vakil [Appeal Nos. 269 of 2006-07, 104 of 2007-08 & 71 of 2008-09, dated 30-3-2010].*

  - *The Tribunal decided the issue in favour of the assessee. These facts were not controverted by the department. Hence, there is no infirmity in the order of the Commissioner (Appeals). Accordingly, the benefit of Indo-UAE Treaty is available to the assessee and short term capital gains derived by him from sale of shares/securities in India were not taxable in India in terms of article 13(3) of the Indo-UAE Tax Treaty.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **KPMG [2013] 142 ITD 323 (Mumbai)**

  - *The term liable to tax in the contracting State has been held by a catena of decisions that it does not necessarily imply that the person should actually pay the tax in that contracting State. Right to tax on such person is sufficient. The Tribunal in Asstt. DIT v. Green Emirate Shipping & Travels [2006] 100 ITD 203 (Mum.), also concluded the same.*

  - *Thus, respectfully following the several judicial precedents, it is held that taxability in one country is not sine qua non for availing relief under the treaty from taxability in other country.*

  - *Liable to tax in the contracting State cannot be implied as the person is actually liable to tax but would also cover the cases where the other contracting State has the right to tax such person. It is immaterial whether or not such right has been exercised.*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Prashant Kumar Gulati [2014] 66 SOT 224 (Pune – Trib.)**

  - *It is, therefore, not possible for us to accept the contentions so strenuously urged by the respondents that the avoidance of double taxation can arise only when tax is actually paid in one of Clearly, therefore, there is no meeting ground between the ruling given by the Authority for Advance Rulings in Cyril Eugene" Pereira's case (supra) and the judgment delivered by the Hon'ble Supreme Court in Azadi Bachao Andolan's case (supra).*

  - *The decision in the case of Green Emirates Shipping & Travels (supra) has been also followed by the other Co-ordinate Benches in the case of ITO v. Rameshkumar Goenka [2010] 39 SOT 132 (Mum.) and Meera Bhatia v. ITO [2010] 38 SOT 95 (Mum.). We, therefore, following the decision in the case of Green Emirates Shipping & Travels (supra) do not prefer to go with the ruling of the AAR in the case of Cyril Eugene Pereira (supra)....*

Liable to tax vs. Subject to tax

- **Liable to tax *vs.* Subject to tax:**

- **Martrade Gulf Logistics FZCO – UAE [2018] 191 TTJ 575 (Rajkot – Trib.)**

  - *In view of the legal position so set out, with which we are in considered agreement, all that is necessary for the purpose of being treated as resident of a Contracting States under Indo-UAE Tax Treaty is that the person should be liable to tax in that Contracting State by the reason of domicile, residence, place of management, place of incorporation etc.*

  - *Clearly, the assessee company was incorporated in UAE and, therefore, the assessee company had this locality related attachment which led to residence type taxation. It is not at all necessary to be treated as "liable to be taxed in UAE", for the purposes of this treaty, that the assessee should actually pay tax in UAE. To this extent, grievance of the Assessing Officer clearly ill conceived.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **BP Singapore Pte Ltd. [2018] 168 ITD 325 (Rajkot – Trib.)**

  - *One may consider this in the light of the factual position admitted to the effect that the assessee has availed exemption under section 13F of the Singapore's Income-tax Act, and, to that extent, the income embedded in these receipts has not actually been taxed in Singapore.*

  - *When assessee is confronted with this glaring contradiction, it submits that a mere exemption of income in Singapore does not take that income out of the ambit of income liable to be taxed in Singapore, and it will be eligible for treaty benefits nevertheless.*

  - *Undoubtedly, by the virtue of the assessee being fiscally domiciled in Singapore, the said income was 'liable to tax' but then 'liable to tax' is not the same thing as 'subject to tax'.*

Liable to tax vs. Subject to tax

- **<u>Liable to tax *vs.* Subject to tax:</u>**

- **Bank of India [2021] 125 taxmann.com 155 (Mumbai- Trib.)**

  - *Ms McCarthy referred me to certain references from HMRC's International Tax Manual to illustrate the long-standing published view of the phrase "subject to tax". Paragraph 332210 of that manual was first published on HMRC's website on 29 December 2006. It reads:*

  "INTM332210 - DT applications and claims - Subject to tax Background

  The expression "subject to tax" usually means that the person must actually pay tax on the income in their country of residence. However, a person is still regarded as "subject to tax" if, for example, he or she does not pay tax because their income is sufficiently small that it is covered by personal allowances that are available to set against liability to tax in the other country.

  A person is not regarded as "subject to tax" if the income in question is exempted from tax because the law of the other country provides for a statutory exemption from tax…

Thank you