

Non-discrimination clause in tax treaties – Select issues and recent developments

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Introduction

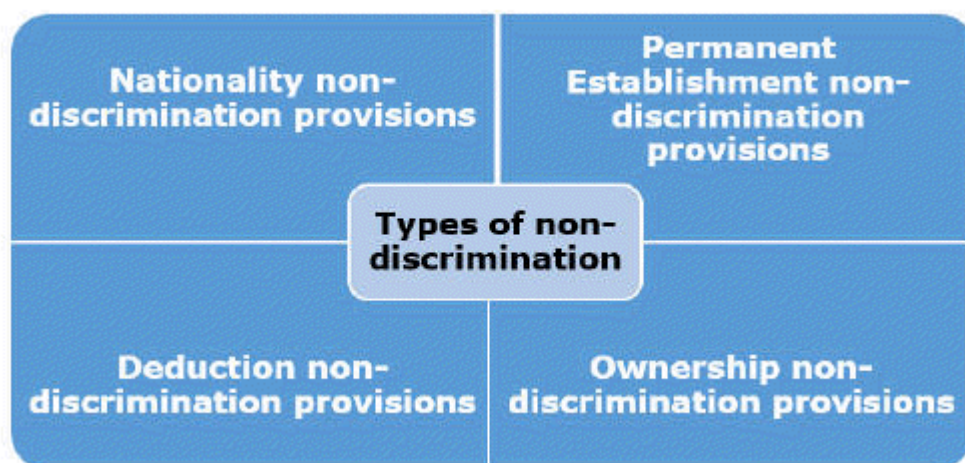
1. Discrimination means unequal treatment in similar and comparable situations. Article 24 of the Model Tax Convention ('MTC') deals with Non-discrimination and provides that the tax provision should not provide for differential treatment to the non-residents in similar situations. Hence, Article 24 of the MTC is a special rule providing for avoidance of discrimination against nationals or residents of another contracting state.

Nupur Jalan

Non-discrimination obligations of Article 24 apply only if nationals or residents of two States are comparably situated. In all, what Article 24 holds is that similar situations should not be treated differently, unless there is a justification to do it. Differential treatment constitutes no discrimination when it is objectively justified *Ruckdeschel v. hauptzollamy hamburg* –St.Annen 1979 2 C.M.L R 445. For example - for Non-discrimination article to apply, they should either carry on same activities or be in the same circumstances. The essence of non-discrimination article is to prevent unfair taxation as distinct from preventing double taxation.

Bird's eye view on the types of non-discrimination discussed in the MTC are –

MTC typically categorizes the non-discrimination into the four types depicted in the diagram below. Detailed discussion on each type of non-discrimination has been done subsequently in the article.



<<The aim of this article is to discuss on the various provisions of non-discrimination clause, recent developments and judicial pronouncements

surrounding it>>

2. Overview of the different paras of Article 24 as enlisted in OECD MTC¹ –

2.1 Article 24(1) of the OECD MTC - deals with Nationality non-discrimination and states that for purposes of taxation, discrimination on the grounds of nationality is forbidden, and subject to reciprocity, the nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances.

2.2 Article 24(2) of the OECD MTC - deals with the non-discrimination for Stateless persons and it prevents Stateless persons resident in a State from being subjected to any taxation or other requirement which is more burdensome than similar requirements with respect to nationals of that State. *Per se*, Article 24(2) extends the same benefits as Article 24(1) to a Stateless person who is a resident of one of the contracting states.

2.3 Article 24(3) of the OECD MTC - deals with Permanent Establishment ('PE') non-discrimination and states that a PE of an enterprise of State 'A' in State 'B' shall not be subjected in State 'B' to taxation less favourable than the taxation levied on an enterprise of State 'B' carrying on the same activities.

2.4 Article 24(4) of the OECD MTC - deals with deduction non-discrimination and it states that there should be no discrimination on the basis of the recipients of disbursements between a resident and non-resident as regards deductibility of amounts paid as interest, royalties and other disbursements by an enterprise to the residents of the other Contracting State. For eg. – Where a resident of State 'A' pays interest, royalties or other disbursements to a resident of State 'B', then the rules for deductibility of such payments in computing taxable profits of the resident of State 'A' should be same as are applicable in respect of the payments made to another resident of State 'A' itself.

2.5 Article 25(5) of the OECD MTC - deals with ownership non-discrimination and states that an enterprise in State 'A' which is wholly or partly owned or controlled, directly or indirectly by residents of State 'B' should not be subjected in State 'A' to any taxation or connected requirement which is other or more burdensome than taxation or connected requirement to which another enterprise in State 'A', in the same circumstance, is subjected to. For eg. – Enterprise in State 'A' which is wholly or partly owned or controlled, directly or indirectly, by residents of State 'B' should not be subjected in State 'A' to any taxation or connected requirement which is other or more burdensome than taxation or connected requirement to which another Enterprise in State 'A', in the same circumstance, is subjected to.

2.6 Article 24(6) of the OECD MTC - deals with General (taxes covered) and states that Article 24 is applicable to taxes of every kind and description notwithstanding the provisions of Article 2 (Taxes covered) of the MTC.

3. Detailed clause by clause discussion on the provisions of non-discrimination as per MTC –

3.1 Article 24(1) of the MTC –

3.1.1 Wordings of the Article 24(1) as per OECD MTC and UN MTC –

OECD MTC

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 to. 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

UN MTC

Nationals of a Contracting State shall not be subjected to 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 to. 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

From the above, it is clear that the wordings of Article 24(1) of the OECD MTC and UN MTC are identical

3.1.2 Some of the important terms used in Article 24(1) –

3.1.2.1 Nationals – Application of this clause is not restricted by Article 1 of the MTC solely to nationals who are residents of a Contracting State, but on the contrary, extends to all nationals of each Contracting State, whether or not they be residents of one of them

3.1.2.2 Any taxation or any requirement connected therewith ² – OECD commentary suggests the definition of 'taxation' as taxes of every kind and description. The expression 'connected requirements' of taxation means that formalities connected with taxation, such as returns, payments, prescribed limits, TDS, issue of notices or refunds, or levy of interest, exemption, deduction, credit or other allowance, etc.

3.1.2.3 Other or more burdensome – The expression 'other' refers to the requirement imposed by the source State on a foreign national which is different from the requirements imposed by source State on its nationals being 'more burdensome'. These relate to the differences in the tax treatment that materially disadvantage the foreign national.

3.1.2.4 In the same circumstances ³ – If the taxpayers are in same circumstances, then only they would be comparable and, accordingly, require same tax treatment. In applying Article 24(1), the underlying question is whether two persons who are residents of the same State are being treated differently solely by reason of having a different nationality?

Certain situations in which the expression 'in the same circumstances' is not satisfied OECD commentary para 18 of Non-discrimination clause and certain Indian Judicial pronouncements like *ABN AMRO Bank NV v. Jt. CIT* [2005] 4 SOT 643 (Kol.) (TM), *Standard Chartered Bank v. IAC* [1991] 39 ITD 57 (Bom.), *Chohung Bank v. Dy. DIT (IT)* [2006] 102 ITD 45 (Mum. - ITAT) Advance Ruling Application No. P 16 of 1998, In re [1999] 236 ITR 103/102 Taxman 377 (AAR) –

- ◆ Differences accorded on the basis of residential status
- ◆ Differences in scope of taxation for domestic residents *vis-a-vis* foreign nationals
- ◆ Institution not for profit but belonging to other Contracting State will not be in the same circumstances as the private institution of the Source State
- ◆ Immunity from the taxation accorded to its own public bodies and services would be justified as they are integral parts of the State and cannot be compared to those of the public bodies and services of the other State

3.1.3 OECD commentary provides examples as to when residence has no relevance whatsoever with respect to the different treatment under consideration in para 19 to 25 of the Article. Some of them are:

- ◆ Where in a DTAA it is provided that if a company is resident of two States (one because of incorporation and other because of POEM), then it shall be treated as resident of that state where it is incorporated. Therefore, the dividend paid by company of State A to that company having dual residence will not be in the same circumstances and can be treated differently for the tax purposes. (Hence, a differential treatment by the source State of resident and non-resident companies is allowed by Article 24(1) even where residence and nationality are linked to the criteria of incorporation or registration)
- ◆ State A levies payroll tax on company that employs resident employees. It does not make any distinction based on the residence of the employer but provides that company incorporated in State A shall benefit from lower rate of payroll tax. If a company incorporated in State B is also a resident of State A (because of POEM) then different tax treatment to this company would be violative.

3.1.4 Indian Judicial pronouncements and principles emanating from it –

- ◆ The applicability of non-discrimination clause is to be seen at the time of assessment proceedings. Once the affected taxpayer files

its return of income and takes the plea before the tax officer, but not at the stage of deduction of taxes *Ericsson Telephone Corpn. India AB v. CIT* [1997] 90 Taxman 144/224 ITR 203 (AAR)

- ◆ Benefit of the principle of interpretation could be allowed to an overseas company when two views are available on an issue, i.e., the one favourable to the taxpayer should be provided for *Dy. DIT v. Solid Works Corpn.* [2012] 51 SOT 34/18 taxmann.com 189 (Mum.)
- ◆ *Disallowance of deduction under section 80M* – Under the Act, deduction under section 80M is available to domestic companies. As far as provisions of the Act are concerned, the foreign company, within the meaning of expression 2(23A) of the Act, is not eligible for deduction u/s 80M. Court held that this kind of classification under the scheme of non-discrimination clause in the applicable India-French tax treaty cannot be considered as discrimination on the ground of nationality *Credit Llyonnais v. Dy. CIT* [2005] 95 ITD 401 (Mum.)
- ◆ Foreign bank (i.e., UK bank) was allowed to claim the benefit of bad debt reserve for loan that was originally granted only to the banks incorporated in India and whose deductibility was restricted based on advances made by rural branches *Standard Chartered Bank v. IAC* [1991] 39 ITD 57 (Bom.)
- ◆ The expression 'taxation' is not defined in Article 24 or Article 3(2) or in the Income-tax Act. The expression 'taxation' and 'tax' are not inter-changeable. Further, it was held that Article 24 which seeks to prevent differentiation solely on ground of nationality and against nationals as such; under this clause State is not obliged to extend same privileges, which it accords to its own residents, to one who is not a resident and no discrimination can be said to have occurred on basis of nationality in such cases *Transworld Garnet Co. Ltd., In re* [2011] 9 taxmann.com 328/197 Taxman 428/333 ITR 1 (AAR)

3.2 Article 24(2) of the MTC –

3.2.1 Wordings of the Article 24(2) as per OECD and UN MTC are as under –

OECD MTC

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 to

UN MTC

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 to

From the above, it is clear that the wordings of Article 24(2) of the OECD MTC and UN MTC are identical

3.2.2 Article 24(2) applies if the following conditions are satisfied –

- ◆ There is a Stateless person⁴
- ◆ Such Stateless person is a resident of contracting State
- ◆ Such Stateless person is subjected, in either contracting state, to any taxation or any requirement connected therewith
- ◆ Such taxation or connected requirement is other than the taxation and connected requirements, to which 'nationals' of the concerned State, are or may be subjected or such taxation or connected requirement is more burdensome
- ◆ The nationals of the concerned State and the Stateless person are placed in the same circumstances in particular with respect to residence

3.2.3 Important texts from OECD MTC in relation to Article 24(2) –

- ◆ The purpose of paragraph 2 is to limit the scope of the clause concerning equality of treatment with nationals of a Contracting State solely to Stateless persons who are residents of that or of the other Contracting State⁵
- ◆ It is possible that in the future certain States will take exception to the provisions of paragraph 2 as being too liberal insofar as they entitle Stateless persons who are residents of one State to claim equality of treatment not only in the other State but also in their State of residence and, thus, benefit in particular in the latter from the provisions of double taxation conventions concluded by it with third States⁶

Note – Indian treaties does not contain similar paragraph in its tax treaties⁷

3.3 Article 24(3) of the MTC –

3.3.1 Wordings of the Article 24(3) as per OECD and UN MTC –

OECD MTC

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

UN MTC

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

responsibilities which it grants to its own residents

civil status or family responsibilities which it grants to its own residents

From the above, it is clear that the wordings of Article 24(3) of the OECD MTC and UN MTC are identical

3.3.2 Article 24(3) applies when following conditions are satisfied –

- ◆ There is a PE of an 'enterprise' of a contracting State in other contracting state
- ◆ Such PE is subject to taxation in other contracting State
- ◆ Such taxation is less favourably levied than taxation levied on enterprise of other contracting State
- ◆ The enterprise of other contracting State carries on same activities as that of the PE

3.3.3 Some of the important terms used in Article 24(1) –

- ◆ *Enterprise/PE* – This applies only if the taxpayer has PE and not otherwise. It seeks to end discrimination on the actual residency of overseas entity
- ◆ *Less favourably* – PE of the Residence State shall not be treated 'less favourably' in taxation matters by the Source State as compared with an 'enterprise' of the Source State
- ◆ *Same activities* – OECD commentary has explained the term through illustrations⁸. It states that regulated and unregulated activities would generally not constitute the 'same activities'
- ◆ *Levied* – Levy means to access, raise, execute, exact, tax, collect, gather, take up, seize. Hence, meaning of the term is to be gathered from the context of the statute in which it has been used
- ◆ *In the same circumstances* – The expression implies that a PE and a local enterprise that is the object of comparison with the PE should always be in the 'same circumstances'

3.3.4 Applicability of Article 24(3) in certain situations -

- ◆ *Computation of taxable income*⁹ – PE must be given the same right as resident enterprises are given in relation to –
 - Claim of deduction of trading expenses
 - Deduction of depreciation
 - Deduction for provision for re-investment in fixed assets
 - Carry forward or backward of a loss
 - Claim benefit of tax incentive provisions
- ◆ *Structure and rate of tax*¹⁰ – Manner of levy of taxes may vary from country-to-country. Indian IT Act expressly permits differential rates of domestic and overseas companies. Relevant extract is reproduced below –

"For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be

regarded as less favourable charge or levy of tax in respect of such foreign company."

- ◆ *Credit for WHT suffered by a PE* ¹¹ – A PE in Source State may receive overseas income (e.g., dividend, interest, etc.) and such income may be taxed in the Source State. It appears that by invoking article 24(3), a PE may be able to avail of a credit in the Source State for the foreign withholding tax on dividends, interest, etc., if such credit is granted to resident enterprises of the Source State
- ◆ *Miscellaneous situations* – As article 24(3) applies to taxation of PE's own business, hence, PE may not be able to invoke Article 24(3) in the following situations –
 - ◆ Rules relating to group consolidation
 - ◆ Rules relating to the distributing profits

3.3.5 Indian Judicial pronouncements and principles emanating from it–

- ◆ Section 44C of the Income tax Act, 1961 limitation on deduction of head office expenditure would not apply in the case of non-resident companies in light of non-discrimination clause in the tax treaty *Metchem Canada Inc. v. Dy. CIT* [2006] 100 ITD 251 (Mum.)
- ◆ Benefit of certain Export linked deductions under Section 80HHE and Section 80HHC of the Income tax Act, 1961 should be allowable to PE of the foreign company *Bhagwan T. Shivlani v. ITO (IT)* [2012] 20 taxmann.com 821/53 SOT 233 (Mum.) (URO)

3.3.6 Distinction between Article 24(1) and Article 24(3) on Non-discrimination clause –

<i>Article 24(1)</i>	<i>Article 24(3)</i>
Taxation or any requirement connected therewith which is other or more burdensome	It states that taxation can't be less favourable for a PE. Other procedural requirements could differ as expression 'connected requirements' is not mentioned
Methodology, mode and basis can't differ	Mode and manner of taxation can differ
Comparison of nationals 'in the same circumstances'	Comparison between PE and domestic enterprise carrying on 'same activities'

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3.4 Article 24(4) of the MTC –

3.4.1 Wordings of the Article 24(4) as per OECD and UN MTC –

<i>OECD MTC</i>	<i>UN MTC</i>
Except where the provisions of paragraph 1 of Article 9, paragraph	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

6 of Article 11, or paragraph 6 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

From the above, it is clear that the wordings of Article 24(4) of the OECD MTC and UN MTC are similar except for minor difference of reference to paragraph Article 12

3.4.2 Certain points that merits consideration –

- ◆ Payment of interest, royalties or other disbursements made by a resident of contracting State to the resident of other contracting State. Hence, not only interest or royalties, in view of the expression 'other disbursements', clause 4 also prohibits discrimination in the allowance of other deductions, being reasonable allocation of the executive and general administrative expenses, research and development expenses and other expenses incurred for the benefit of a group of related persons that include the person incurring the expenses. Reliance in this regard can be placed on the US technical explanation
- ◆ Any denial of deductions on account of Arm's length price ('ALP') application is not subject to non-discrimination
- ◆ This paragraph equally applies to debts for the purposes of determining the taxable capital. However, this part may not be relevant for India as there is no tax on capital

3.4.3 Indian Judicial pronouncements and principles emanating from it –

- ◆ Section 40(a)(i) provides for a disallowance of payment made to a non-resident where withholding is not deducted on such payment. However, where similar payments are made to the resident, no such disallowance (now though 30% is disallowed for payments to residents also) is made. Deduction non-discrimination clause of the tax treaty seems to neutralize such dis-allowance on payments to non-residents *CIT v. Herballife International India (P.) Ltd.* [2016] 69 taxmann.com 205/240 Taxman 21/384 ITR 276 (Delhi)/*DIT (International Taxation) v. Citibank NA* [2016] 66 taxmann.com 373/[2015] 377 ITR 69

(Bom.)/*Mitsubishi Corpn. India (P.) Ltd. v. Dy. CIT* [2014] 50 taxmann.com 379/[2015] 67 SOT 83 (Delhi - Trib.) (URO), *Central Bank of India v. Dy. CIT* [2010-TII-183-ITAT-MUM-INTL] <<Pertinant to note, Protocol to the India-Spain DTAA provides that payments by way of interest, royalties and FTS made by an enterprise of India to a resident of Spain, shall not be allowed as a deduction for the purpose of determining the taxable profits of such Indian enterprise unless tax has been paid or deducted at source from such payments under Indian law and in accordance with the provisions of the said DTAA>>

- ◆ 'Other disbursements' connote something other than 'interest and royalties'. If the intention was that 'other disbursements' should also be in the nature of interest and royalties then the word 'other' should have been followed by 'such' or 'such like' *Herballife International India (P.) Ltd. (Supra)*

3.5 Article 24(5) of the MTC –

3.5.1 Wordings of the Article 24(5) as per OECD MTC and UN MTC are as under –

OECD MTC

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 first mentioned State are or may be subjected to

UN MTC

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 first mentioned State are or may be subjected to

From the above, it is clear that the wordings of Article 24(5) of the OECD MTC and UN MTC are identical

3.5.2 Article 24(5) applies if the following conditions are satisfied –

- ◆ Presence of Enterprise X in the contracting State A, the capital of which is owned by one or more residents in other contracting State B
- ◆ The enterprise is subject to tax in State A to any taxation or other connected requirement thereto
- ◆ The taxation is more burdensome than taxation, etc., to which the other enterprise in State A may be subjected to the taxation or connected requirement to which a similar enterprise may be subject to in that State

3.5.3 The object of comparison in this clause is 'similar enterprise'. Reference in this regard can be drawn from OCED Discussion Draft (2007) on Application and Interpretation of Article 24 para 88, which reads as under –

'88. The Working Group reached the conclusion that the right comparator for the purposes of paragraph 5 was a domestic enterprise owned by residents but agreed that there was no need to clarify this issue in the Commentary as long as there was no practical reason to do so'

3.5.4 Illustrative list of situations in which Article 24(5) cannot be invoked –

- ◆ If the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, this clause cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company
- ◆ Withholding tax obligations that are imposed on a resident company with respect to dividends paid to non-resident shareholders but not with respect to dividends paid to resident shareholders cannot be considered to be violated
- ◆ Information requirement imposed by the contracting State on the company during the time of transfer pricing assessments
- ◆ Deferral of a deduction for interest expense accrued to the foreign related party until such interest is paid

3.5.5 Indian Judicial pronouncements and principles emanating from it –

- ◆ An Indian resident company having foreign parent company cannot be discriminated from Indian resident company having resident parent company (*Daimler Chrysler India (P.) Ltd. v. Dy. CIT* [2009] 29 SOT 202 (Pune))

Ruling in brief – In this case, by invoking article 24(4) of India-Germany tax treaty, Tribunal held that Indian subsidiary of the German company, shares of which are listed on German stock exchange is to be treated as 'company in which public is substantially interested' under section 2(18) of the India Income-tax Act. The reason for this is that an Indian company having foreign parent company should not be discriminated with an Indian company having Indian parent company shares of which are listed on the India stock exchange.

3.6 Article 24(6) of the MTC –

3.6.1 Wordings of the Article 24(5) as per OECD and UN MTC are as under –

OECD MTC

The provisions of this Article shall, notwithstanding the provisions of

UN MTC

The provisions of this Article shall, notwithstanding the provisions of

Article 2, apply to taxes of every kind and description

Article 2, apply to taxes of every kind and description

From the above, it is clear that the wordings of Article 24(6) of the OECD MTC and UN MTC are identical

3.6.2 This means that Article 24 is applicable to taxes of every kind and description notwithstanding the provisions of Article 2 of the convention. Further, this clause does not appear in all the DTAA's entered into by India, except for a few like South Korea, Australia, Portugal, etc. Generally the wordings found in the Indian DTAA are -

'the term "taxation" means taxes which are the subject of this Convention'

4. Variations in provisions of the Non-discrimination clause in some of the Indian treaties :

- ◆ Interestingly, Article 24(5) of certain treaties¹² provides that enterprises owned by residents of the other Contracting State must be treated in the same way as enterprises owned by residents of a third State *vis-à-vis* enterprises owned by residents of the Contracting State itself
- ◆ Presence of avoidance or evasion of taxes provision –
 - Article 24(5) of India - New Zealand tax treaty states that non-discrimination Article shall not apply to any provisions of the taxation laws of a Contracting State which are reasonably designed to prevent or defeat the avoidance or evasion of taxes
 - Article 24(6)(a) of India - Australia tax treaty provides that non-discrimination Article shall not apply to any provision of the laws of a Contracting State which is designed to prevent the avoidance or evasion of taxes, including measures designed to address thin capitalization or to ensure that taxes can be effectively collected or recovered; or provides tax incentives to eligible taxpayers for expenditure on research or development; or is agreed between the Contracting States through an Exchange of Notes
- ◆ India Kuwait tax treaty provides that concessions accorded to third State or its residents by virtue of the formation of a customs union, free trade area, etc., need not necessarily also be granted to the other Contracting State

5. Other issues

5.1 Interest deduction limitation and non-discrimination clause

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Two views are possible for this –

- ◆ Article 9(1) prohibits transfer pricing adjustments which do not comply with arm's length standard. Further, Article 24(4) provides that interest paid to a resident of other State is deductible under the same conditions as interest paid to a

resident. As both Article 9(1) and Article 24(4) may apply to interest deduction restrictions, such as thin capitalization rules, they cannot apply simultaneously in view of the carve-out in Article 24(4) for adjustments based on Article 9(1). Hence, non-discrimination clause should not apply to interest deduction limitation

- ◆ Article 9 addresses only non-arm's length conditions and also situations in which the parties dealing at arm's length would not have concluded the transactions. Hence, non-discrimination should apply to such interest payments as interest deduction limitation talks only about interest deductibility and is merely deferring the deductibility of interest

5.2 Non-discrimination clause and Most favoured nation –

Question often arises as to whether grant of Most Favoured Nation ('MFN') status amounts to discrimination with others. It may be construed that this is a discrimination not always by a positive discrimination in domestic law but by differential treatment of the same kind of income differently in different agreements.

Relevant lines from the book of renowned author, Philip Baker¹³ -

The Commentary to the 1977 Model made two points of general application – not limited to the Non-Discrimination Article. Firstly, permanent establishment in State A of an enterprise may not take advantage of State A treaties; this is an application of the principle of the relative effect of treaties. Secondly, the benefit secured by a double taxation agreement are granted on the basis of reciprocity; no other state can claim the benefit of the treaty by virtue of a most-favoured nation clause, however general its terms. These clause operate in other treaties such as those granting customs and trade preferences.

The following example displays an unusual application of Non-discrimination Article to extend the benefits of third country treaties. –

A German resident and a Dutch national worked for a short period in Italy on behalf of the German employer. The taxpayer wants to claim protection of the old Germany-Italy treaty against taxation of its income in Germany. The treaty on several occasions has been held to apply only to German or Italian nationals and not to third country nationals who were residents of either state. Courts held that the taxpayer could rely upon Non-discrimination Article of Germany-Netherlands treaty on the basis that a Dutch national should not be subjected to a higher tax liability than a German national in similar circumstances. Since a German national would be entitled to the protection of the treaty with Italy, the Dutch national was allowed that protection.

Conclusion

6. Non-discrimination clause plays an important role in taxation of international transactions. Presence of this Article in the tax treaties helps

in promoting equity and, accordingly, in promotion of cross border flow of trade, investments, etc.

In the Indian context, though Indian courts on several occasions made contributions to provide more clarity to the various provisions of Non-discrimination clause, it would be interesting to see how more contextual clarity will be provided overtime for interpretation of Non-discrimination clause.

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- [1.](http://campus.unibo.it/146811/1/Modello_di_convenzione_OCSE.pdf) http://campus.unibo.it/146811/1/Modello_di_convenzione_OCSE.pdf.
 - [2.](#) *From Indian context, it is relevant to note that the word taxation is not defined in the tax treaty nor in the domestic laws of India. Article 366(28) of the Constitution of India defines 'taxation' in an inclusive manner as 'taxation includes the imposition of any tax or post whether general or local or special, and tax shall be construed accordingly'*
 - [3.](#) Certain Indian DTAA's Germany, Spain, UAE, Egypt, Belgium and Italy refers to comparison between nationals 'in same circumstances and same conditions'
 - [4.](#) A stateless person as 'a person who is not considered as a national by any State under the operation of its law' (Reference in this regard can be made to para 32 to commentary on Article 24 of OECD MTC, 2017)
 - [5.](#) Para 28 to commentary of the OECD MTC, 2017
 - [6.](#) Para 31 of the OECD MTC, 2017
 - [7.](#) Except for DTAA's with Romania, Latvia and Norway
 - [8.](#) Para 38 of the OECD MTC commentary
 - [9.](#) Para 40-47 of the OECD MTC commentary
 - [10.](#) Para 55-61 of the OECD MTC commentary
 - [11.](#) Para 67 and 68 of the OECD MTC commentary
 - [12.](#) DTAA's with Brazil and Canada
 - [13.](#) Page 395 of the second edition