



**The Bangalore Branch of SIRC of Institute of
Chartered Accountants of India**

**Intensive Workshop on International
Taxation**

Article – 24 Non – Discrimination Clause

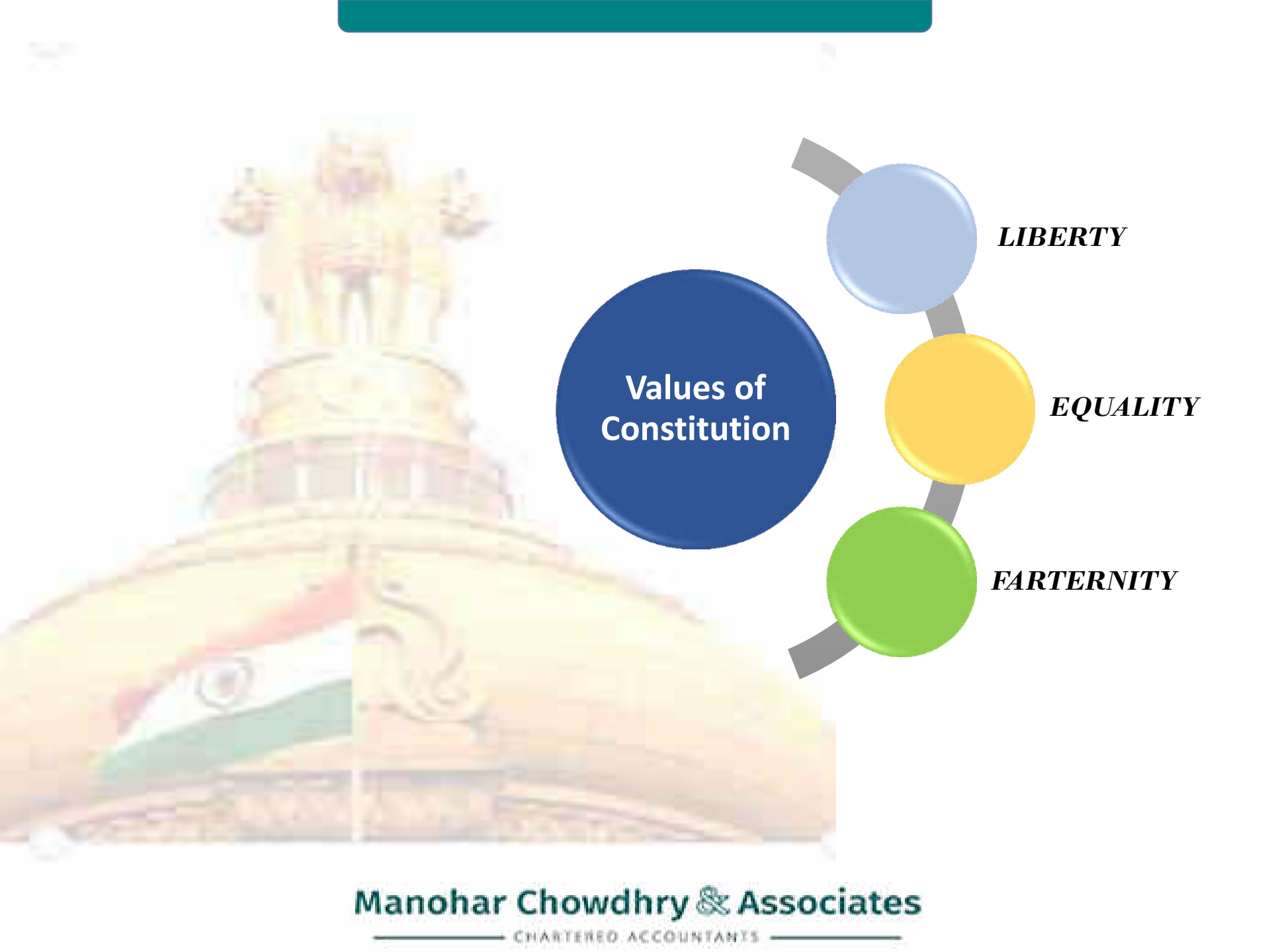
June 18th, 2016

CA Omar Abdullah S M

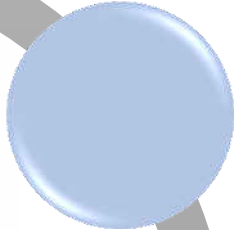
Manohar Chowdhry & Associates

CHARTERED ACCOUNTANTS

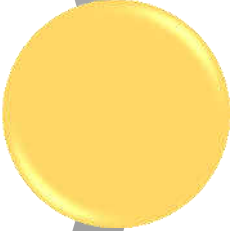
“The claim to equality before Law in a substantial sense the most fundamental of the rights of man”.
- Prof. Hersh Lauterpacht



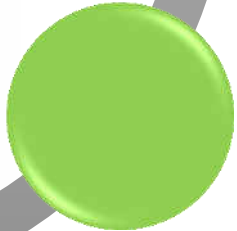
**Values of
Constitution**



LIBERTY



EQUALITY



FRATERNITY

Non Discrimination

Article 14 – Constitution of India

“The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India. Prohibition of discrimination on grounds of religion, race, caste, sex or place of birth .”

Non Discrimination

Article 14 – Constitution of India

- "[t]he equal protection of laws: guaranteed by Article 14 of the Constitution of India does not mean that all laws will have to be general in character and universal in application and that the State is no longer to have the power of distinguishing and classifying persons or things for the purposes of classification".

- In Kedar Nath Bajoria Vs State of West Bengal
 - (AIR 1953 SC 404,406)

Two Dimensions of Article - 14

**discrimination, based on an
impermissible or invalid
classification**

**excessive delegation of powers;
conferment of uncanalised and
unguided powers on the
executive, whether in the form of
delegated legislation or by way of
conferment of authority to pass
administrative orders-if such
conferment is without any
guidance, control or checks**

PEPSI FOODS PVT. LTD. vs. ACIT & ANR (2015) 93 CCH 0077 Delhi HC

Article 14 of the Constitution

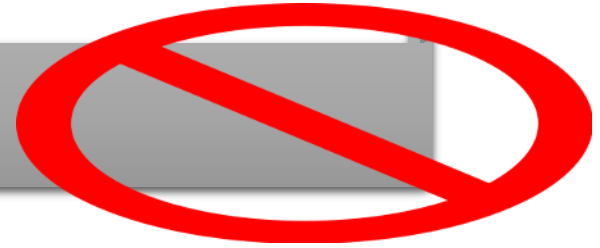
Third proviso to Sec 254(2A) provides "even if the delay in disposing of the appeal is not attributable to the Assessee"

Clubs the delaying assessee and non-delaying assessee in one class

hostile discrimination against those assessee who are law abiding and did not cause any delay in the hearing of their respective appeals-

Held - violation of Article 14 of the Constitution of India

Discrimination



Discrimination is treatment or consideration of, or making a distinction in favor of or against, a person or thing based on the group, class, or category to which that person or thing is perceived to belong to rather than on individual merit.

Types of International Taxation

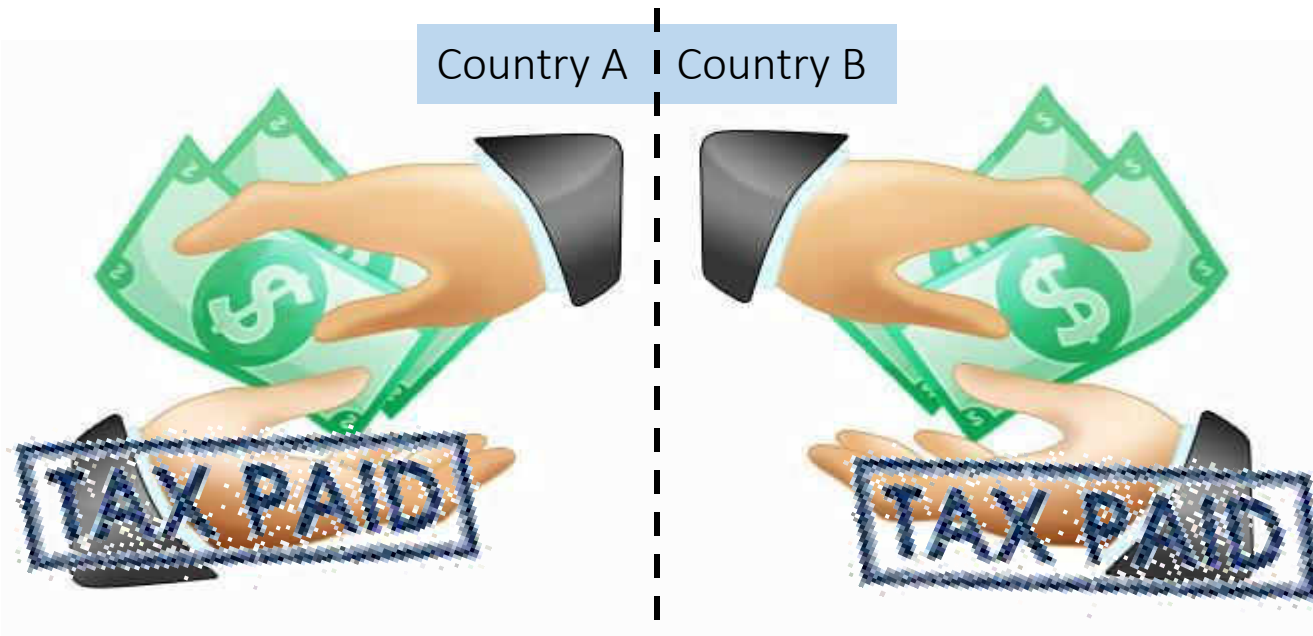
Resident based taxation: The resident of the country are taxed based on their worldwide [local and foreign Income].

Source based taxation: Only local income [income earned by the source inside the country] are taxed. Usually the non residential are taxed only on the income locally earned.

In India, the Central Government has been provided with right to enter into agreement with Government of any other country outside India for granting tax relief and avoiding double taxation issue [section 90(1)].

Double Taxation of Income

When a taxpayer is resident in one country but has source of income situated in another country.

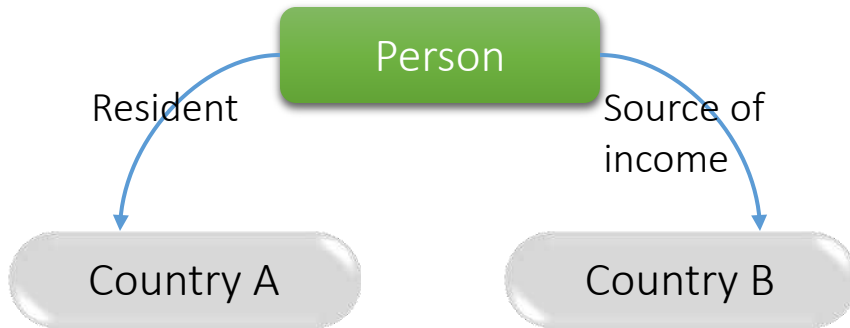


The tax is charged based on the source of income.

The tax is charged based on the residential status of the assessee.

Types of Double taxation

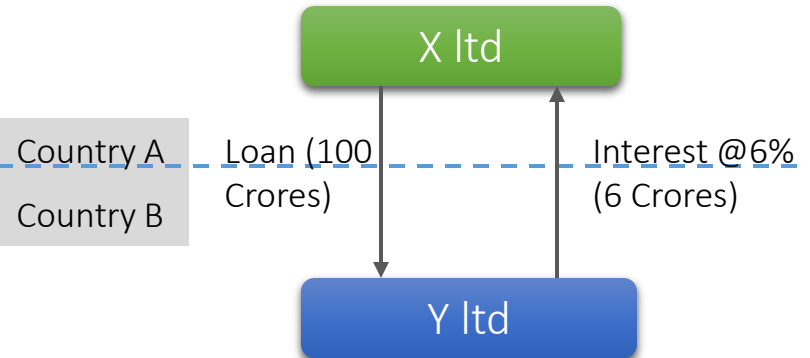
Juridical: Double taxation is juridical when the same person is taxed twice on the same income by more than one country.



Pays tax in both countries.

Economic: Double taxation is economic if more than one person is taxed on the same item.

X Ltd and Y Ltd are associated enterprises.



Country B consider that arm's length price of interest is 5%. Even Y Ltd. Will be liable to pay taxes on 1 crore

Tax treaty

A tax treaty is a bilateral agreement made by two countries to resolve the issues involving double taxation of passive and active income.

Active income is income for which services have been performed. This includes wages, tips, salaries, commissions and income from businesses in which there is material participation.

Passive income is earnings which an individual derives from a rental property, limited partnership or other enterprise in which he or she is not materially involved.

Arrangement of the OECD Model Convention

Section	particulars	Articles covered
A	Articles to clarify application of the treaty	<i>Article 1 - Personal Scope, Article 2 - Taxes Covered, Article 3 - General Definitions, Article 4 – Residence, Article 5 - Permanent Establishment, Article 29 - Entry into Force, Article 30 – Termination</i>
B	Articles to avoid double international juridical taxation	<i>Article 6 - Income from Immovable Property, Article 7 - Business Profits, Article 8 - Shipping, Inland Waterways Transport And Air Article 21 - Other Income, Article 23 - Methods for Elimination of Double Taxation</i>
C	Articles to prevent tax avoidance/evasion	<i>Article 9 - Associated Enterprises, Article 26 - Exchange of Information</i>
D	Miscellaneous Provisions	<i>Article 24 - Non-discrimination, Article 25 - Mutual Agreement Procedure</i>

Non-Discriminating clause in tax treaties

It is inserted in the tax treaties not to prevent double taxation but to address regimes which are aimed at tax discrimination.

The non discrimination clause ensure that residents of one of the treaty partner jurisdiction are not discriminated against in the other treaty partner jurisdiction.

Restrict the application of domestic tax law in the treaty partner jurisdiction to the extent it is discriminatory.

Extends the scope of beneficial domestic tax law provisions, vis-à-vis the residents of treaty partner country, in the host country.

This also extends to a domestic enterprise which is owned or controlled by the residents of the treaty partner country.

Historical background

to strengthen diplomatic protection to nationals wherever resident

Principle of reciprocity

In international relations and treaties, the principle of reciprocity states that favors, benefits, or penalties that are granted by one state to the citizens or legal entities of another, should be returned in kind.

Differentiation Vs Discrimination

Non- Discrimination is distinct from legitimate distinction

Discrimination is defined as equal treatment of different cases or unequal treatment of comparable cases.

Differences in liability will not tantamount to discrimination if it is justified.

Discrimination based on factors other than nationality is justified

Article 24 Non-Discriminating clause

ARTICLE 24

Contains non-discrimination clauses for a variety of situations:

Paragraph 1

The taxation of nationals of the other contracting state

Paragraph 2

The taxation of stateless persons resident in the other state

Paragraph 3

The taxation of permanent establishments (pes) carried on by an enterprise of the other state.

Paragraph 4

The deduction of interest, royalties and other disbursements paid to an enterprise of the other state.

Paragraph 5

The taxation on foreign-owned enterprises.

PARAGRAPH 6

The clause applies to all taxes and are not limited to those specifically enumerated in the treaty.

Non-Discriminating Rule

Article 24 establishes principle of non-discrimination in tax matters in double taxation law.

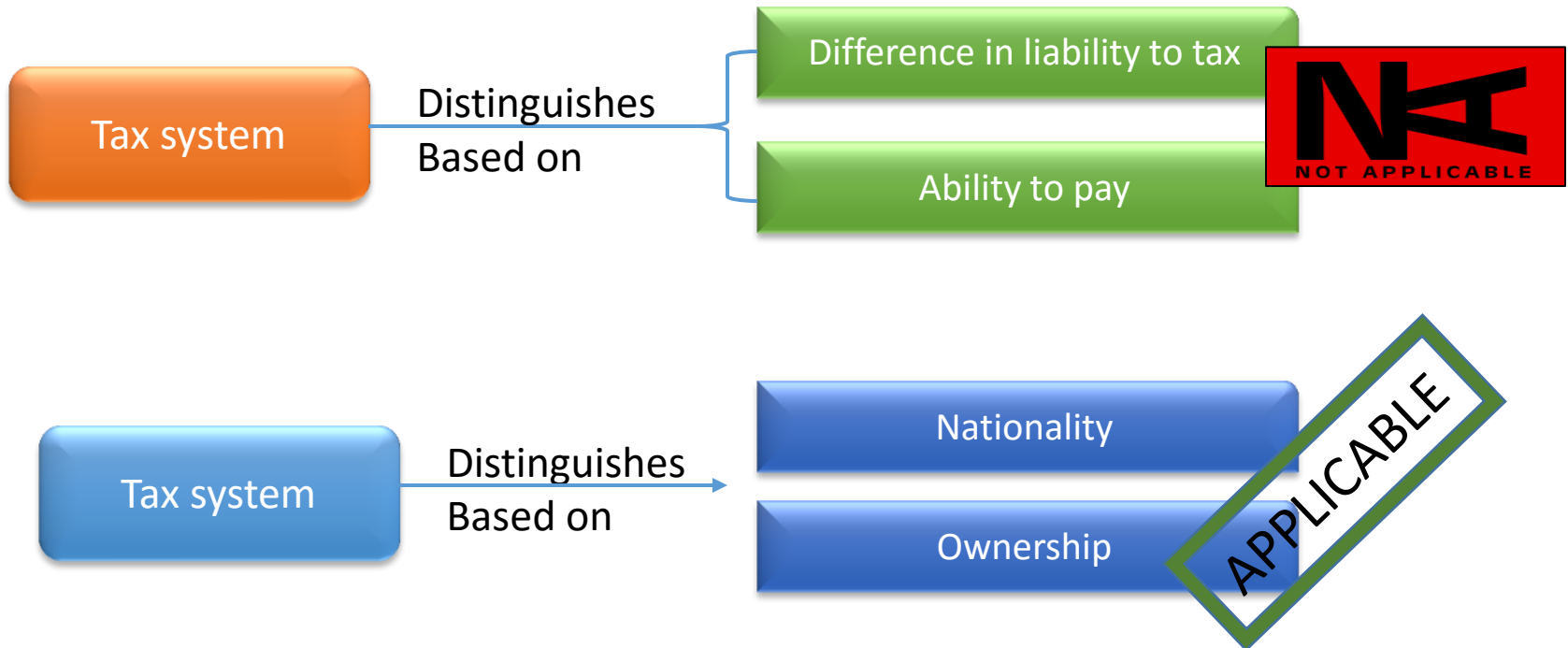
The Article 24 recognizes the following three kinds of non-discrimination:

Nationality non-discrimination

Permanent establishment non-discrimination

Ownership discrimination

Applicability of non-discriminating clause



The non-discrimination provision of article seek to prevent unjustified discrimination with the need to take account of legitimate distinctions.



Article 24(1):

Nationals of a Contracting State shall not be subjected in the other Contracting State to **any taxation** or **any requirement connected therewith**, which is **other** or **more burdensome** than the taxation and connected requirements to which **nationals** of that other State **in the same circumstances, in particular with respect to residence**, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

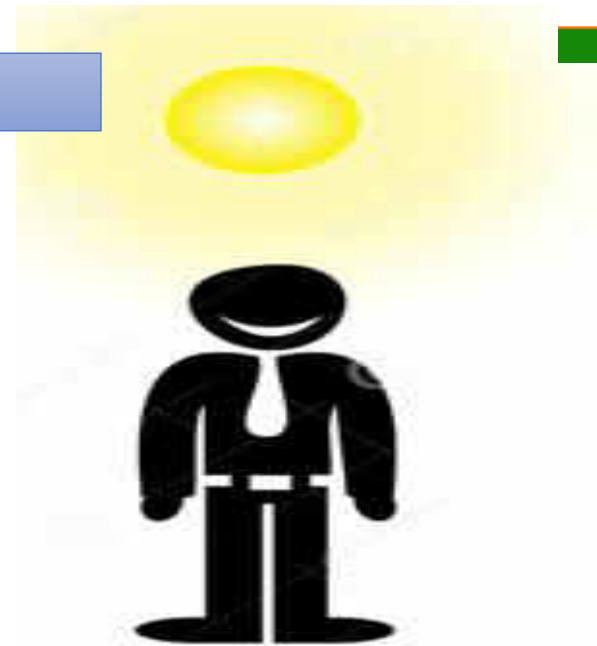
Discriminatory treatment to Foreign National

Favourable treatment to Nationals



Undesirable distinction based on

Nationality



Introduction of Non-Discrimination Clause in the DTAA

Expressions and meaning

“In the same circumstances”

This expression refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and in fact.

“In particular with respect to residence”

This expression makes it clear that the residence of the taxpayer is one of the actors that are relevant in determining whether taxpayers are placed in similar circumstances.

Expressions and meaning

Taxation	Basis of charge, computation & rate
Other requirement connected therewith	Returns, payment of tax (including advance tax, TDS), prescribed forms, prescribed periods, etc.
Other	Taxation as well as other requirements connected therewith cannot deviate from those applicable to nationals even though they may not be burdensome for non-nationals.
More burdensome	Must not be more onerous

Even though Art. 24(1) prohibits taxation or connected requirements which are different than those applicable to nationals, preferential treatment can be granted to non-nationals without violating Art. 24(1) – By virtue of Para 3 and 14 to Art 24 OECD MC Commentary [M. No. 32 Klaus Vogel]

Residential criteria [Country A]– incorporated or place of effective management .

Country A



A Ltd.



Top level managers

Declares dividend

Country B



B Ltd.

Country A (Domestic Law)

Company Incorporated in Country A $\xrightarrow{\text{Dividend}}$ Company Incorporated in Country A

Tax exempt for recipient

Article 24(1) application ✓

Company Incorporated in country A $\xrightarrow{\text{Dividend}}$ Company Y

Therefore, Tax exempt for Co. Y

Residential criteria [Country A]– incorporation

Country A



A Ltd.



Declares dividend

Country B



B Ltd.

Top level managers

Country A (Domestic Law)

Company Incorporated in Country A $\xrightarrow{\text{Dividend}}$ Company Incorporated in Country A

Tax exempt for recipient

Article 24(1) application **X**

Company Incorporated in country A $\xrightarrow{\text{Dividend}}$ Company Y

Cannot be Tax exempt for Co. X

Conditions

	Country A	Country B	Country C
Residential criteria	Incorporation	Place of effective management	-
Company X	-	Incorporated	Place of effective management

- Country A and Country B have tax treaty
- Country A and Country C doesn't have any tax treaty between them

Country A



Earns income
from land

Country B




X Ltd.

Top
Management

Country C



- ✓ Domestic rule of Country A states if a resident of any other country which doesn't have tax treaty would be charged annual tax of 3% of intangible asset.
- ✓ Can the article of non-discriminating clause be invoked of Country A and B tax treaty ??



Country A and country B enter into tax treaty

X Ltd incorporated in Country A and resident of both countries.

As per article 4

X Ltd is resident of country in which it is incorporated i.e. Country A

Domestic law of Country B:

Every company employing residents shall pay payroll tax, but the company incorporated in Country B shall benefit from lower rate of payroll tax

The indirect discrimination and unfair laws would activate the article 24 as the companies incorporated in Country A (X Ltd) should be treated same as a resident.

APPLICABLE

State - A

State - B

Domestic Law - Residential Status

Domestic Law - Residential Status

Incorporation

POEM

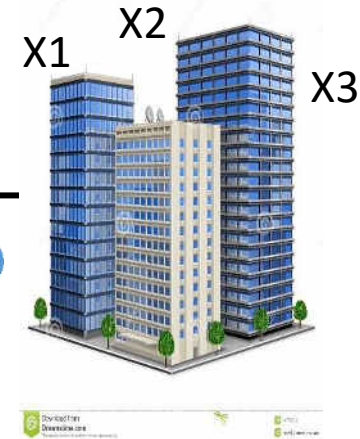
Incorporation

State A

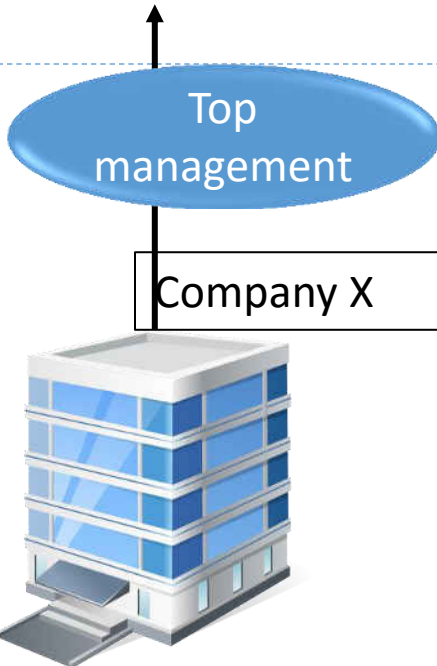
State B

State A – State B Treaty
Residential Status - Incorporation

State A



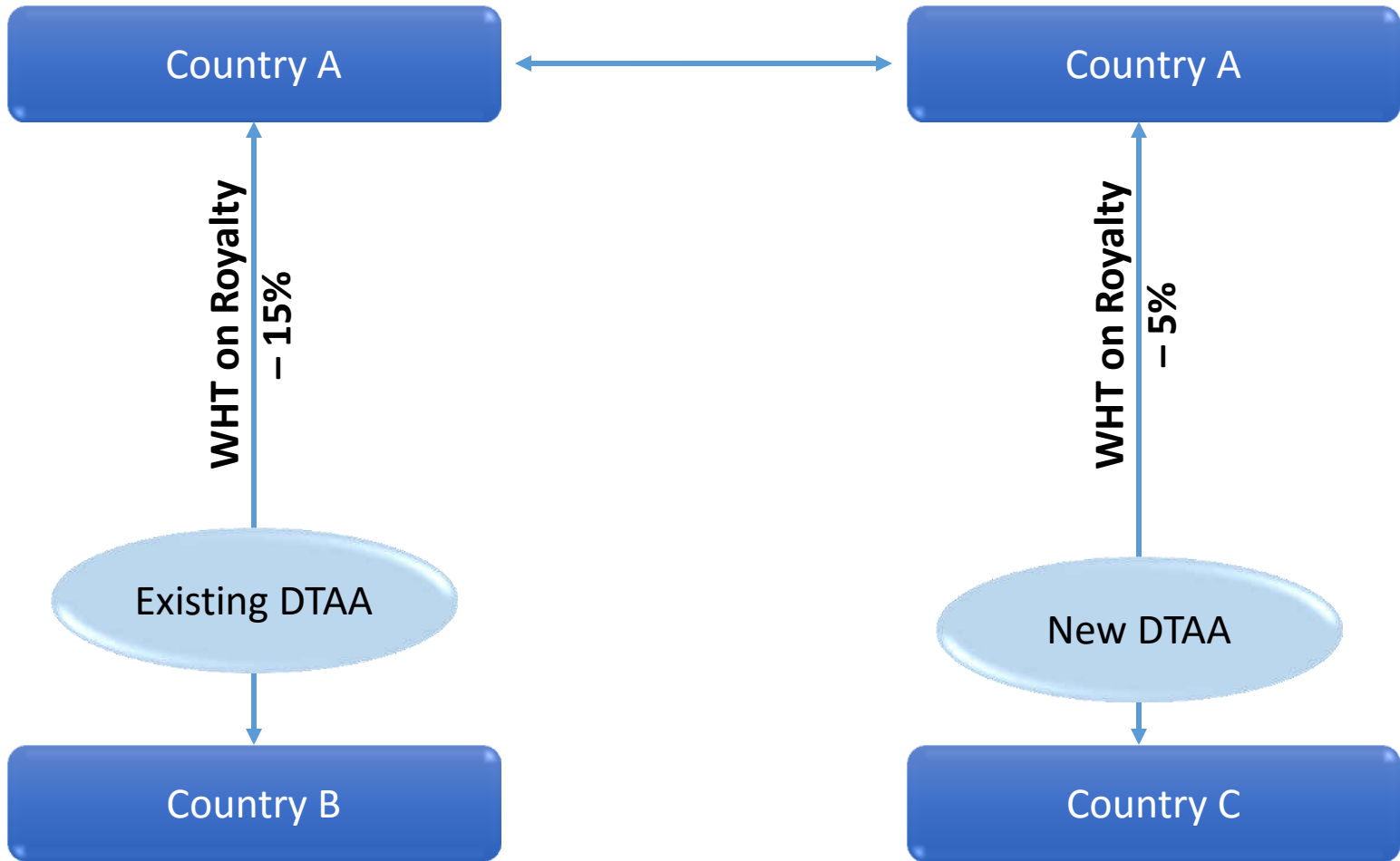
State B



Domestic law of State A: It require the income of the resident companies to be consolidated for tax purpose.

As the POEM is in state A – company A is resident of State A.

As per Treaty – Company is Non-Resident
The accounts need not be consolidated as the Company is incorporated in State B [satisfy the condition of Article 4]





Article 24(2):

Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.



Article 24(3):

The **taxation** on a **permanent establishment** which an enterprise of a Contracting State has in the other Contracting State **shall not be less favourably levied** in that other State than the taxation levied on enterprises of that other State **carrying on the same activities**. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

Scope of article 24(3)

The paragraph 3 of article 24 only applies to the taxation of the permanent establishment's own activities.

It is thus restricted to comparison of rules of taxation applicable to permanent establishment to that of an independent resident enterprise.

It does not apply to rules that take account of the relationship between an enterprise and other enterprises like allowing consolidation, transfer of losses or tax-free transfers of property between companies under common ownership.

It is restricted to the taxation of the profits from the activities of the permanent establishment itself and does not extend to the taxation of the enterprise as a whole

Article 7 determines the profit of permanent establishments

Profits attributable to permanent establishments

Same as

An independent establishment engaged in same or similar activities under similar conditions would have expected to make.

Article 24(3)

Country A

can

Charge Tax on the permanent establishment

At rate different from the normal rate which is applicable to the resident companies

Country A



Bank incorporated in
Country A



Permanent establishment
of bank of Country B

Country A and B has entered in tax treaty

The banks incorporated in country B can not claim for non-discrimination clause as the condition and regulation under which the local banks of country A operate is different than the condition under which the other PE function.

State A



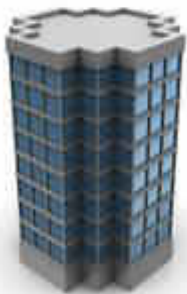
PE of foreign company

- The deduction is allowed till arm's length price.
- The excess payment made is added to taxable income of PE.

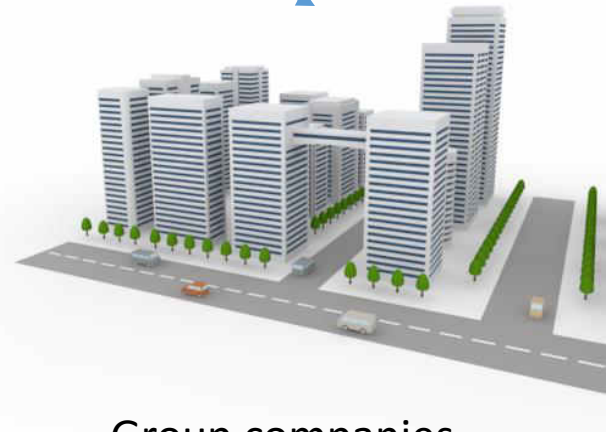
Does this lead to discrimination??

Interest payment above ALP

State B

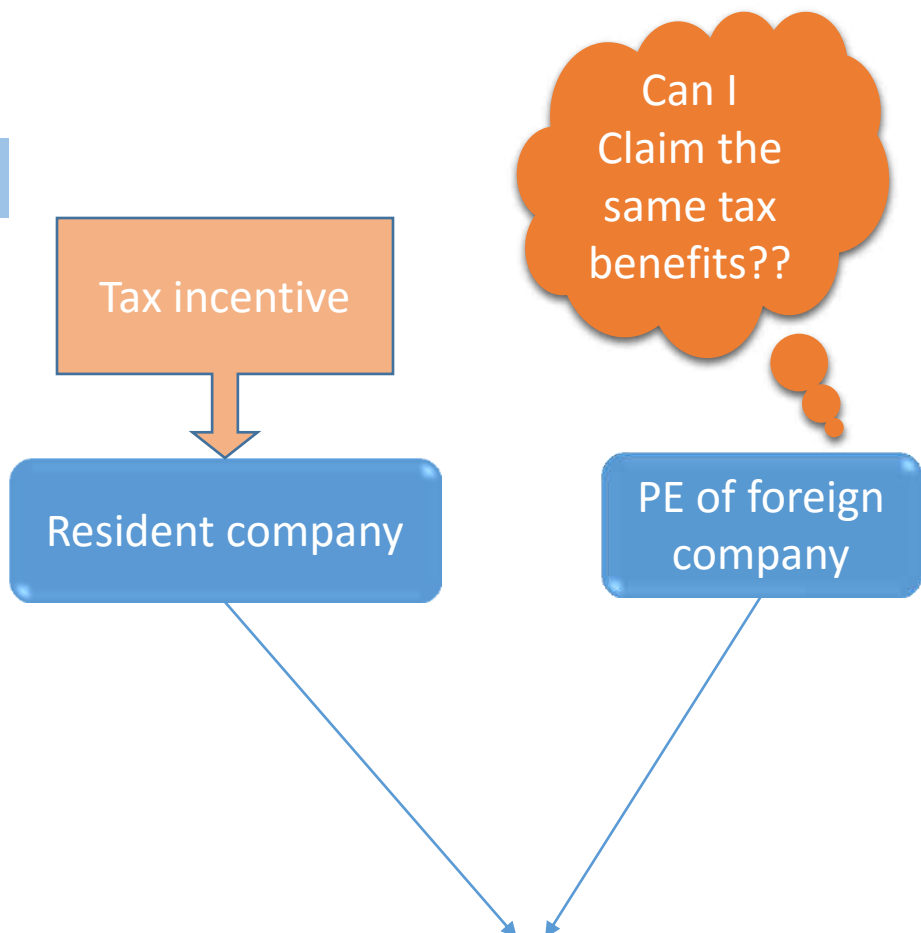


Head Office



Group companies

State A



The PE of foreign can also claim the same benefit as available to independent resident company provided they **fulfil the condition and requirement as residential company.**

Non Resident enterprises are not entitled to tax advantage attaching to specified activities: **On grounds of national interest, defence, protection of national economy, etc.**

Invest in official objectives like:- development of economically backward regions, or the promotion of new activities necessary for the expansion of the economy

Country A

Tax incentives

Non profit institution {X}

Am I eligible for all such tax incentives?

PE of foreign NPO {Y1}

Country B

Non profit Organisation {Y}

The permanent establishment of foreign NGO if not set up exclusively for the benefits of the local resident then **no tax incentive will be available**

CASE 1



Head office

No tax implication

Transfer of assets



Subsidiary

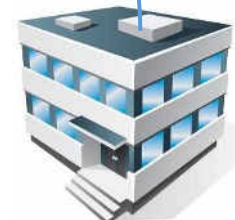
CASE 2



PE of foreign company (branch)

Tax implication

Transfer of assets



Subsidiary of foreign co.

Is this discrimination?

State A

PE of foreign company

Liable for
additional tax

Branch tax

The additional tax charged on profits of permanent establishment will be considered as it is levied on profits of the activities of the permanent establishment itself and not as a tax on the enterprise in its capacity.

This is contrary to Article 24(3)

The concept of **branch tax** can be explained by the fact that if a subsidiary of the foreign enterprise earned the same profits as the permanent establishment and subsequently distributed these profits as a dividend, it would require to pay dividend distribution tax.

CASE 1

Resident company A

Professional fees

Resident company B

Company A deducts tax at source @ 10%

CASE 2

Resident company A

Professional fees

PE of foreign company

Company A withholds tax @ 40%

Does this constitute discrimination?

Rolls Royce Industrial Power Ltd. V Asstt.CIT Delhi ITAT
Indo-UK DTAA
Article 26(2)

Assessee is a non-resident company

Undertaking Works Contract

However for Domestic company @ 2% under section 194C and also net profits will be taxed without the application of section 44D

Assessee subjected to tax on gross basis @ 30% by artificially invoking section 44D read with section 115A the Act

held Assessee entitled to PE non-discrimination

State A

Parent Company

State B

Permanent establishment

State C

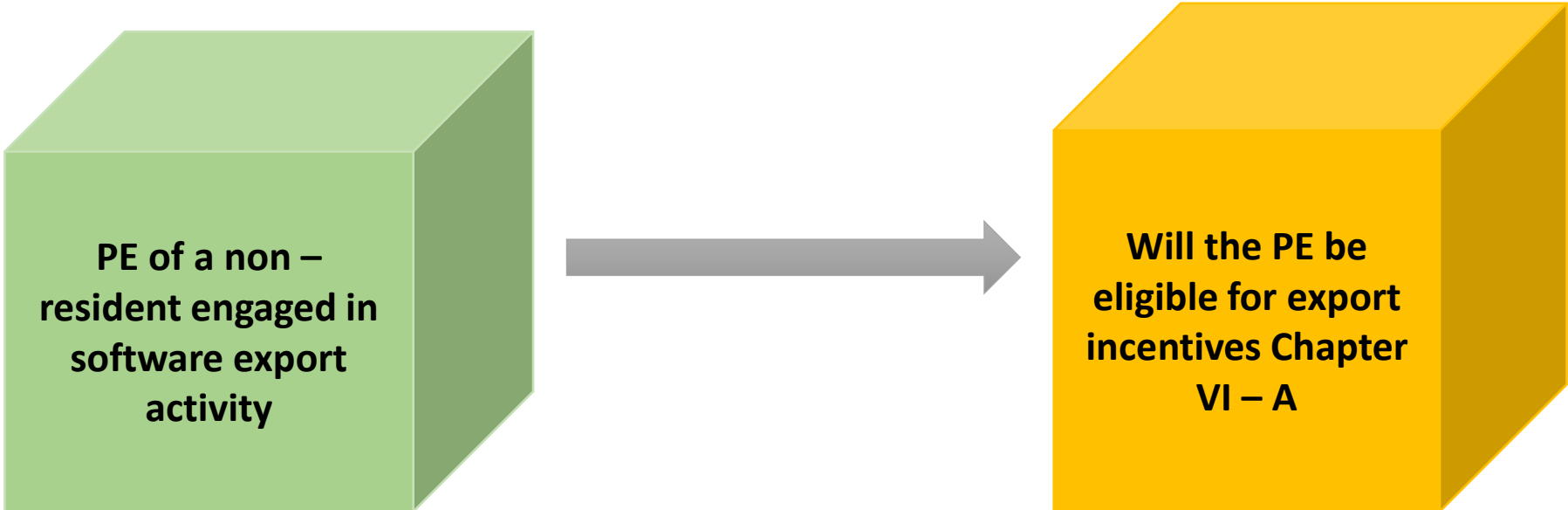
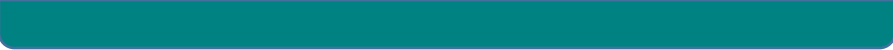
Source of Income

Three scenario

Domestic tax law of State B provides for credit to be granted residents as well as PE of a non-resident: No need for application of Non Discrimination provision

Domestic tax law of State B provides for credit to be granted residents but not to PE of a non-resident: Application of Non Discrimination provision and therefore credit granted to PE by State B.

Credit is allowed to residents only under DTAA entered by State B: Can benefit of Article 23 of B-C DTAA be applied to PE by virtue of Non Discrimination provision under A-B DTAA?



**PE of a non –
resident engaged in
software export
activity**

**Will the PE be
eligible for export
incentives Chapter
VI – A**

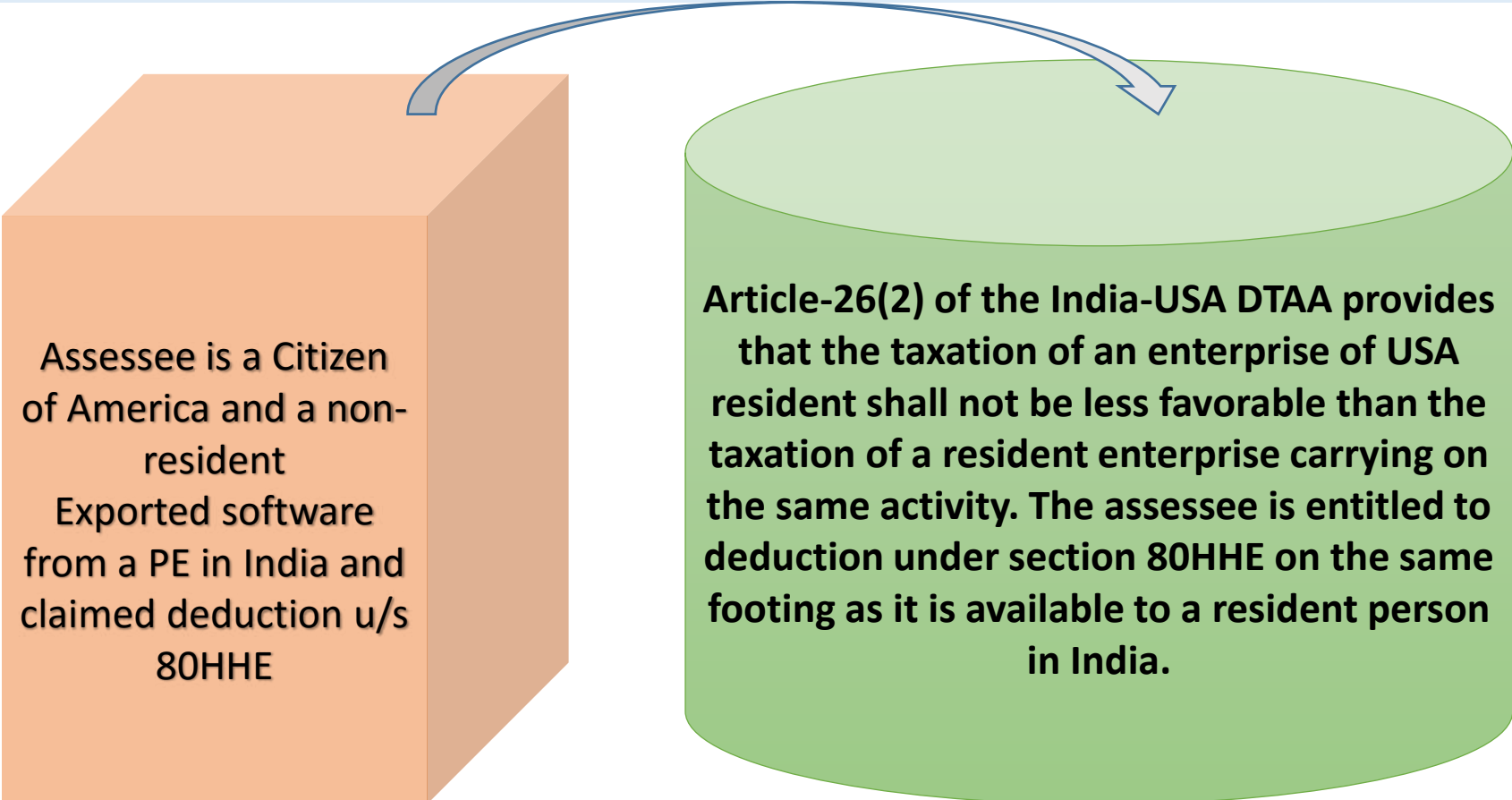
AUTOMATED SECURITIES CLEARANCE INC. vs. ITO ITAT, PUNE 'B' BENCH
India-USA DTAA

Assessee is a
Citizen of
America and a
non-resident
Exported
software from a
PE in India and
claimed
deduction u/s
80HHE – allow
benefit under
Article 26(2)

The courts
examined how
discrimination to
be established?

**Held that, in order to establish
discrimination, the taxpayer has to
demonstrate that it has been
subjected
to different treatment vis-à-vis
other
taxpayers, which is unreasonable,
arbitrary or irrelevant**

Rajeev Sureshbhai Gajwani Vs. ACIT(ITAT Ahd- Special Bench)
2011-TII-38-ITAT-AHM-SB-INTL
India-USA DTAA - Article-26(2)



Assessee is a Citizen
of America and a non-
resident
Exported software
from a PE in India and
claimed deduction u/s
80HHE

Article-26(2) of the India-USA DTAA provides that the taxation of an enterprise of USA resident shall not be less favorable than the taxation of a resident enterprise carrying on the same activity. The assessee is entitled to deduction under section 80HHE on the same footing as it is available to a resident person in India.

Examples of PE tax equality

- Same right for deduction of expenses
- Same facilities for depreciation and reserves
- Same option for carry forward of losses
- Same rules for computation of capital gains

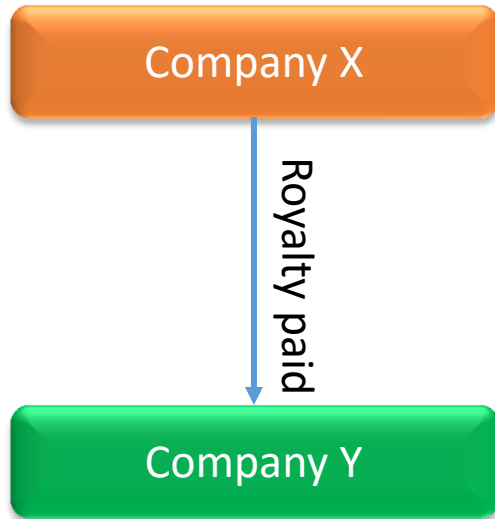


Article 24(4):

Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

Situation 1

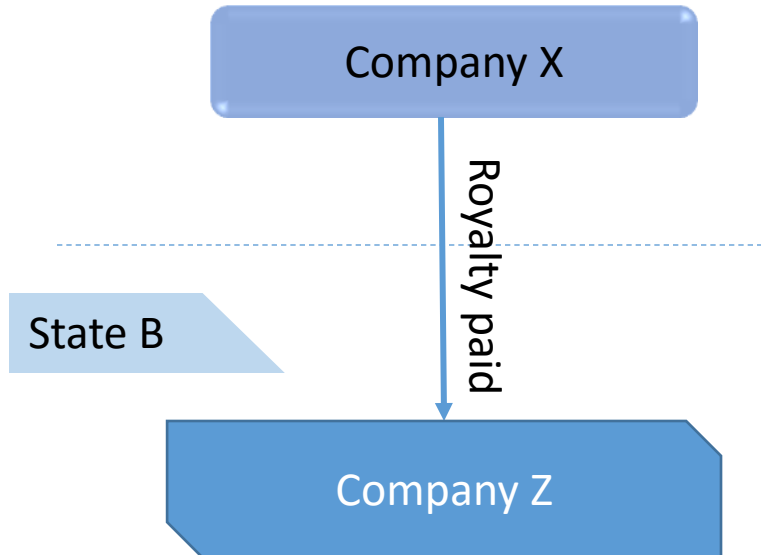
State A



Royalty paid is deductible from taxable profits

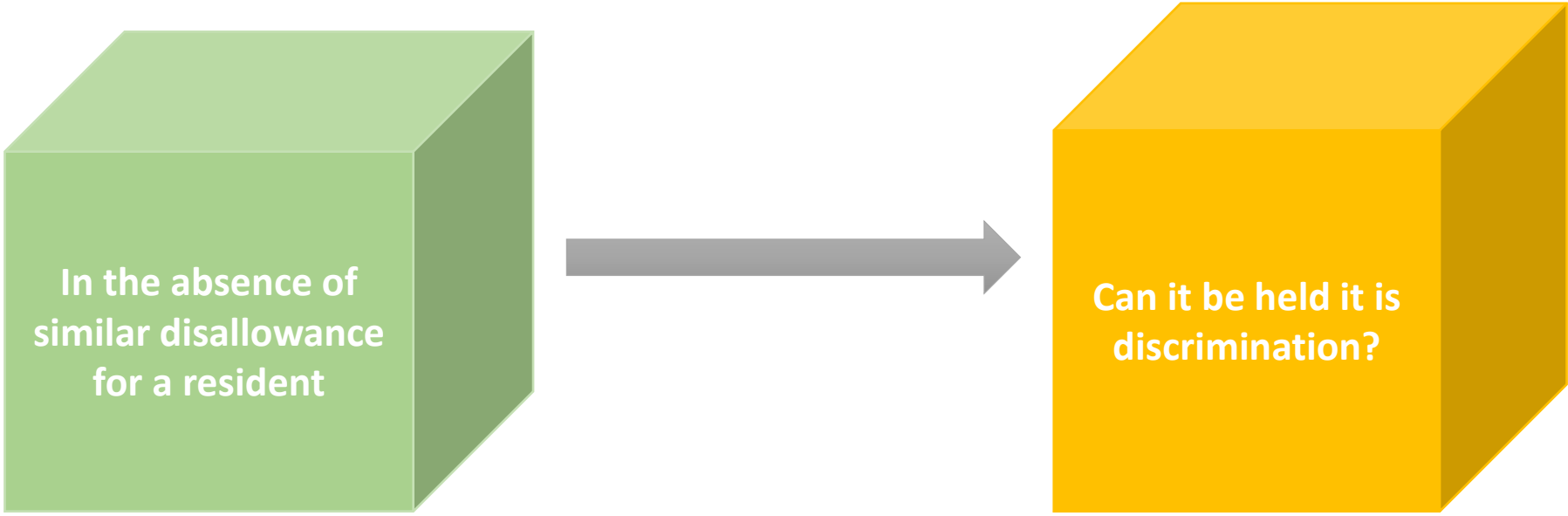
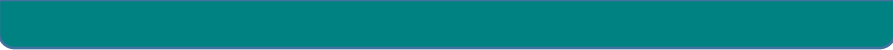
Situation 2

State A



Royalty paid is not deductible from taxable profits

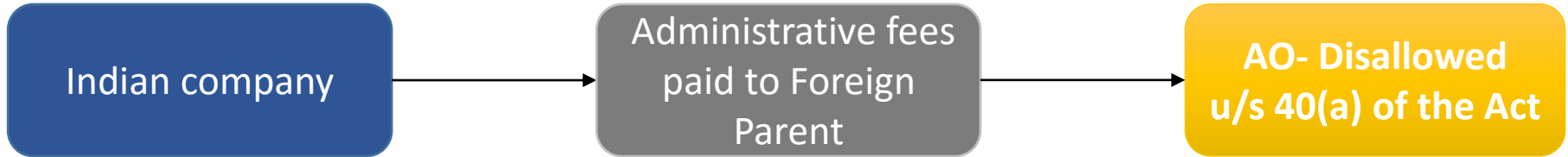
Is this discrimination?



In the absence of
similar disallowance
for a resident

Can it be held it is
discrimination?

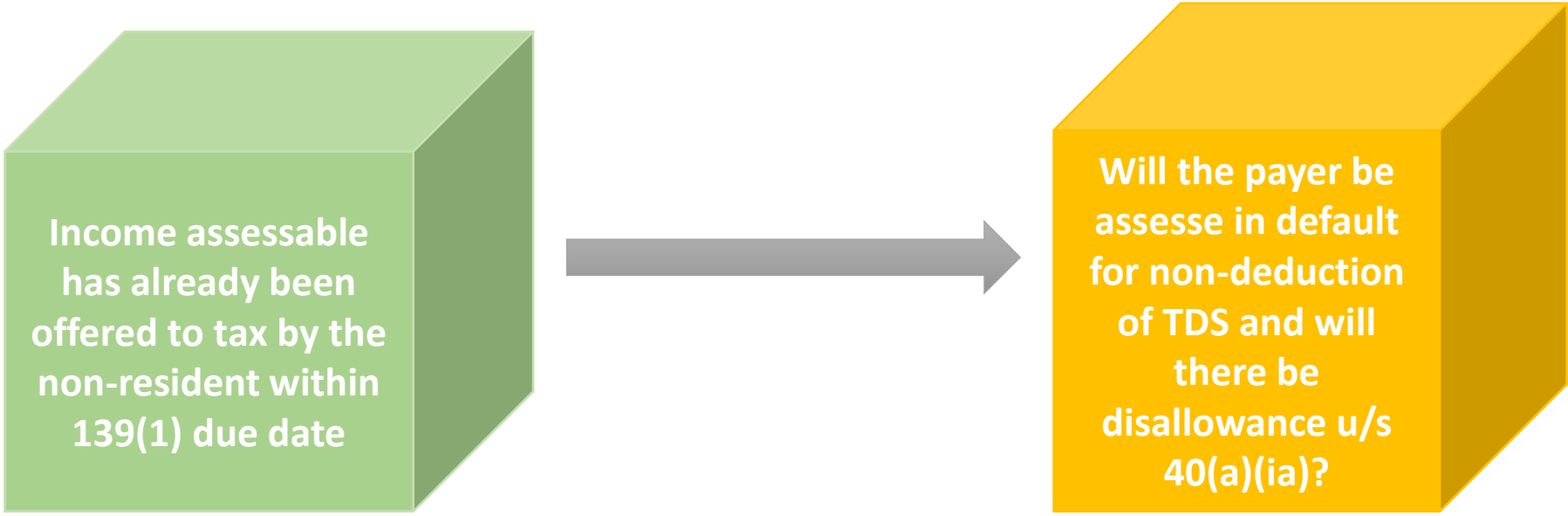
CIT vs Herbalife International India Pvt. Ltd. (ITA 7/2007) Delhi High Court
India –US DTAA
AY -2000-2001



“other disbursements” FTS covered- Article 26(3)

Held that the provisions of section 40(a)(i) was discriminatory in nature, as it provided for disallowance of payments made to non-residents where tax was not deducted at source, whereas, similar payments to residents did not result in any such disallowance

Section 40(a)(ia) w.e.f April 1, 2005
The disallowance of expenses for non-deduction of tax on payments made to a resident was inserted.

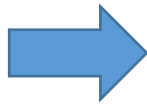


Income assessable
has already been
offered to tax by the
non-resident within
139(1) due date

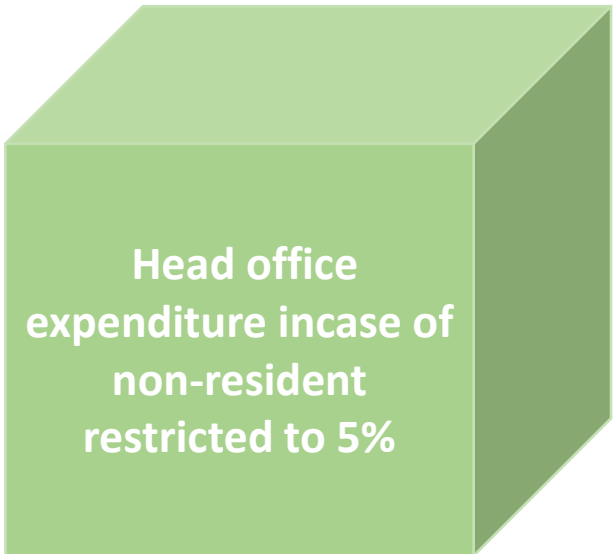
Will the payer be
assesse in default
for non-deduction
of TDS and will
there be
disallowance u/s
40(a)(ia)?

Mitsubishi Corporation India Pvt. Ltd v. DCIT (I.T.A. No.: 5042/Del/11)
India-Japan tax treaty
Article 24(3)

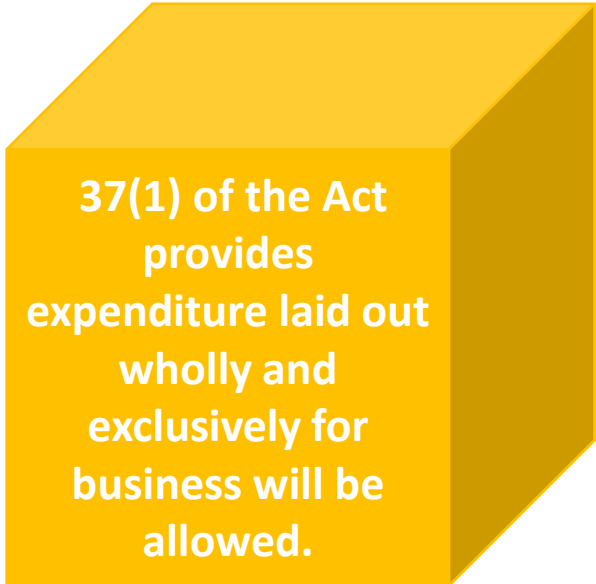
No disallowance under Sec 40(a)(i) -if payments are taken into account by the non-resident recipient in its computation of income, taxes on such income are paid and income tax return has been filed by such recipient,



In view of non-discrimination clause in the India-Japan tax Treaty. Tribunal held different tax treatment to the foreign enterprise per se is enough to invoke the non-discrimination clause in the India-Japan tax treaty.



Head office
expenditure incase of
non-resident
restricted to 5%



37(1) of the Act
provides
expenditure laid out
wholly and
exclusively for
business will be
allowed.

Metchem Canada -2006 ITAT MUM-INTL India-Canada tax treaty

Section 44C deals with deduction of head office expenditure in the case of non-residents .

There is a ceiling limit in respect of deduction of specified expenses -in sections 28 to 43A

will apply in the case of non-resident

The head office expenses, to the extent the same can be fairly allocated to the permanent establishment are admissible as deduction under section 37(1)

The scope of deduction under section 37(1) will not stand curtailed by the restriction placed under section 44C of the Act.



Article 24(5):

Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any **taxation** or **any requirement connected therewith** which is **other** or **more burdensome** than the taxation and connected requirements to which **other similar enterprises** of the firstmentioned State are or may be subjected.

Situation - 1



Company – X
Ownership: Residents

Situation - 2



Company – X
Ownership: Non - Residents

**More burdensome taxation
due to ownership by non -
residents**

Is it discrimination?

Does the scope extend to owners as well?

Parent company
domiciled in Germany



subsidiary in India

shares of the Parent
listed on stock
exchange in Germany



AO held business loss will
not be allowed to set off
and carry since not listed
on a RSE in India.

Ownership based Non-discrimination

DAIMLERCHRYSLER INDIA (P) LTD. vs. DCIT
ITAT, PUNE 'B' BENCH
DTAA between India & Germany

can the subsidiary be treated
as a company in which public
is substantially interested u/s
2(18) of the Act?

Ownership based Non-discrimination

Position under the Act

Indian subsidiary having an Indian Parent whose Shares are listed on a RSE in India will be treated as a company in which public is substantially interested.

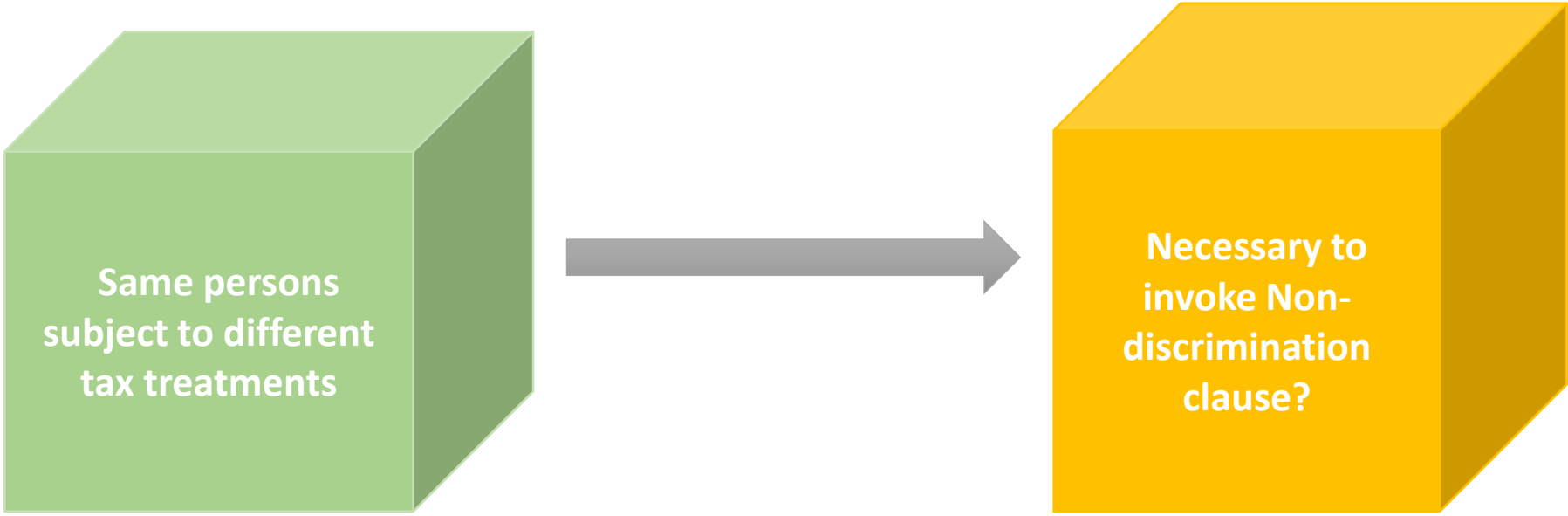
**Disentitlement
to carry
forward and
set-off
accumulated
business losses
u/s 79 ?**

**In the light of Article
24(4) will the same
will be allowed**



Article 24(6):

The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.



Same persons
subject to different
tax treatments

Necessary to
invoke Non-
discrimination
clause?

MASHREQBANK PSC vs. DEPUTY DIRECTOR OF INCOME TAX
ITA No. 2153/Mum/2001
DTAA India-UAE

Assessee is admittedly a banking company incorporated in UAE

Assessee's case was that since 'subject to provisions of' words missing in Article 7 (3) of India UAE tax treaty, the expenses must be allowed without recourse to artificial disallowances such as under section 37(2A), 43 B etc.

ITAT confirmed the action of the AO and CIT(A) on the ground that it will amount to reverse discrimination.

AO rejected the claim and disallowed the expenses under provisions of the IT Act. In appeal, CIT(A) confirmed the disallowance.

Impact of non discrimination provisions in tax treaties- manner

- ▶ In view of the provisions of Section 90(2), treaty provisions override the provisions of Income Tax Act, 1961, except to the extent these are beneficial to the assessee.
- ▶ When domestic law comes in conflict with the provisions of the treaty, it ceases to be enforceable in to that extent. Therefore, if any provision of the domestic law is seen in conflict with NDC in tax treaties, to that extent, domestic law is ineffective.

Impact of non discrimination provisions in tax treaties- areas

- ▶ Taxability of an income, or admissibility of deduction, in the hands of a resident of the other contracting state.
- ▶ Deductibility of an expenditure in respect of payment made to other contracting state.
- ▶ Treatment to an enterprise in which resident of other contracting state holds capital or control



Thank
You

Manohar Chowdhry & Associates

— CHARTERED ACCOUNTANTS —