Study Course on DTAA

Income from Immovable property and other Income

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Income from Immovable Property

Article 6 (UN Model)
**Income from Immovable Property – Article 6**

Article 6(1)

- Grants right of taxation to Country where IP is situated

“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.”

- Indo-Singapore DTAA – Identical wordings
Income from Immovable Property – Article 6

Article 6(2)

• Meaning of IP explained

“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 respective landed property apply, usufruct of immovable property and rights to variable and 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.”

• Indo-Singapore DTAA – Identical clause except highlighted word is not included
Income from Immovable Property – Article 6

Article 6(3)

• Form of exploitation of IP explained

“The provisions of paragraph 1 shall also apply to income derived from the direct use, letting or use in any other form of immovable property.”

• Indo-Singapore DTAA – Identical wordings
**Income from Immovable Property – Article 6**

**Article 6(4)**

- **Treatment of IP of an Enterprise / used for performing services explained**

  “The provisions of paragraph 1 and 3 shall also apply to the income from immovable property of an enterprise and to the income from immovable property used for performance of independent personal services”

- **Indo-Singapore DTAA – Identical wordings**
**Income from Immovable Property – Article 6**

**UN Model**
- May be taxed in source state
- Meaning as given in source country laws – further inclusive explanation
- Ships, Boats & Aircrafts not regarded as Immovable Property
- Form of exploitation is not relevant

**OECD Model**
- May be taxed in source state
- Meaning as given in source country laws – further inclusive explanation
- Ships, Boats & Aircrafts not regarded as Immovable Property
- Form of exploitation is not relevant

**US Model**
- May be taxed in source state
- Meaning as given in source country laws
- No such specific exclusion
- Form of exploitation is not relevant

Both OECD and UN Model are identical
Most Indian DTAAAs are based on UN Model
**Income from Immovable Property – Article 6**

- Right of taxation to Country of situs of the property
  - Logic – close economic connection
  - Situation / location of property decisive criterion
- Income from IP situated in third state not covered
- Income from agriculture and forestry included
  - May be taxed under Article 7 if specifically agreed between two States
- No mechanism for computation of taxable income
  - Local laws should apply – Para 2 of commentary
Income from Immovable Property – Article 6

• Definition as per Section 269UA of IT Act
  - Land or building or part thereof and includes
    ◦ Plant & Machinery, furniture, fittings and other things transferred along with land or building
    ◦ Including right therein (eg. rights in case of co-operative society)

(please refer to Annexure A for the complete definition)

• Definition as per 194IA of the IT Act
  - Land [other than agricultural land] or any buildings or any part of building

• Immovable property not defined in DTAA
  - Reference to meaning assigned under domestic law
  - Term “immovable property” explained in inclusive manner
**Income from Immovable Property – Article 6**

- Immovable property includes:
  - Property accessory to IP;
  - Livestock, equipment used in agriculture and forestry;
  - Rights to IP;
  - Right of enjoying the use and advantages of another IP (usufruct of IP);
  - Mineral deposits and other natural resources

- Ships, boats and aircraft are not immovable property
Income from Immovable Property – Article 6

Whether following would be immovable property

• Interest of Partner in firm holding IP
• Shares of Co-op society
• Shares of Company etc. in lieu of which immovable property is allotted

Issue – What if one country treats one asset as IP and other country treats the same as movable property?
Income from Immovable Property – Article 6

• Article applies to:
  - Direct use
  - Letting out (subletting included)
  - Use in any other form / indirect use

• No specific definition of term ‘use in any other form’
  - Not defined in the convention
  - Governed by the tax laws of the country where the property is situated

Situs based taxation of income from IP irrespective of form of exploitation of property
**Income from Immovable Property – Article 6**

- Income from immovable property used by enterprise / used for performing services are covered by this article
  - Priority over Article 7
  - Income taxable under this article even if such property form part of PE of the enterprise or service provider
  - Principles of domestic law (including deductions) would prevail

- Situs based taxation of income from IP irrespective of form of exploitation of property

Note: No special provision with regard to income from indebtedness secured by IP – settled in Article 11 (Interest)
**Income from Immovable Property – Article 6**

**Taxability of income arising on alienation of Immovable Property**

- Covered under the head “Capital Gains”
- Taxability on the same line as income from immovable property
- UN Model – company holding immovable property principally – distinguished from OECD Model
Income from Immovable Property – Article 6

• Taxation regime in relation to REIT introduced vide Finance (No.2) Bill 2014
  - REIT is set-up as trust under the Indian Trust Act
  - Listing of units of REIT mandatory
  - Local tax laws – ‘pass-through’ treatment for interest income of trust

• OECD commentary on Article -10
  - Small investors – no control over the immovable property – income should be treated as portfolio dividend
  - Larger investors (typically holding at least 10% of capital)– particular interest in immovable property – source taxation
Income from Immovable Property – Article 6
Issues on Income from Immovable Property

• SRM firm’s case (208 ITR 400)
  - Income from Rubber estate in Malaysia
  - IP as per Indo-Malaysia DTAA taxable on situs basis
  - Held – income taxable in Malaysia and not taxable in India
  - Albeit on different reasoning
• CIT Vs. R. M. Muthaiah (1993) (202 ITR 508/67)
**Income from Immovable Property – Article 6 - Indian Approach (Select India’s DTAA)***

**Australia**
- Expression “real property” used though the heading is “Immovable Property”
- It does not exclude “ships, boats and aircrafts”
- Additional para 3 – lease of land or any other interest in or over land

**Germany**
- Does not include “income from agriculture or forestry”
- “Immovable Property” not defined in Article 6
  - Defined in Article 3 (definitions) – same definition
Income from Immovable Properties – Article 6 - Indian Approach (Select India’s DTAA)

USA

- Expression “real property” used
- Inclusive and Exclusive part of the definition not included

Singapore

- Same as per UN Model
Issues on Income from Immovable Properties

- Mr. Bhatt, a NRI, is settled in Dubai. He has purchased a residential flat in Mumbai. The flat is rented out. Mr. Bhatt has borrowed in Dubai in $ for acquisition of the flat. Interest payable on the borrowings amounted to $ 5000/- for financial year 06-07.

- Would the interest be deductible in computing HP income of Mr. Bhatt.

- Would it make any difference if Mr. Bhatt had borrowed in India initially to purchase the flat and later had repaid loan taken in India by borrowing in Dubai.
Issues on Income from Immovable Properties

• Mr. Raja is NRI and settled in UK for last several years. He has ancestral house property in India and some financial assets – Mr. Raja wants to sell off his assets in India and in turn wants to buy a residential house in UK.

• Mr Raja needs your advice on his tax liabilities.
**Issues on Income from Immovable Properties**

- Mr. Sheth returned back to India in 2002. While returning back he retained house in London acquired while in UK. This house is kept locked and used only when Mr. Sheth visits London. In India, he always stays in a house owned by him.

  - For A.Y. 2006-07, the AO proposes to assess one of the house property of Mr Sheth as DLO. Kindly advise Mr. Sheth.

- Would it make any difference if Mr. Sheth had been to Hong Kong and kept a property there in place of UK.
Other Income

Article 21 (UN Model)
Other Income – Article 21

Article 21(1)

• Grants exclusive rights of taxation to residence country

“Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing articles of this Convention shall be taxable only in that State.”
Other Income – Article 21

Article 21(2)

Exception – Income attributable / effectively connected to PE

“The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.”
Other Income – Article 21

Article 21(3)

Grants rights to source country also to tax

“Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention and arising in the other Contracting State may also be taxed in that other State.”
Indo-Singapore DTAA – Article 23
Income not expressly mentioned

Article 23

“Items of income which are not expressly mentioned in the foregoing Articles of this Agreement may be taxed in accordance with the taxation laws of the respective Contracting States”
## Other Income – Article 21

<table>
<thead>
<tr>
<th>UN Model</th>
<th>OECD Model</th>
<th>US Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Shall be taxed in residence state</td>
<td>• Shall be taxed only in residence state</td>
<td>• Shall only be taxed in residence state</td>
</tr>
<tr>
<td>• May also be taxed in source state</td>
<td>• Income from property taxable under Article 6</td>
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<tr>
<td>• Income from property taxable under Article 6</td>
<td>• Income from source effectively connected with PE/Fixed base, taxable under Article 7 or 14</td>
<td>• Income beneficially owned and attributable to PE/Fixed base, taxable under Article 7 or 14</td>
</tr>
<tr>
<td>• Income from source effectively connected with PE / Fixed base, taxable under Article 7 or 14</td>
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</tbody>
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Indian Treaties are by and large based on UN Model

OECD:- Residence Based Taxation
UN :- Both States have right to tax
Other Income – Article 21
Income or source not covered by other paragraphs – Residuary Article
Taxable in the country of residence

- “wherever arising”
  ◦ Income arising in Source country
  ◦ Income arising in Third country
    › Tie breaker test applies when resident of both countries

No mechanism for computing taxable income

- Domestic regulations should apply – taxable on net basis
• In order to apply Article 21, there should be an element of “income”
  - Distribution from partnership firms, trusts, may not constitute income and therefore may not be covered
**Other Income – Article 21**

- Other income is not synonymous/same as “Income from other sources”
  - For e.g.: Dividend, interest etc.

- Article covers (List not exhaustive):
  - Non-compete receipts
  - Income from gambling / lottery
  - Punitive damages
  - Non-business income from certain non –traditional financial instruments like derivatives

- Income distributed by Non-corporate mutual fund is covered under ‘Other income’
  - DLJMB Mauritius Investment Co. (228 ITR 268) (AAR)
Other Income – Article 21

• Covers items of income not dealt with in other Articles because of their source or some other reason, eg. Article 11 (Interest) covers interest arising in a Contracting State; hence interest arising in third State that is not effectively connected with a PE is subject to Article 21 (Source: US Technical Explanation)
Other Income – Article 21

Paragraph 21(2)

• Exceptions to Paragraph 21(1)
  - “Other Income” – effectively connected with PE/FB
  - Income from immoveable property
Other Income – Article 21
Paragraph 21(3)

- Exclusive to UN Model
  - Permits Source Country also to tax income arising therein
  - May result in double taxation
  - No rules for determining “Other Income”
Other Income – Article 21

Some Interesting case-laws

• Tekniskil (Sendirian) Berhard (222 ITR 551) (Malaysia)
  - FTS in absence of specific Article thereon, will be governed by provisions of Article 7 – In absence of PE the same is not taxable – Revenue cannot fall back to Article on ‘Other Income’

• Lanka Hydraulic Institute Limited (337 ITR 47) (Sri-Lanka)
  - If Treaty does not contain specific Article on FTS. FTS should be governed by Article 22 (This was a observation in nature of ‘Obiter Dicta’ – The matter was decided by considering nature of activity of applicant as Royalty)

• Andaman Sea Foods Private Limited (TS-440-ITAT-2012(Kol)) (Singapore)
  - Article 23 does not apply to items of income which can be classified under Article 6-22 whether or not taxable under this Article.

• Mckinsey & Company (Thailand) Co. Ltd (TS-332-ITAT-2013(Mum))
  - Similar observations as Tekniskil
**Other Income – Article 21**

*.....not dealt with / not mentioned ......*

- **Mediterranean Shipping Co. SA (27 taxmann.com 77) (2012) (Mum ITAT)**
  
  - Mere exclusion of international shipping profit from Article 7 cannot be regarded as an item of income dealt with by the said Article as envisaged by Article 22 of India-Swiss treaty
  
  - An item of income can be regarded as ‘dealt with’ by an article of DTAA only when such article provides for and positively vest the powers to tax such income in one or both states

  
  - Allocation of taxing right to the source state can well be done by a process of exclusion
  
  - The expression ‘dealt with’ does not necessarily mean that there should be a detailed or elaborate treatment of the subject
  
  - Held, income from shipping operations not covered by India-Swiss treaty and liable to tax in India as per domestic laws
Other Income – Article 21
Optional Para as per Model Commentaries

Where, by reason of special relationship between the person referred to in paragraph 1 and some other person, or between both of them and some third person, the amount of income referred to in paragraph 1 exceeds the amount (if any) which would have been agreed upon between them in the absence of such relationship, the provision of this Article shall apply only to the last mentioned amount. In that case, the excess part of the income shall remain taxable according to the laws of each Contracting State, due regard being had to the other applicable provisions of this convention.
Other Income – Article 21

Indian Approach

Singapore

- Article - “Income not expressly mentioned”
- Tax liability as per taxation law of respective countries

Australia

- Taxable in both the states
- Income effectively connected with PE taxable under Article 7
**Other Income – Article 21**

**Indian Approach**

**USA**

- Taxable in both states
- Income beneficially owned and attributable to PE taxable as business income

**Germany**

- Income from gambling in source state is taxable in source state

**Some treaties don’t have other income clause**

- Netherlands
- Greece
- Libya
Thank you
Annexure A

“immovable property” means—

(i) any land or any building or part of a building, and includes, where any land or any building or part of a building is to be transferred together with any machinery, plant, furniture, fittings or other things, such machinery, plant, furniture, fittings or other things also.

Explanation.—For the purposes of this sub-clause, “land, building, part of a building, machinery, plant, furniture, fittings and other things” include any rights therein ;

(ii) any rights in or with respect to any land or any building or a part of a building (whether or not including any machinery, plant, furniture, fittings or other things therein) which has been constructed or which is to be constructed, accruing or arising from any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement of whatever nature), not being a transaction by way of sale, exchange or lease of such land, building or part of a building