concession are subject to tax as *commercial and industrial profits*, provided that the sources of profit are situated in Egypt.

(d) Income from mortgages on real property, ships or aircraft (including mortgaged bonds if considered as interests in realty rather than as securities)

According to Article III of the Mexico Model Convention, the rule governing the income from real property applies also to taxation of income from mortgage on such property. This rule, however, does not apply to "those so-called mortgage bonds which are not guaranteed by any specific real property and which are issued by credit institutions in order to finance the loans they grant on mortgages drawn up in their names."

By analogy with the rule regarding taxation of income from mortgages on real property, income from mortgages on sea and air vessels is taxable in the country of registry according to this Convention. This is due to the fact that "such vessels are generally regarded as being legally situated in the country where they are registered."

It may, however, be mentioned that according to the tax laws of Ceylon and the Egyptian Region of the U.A.R. income from mortgages real property etc. is considered as income from securities, and not as income from reality. Under the laws of India and Pakistan, taxation of such income depends on the location of mortgaged property and or the place of use of the capital secured by the mortgage.

(e) Income From Business

(i) Taxation on the basis of Permanent Establishment

The general principle followed in the Conventions for the avoidance of double taxation is that industrial and commercial profits accruing to an enterprise of one of the contracting States cannot be subject to tax in the other contracting State unless the enterprise carries on a trade or business in the other State through a permanent establishment situated therein.

(ii) Constituents of a permanent establishment :

Permanent establishment generally includes head offices, branches, mines and oil wells, plantations, factories, workshops, warehouses, agencies, installations, professionals premises and other *fixed places* of business having a *productive character*. It does not include research laboratories' experimental plants, information bureaus, store houses' purchasing offices, advertising displays, show rooms where no goods are sold. This is due to the fact that such establishments "are not directly engaged in actual productive operations but render general or particular services to the concern having no definite connection with the profits earned by the concern." *Cf. Mexico Model Convention). Profits realised through isolated or occasional transactions in a country where the enterprise does not possess a permanent establishment are not taxable in that country.*

(iii) Independent and dependent agents :

This is a general practice followed in the bilateral Tax Agreements that foreign enterprises doing business in a country through brokers and commission agents of a genuinely *independent status*, or through commercial travellers, visiting customers or suppliers in a country, should not be regarded as having a permanent establishment and hence liable to tax in that country.

An agent is not, however, considered as independent and the enterprise for which he acts is liable to income tax in the country where he is established if (i) he "habitually acts in the name of enterprise concerned as a duly accredited agent and enters into contracts on its behalf" (ii) he "is a salaried employee of the enterprise and habitually transacts business on its account" and (iii) he "habitually holds, for the purpose of sale, a stock of goods that belongs to the enterprise.[1])

(*iv*) *Position of subsidiary companies*

The Mexico and London drafts of Model Conventions and numerous other conventions for the avoidance of double taxation, provide that the existence of a subsidiary company does not of itself constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity.

It may be stated that the concept of permanent establishment as generally employed in the Tax Agreements (based on the Model of Mexico or London drafts) might not be suitable for adoption by some of the member countries, particularly India and Pakistan. The definition of permanent establishment implies the existence of a fixed place of business of a productive character. The adoption of the principle of taxing only those profits which are attributable to a permanent establishment in these countries would deprive them of revenues on profits derived from 'business connection', unless 'permanent establishment' is defined so as to include an agency.

As stated in earlier paragraphs, profits realised through isolated or occasional transactions in a country where the enterprise does not possess a permanent establishment are not taxable in that country according to the general principle followed in the Tax Agreements. Such profits are, however, taxable under the tax laws of India, Pakistan and the Egyptian Region of the U. A. R. In Ceylon, the Income-Tax Ordinance specifically provides for exemption of profits of a casual and non-recurring nature.

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1 *Mexico Model Convention*, July 1943, page. 46.

(f) **Income derived from the operation of ships or aircraft**

The general principle embodied in numerous Tax Agreements is to give the right to tax such income to the country where the vessel concerned is registered. This is intended to facilitate international traffic and to avoid the difficulties of taxing the profits from international navigation in a country other than that in which the vessel is registered or, that in which the owner has his 'fiscal domicile.' Inland water transport is not, however, affected by this rule and remains, like rail and road transport, subject to principles governing taxation of business income in general.

The adoption of the principle that shipping profits should be taxed by the country in which the ships are registered would, however, operate unfavourably for these countries whose shipping industry has not made substantial progress. They would get practically nothing in return for the large amount of tax on the profits of the carrying trade arising from those countries which they would have been collecting otherwise.

(g) **Income from movable capital**

The phrase "income from movable capital" may include the following main classes of receipts which are often treated differently in the various national tax legislations :

(a) "Interest and other earnings on debentures, bonds, certificates, notes, bills and similar documents issued by governments and other public bodies;

(b) Interest and other earnings on debentures, bonds, certificates, notes and bills issued by private companies and other similar juristic persons;

(c) Interest on private loans and similar claims (including mortgage claims, if considered as personal, rather than real, property under the domestic law.)

(d) Interest on deposits and current accounts, other than earnings on deposits and current accounts that are taxable as part of business income.

(e) Dividends and other income from company shares and sleeping partner shares in limited liability partnership.[5]

No general principle is followed in the Tax Agreements with regard to the taxation of income from movable capital. It is generally said that the treatment of income from movable capital is one of the most complex questions that arise in connection with the prevention of international double taxation. "In this matter there is an opposition of interests from capital exporting countries and capital-importing countries. The revenue interests of the former are best served by taxation of income from capital *at the home of the creditor or beneficiary*, those of the latter countries by taxation *at home of the d.btor or rather, the place where the investment is used*." [6]

Under the tax laws of India and Pakistan, if money is borrowed in a foreign country and is brought into and used in these countries, the interest is taxable there. Any income received in India and Pakistan is taxable under their laws. No income-tax is payable on the interest receivable on any security of the Central Government (domestic) issued or declared to be income tax free. Interest on bonds issued by a foreign government is liable to income-tax in India and Pakistan if brought into or received there or when the recipient is a person 'resident and ordinarily resident' in these countries. The form under which the income is received (interest or dividends) does not affect its treatment under the laws of these countries.

Under the tax laws of Ceylon, income from movable property is assessed normally as income from investments, except

5 *Mexico Model Convention*, July 1943, page 55.

6 Ibid.

when it arises as profit from a business of buying and selling such investments, in which case it is assessed as a trade. Where a non-resident person derives income from dividends, interest, rents, ground rent, royalty or annuities, the tax on such income is collected at the source from the payer of the income. The same provisions apply in the case of bonds issued by a foreign or domestic, central or local government agency.

According to the Income-Tax Law of the Egyptian region of U. A. R., a tax imposed "on all incomes derived from capital invested in negotiable securities such as shares and debentures, dividends of sleeping partners, remunerations of members of the board of directors, payments and redemption effected by the Egyptian companies on the share and founder's shares and the partners' shares prior to the dissolution of the company or its winding up. This is called "tax on negotiable securities".

Income-tax is also levied on "interest of debts, cash deposits and guarantees due to Egyptians or foreigners domiciled or resident in Egypt even if such interest is payable in respect of the capital invested abroad". Tax is also levied on interest accruing from capital invested in Egypt even if the persons entitled thereto are foreigners having actual or legal domicile in Egypt.[10]

(h) Income derived from royalties on patents, trademarks and other commercial or industrial profits and income from royalties on copyrights and other intellectual properties

The problem of double taxation of royalties arises when the owner of the property is resident in one country and the

7 Income Tax Ordinance, 1932, Sections 43 and 44.

8 Articles 1 and 2 of Act No. 14 of 1939.

9 Article 15 of Law No. 14 of 1939.

10 Article 16 of Law No. 14 of 1939.

suer is resident in another. "Each of two countries claims to be the country of origin, in consequence of which neither will afford relief for the tax paid to the other."[11]

Some bilateral tax agreements, particularly those concluded by European countries, employ a formula. according to which royalties paid to a person who is a resid/ent of one territory *should be exempt from tax in the other territory in which the property is used*, unless they are attributable to the activities carried on by that person at a permanent establishment in that country. There are agreements, including those concluded by some of the member countries, that give the *right of taxation to the country in which the property is used.* The latter formula is also in conformity with the internal legislations of India, Pakistan and Ceylon. Royalties are, however, not subject to any income-tax under the law of the Egyptian Region of the U.A.R.

(i) Earned income from personal services, private employment or liberal profession

According to the general provision contained in the Tax Agreements, remunerations for personal services etc. are taxable only in the country where the services are performed. This rule is, however, subject to an exception in the case of employment of short duration. For example, remunerations paid to an individual who is resident in one of the contracting States for personal services performed within the other contracting State are not subject to tax in that other State if his stay there does not exceed one hundred and eighty-three days. "This exception is designed in particular to facilitate the international movement of qualified personnel." [12].

The practice followed in the tax agreements with regard to the taxation of professional services is not, however, uniform.

11 Taxation of Royalties, *Report of the Commission on Taxation of International Chamber of Commerce*, May 1960, page 6.

12 *Elimination of Double Taxation*, Fiscal Committee of the O.E.E.C. 2nd Report, July 1959. page 18.

Some agreements employ the concept of permanent establishment or the concept of 'fixed base' (to use the term of the O.E.E.C.) according to which the country where the earnings from professional services or other independent activities of a similar character are to be taxed is determined not by the actual place where the services are renderd but by the place where the tax payer concerned has a permanent establishment in which or from which he renders his services.

It may, however, be noted that the domestic tax laws of India, Pakistan and Ceylon do not make any difference in the tax treatment of liberal prefessions on the one side and personal services and private employment on the other. According to the tax law of the Egyptian Region of the U.A.R., "an annual tax is imposed on the profits of liberal professions and other non-commercial professions exercised by the tax payer independently and having labour as its main factor This tax is imposed, together with the other taxes due in accordance with the provisions of the law, on the earnings from wages and salaries or commercial and industrial profits.[13]

It may be of interest to note a paragraph relating to the tax on liberal professions from the Memorandum presented by the Delegation of the U.A.R., on the subject of Double Taxation. The paragraph lays down that "the tax on liberal professions is territorial." It is applicable, like the tax on agricultural land and buildings, to "incomes realised in Egypt and does not extend to incomes produced abroad even if it concerned an Egyptian or a foreigner resident in Egypt." "*There can never be international double taxation*" in such cases unless the nationality law of the person who performs the profession "adopts the principle of political subordination as is the case under the income-tax law in force in the United States of America".

13 Article 72 of Act No. 14 of 1939.

(j) Private pensions and life annuities

According to the principle adopted in most of the bilateral Tax Agreements, private pensions and life annuities derived by a resident of one of the countries from sources in the other country are taxable only in the *country of residence of the recipient*. There are, however, some agreements which give the right to tax such income *to the country of source*, i.e., the country from which the income is derived. The latter formula also conforms to the domestic provisions of law in India, Pakistan, Ceylon, Iraq and the U.A.R.

(k) Public salaries and pensions

In order to conform with the rules of international courtesy and mutual respect for sovereignties"[14] bilateral Tax Agreements follow the principle that remunerations, including pensions, paid by or out of funds created by a contracting State or a political sub-division or a local authority thereof to an individual who is a national of that State in respect of services rendered to that State or sub-division or local authority thereof in the discharge of governmental functions are taxable only in that State. The place where the services are or were rendered is immaterial, "provided that the services relate to the normal sphere of public activities as understood in international usage." [15] Hence services performed in connection with trade or business carried on by the State, political sub-division etc. paying the remuneration, are not governed by this rule.

(l) Capital gains

Most of the bilateral Tax Agreements embody the principle that gains derived from the sale, transfer or exchange

14 *Model Bilateral Convention for the Prevention of International Double Taxation and Fiscal Evasion*, League of Nations, Mexico Draft, 1943, page 54.

15 *Ibid.*

of immovable property is taxable only in the country in which the property is situated. As regards gains derived from the sale or exchange of any capital assets other than immovable property, the rights of taxation in some agreements are reserved to the State of which the recipient is a resident. Some agreements, however, stiputate the rule that gains derived from the sale, exchange or transfer of a capital assets (movable or immovable) may be taxed only in the country in which the capital asset is situated at the time of such sale, exchange or transfer.

(m) Technical method of avoiding double taxation, i. e. the exemption method and the tax credit method

The problem of double taxation arises when the same income becomes the taxable subject of two different taxing countries, one claiming tax as the country of origin of the income and the other as the country of residence of the tax payer. It is generally accepted that the country where the income arises has the right to tax that income in priority to any claim by the country where the owner resides. There is, however, a wide divergence of practice between countries when it comes to the exercise of their residual power to tax residents on income derived from abroad after the country of origin of the income has had its cut. Some tax foreign income (after deduction of the foreign taxes) like any other income, some exempt it altogether, some exempt particular types of income from abroad and some give a measure of relief by setting off the foreign taxes against their own tax (either under Double Taxation Agreements or unilaterally) or by charging income from abroad at a lower rate.

It may be pointed out that if the problem of allocation of taxes between the contracting States is resolved, double taxation is completely eliminated under the exemption method. But this is not so with tax credit method which involves intricate procedure of calculating foreign tax to be credited against home tax and which "often fails to give adequate relief from double taxation owing to differences in the types of tax levied in the country of residence and the country of origin, in the bases of assessment to income-taxes and owing to the existence of subordinate taxing authorities in addition to the central government".[16]

16 For details see Appendix V. Report of the Commission on Taxation of International Chamber of Commerce.

VI. COMMENTS RECEIVED FROM THE MEMBER GOVERNMENTS ON THE TOPICS OF DISCUSSION

CEYLON

(a) Definition of the terms 'nationality', 'residence' and 'domicile'

For the purposes of Ceylon Income-Tax, 'nationality' and 'domicile' are immaterial; it is 'residence' that matters.

As regards an individual, his residence in Ceylon depends on the length of stay in the Island and does not depend on the fact whether a permanent home is available to him in Ceylon or not.

The residence of a body of persons or a company, i. e., a 'legal person' is in the country in which it has its 'real centre of management'.

(b) Income from real property

Under the Double Taxation Relief Agreements Ceylon has entered into, whether the source of income is real property or otherwise, the principle adopted by Ceylon, except for certain variations, is that the country in which the income arises is entitled to retain the tax and the other country gives the relief.

(c) Income from royalties or internal sources

The statement made in the first sentence of sub-para. 2 is not correct. It would appear that this presumably has been taken from a reply sent to a questionnaire in November, 1950. The position has not been set out clearly in this letter, and apparently it has been misunderstood. The true position is that royalties derived from Ceylon are taxed in Ceylon whether they arise from natural resources or not, although there is no specific reference in the law to royalties on natural resources.

(d) Income from mortgages

Income from mortgages and loans given out in Ceylon are liable to tax in Ceylon as the income arises in Ceylon. The position set out in para. (b) above under income from real property holds good in respect of income from mortgages as well, as no distinction is drawn in Ceylon between income from real property and securities.

(e) **Income from business**

The position outlined in sub-paras. (i) and (ii) is substantially the same as that adopted by Ceylon.

In regard to sub-para. (iii) liability to Ceylon tax will arise where any person in Ceylon acts on behalf of a non-resident person and is instrumental in effecting any sale or disposal of property. The profits derived by such non-resident person from the sale or disposal will be liable to Ceylon tax and the person in Ceylon who acts on his behalf will be deemed to be his agent. The element of instrumentality is therefore more significant in the Ceylon Income-Tax Ordinance than what is set down in sub-para. (iii). If the transaction was effected through the instrumentality of a person in Ceylon, liability to tax will arise. If, however, the transaction was negotiated direct between the person in Ceylon and the non-resident without the intervention or assistance of anyone in Ceylon, there will be no liability to tax in Ceylon.

Concerning sub-para. (iv) isolated or occasional transactions are liable to tax in Ceylon if such transactions are in the nature of business or trade. Casual or non-recurring profits are not taxable provided they are not in the nature of trade or business.

(f) Income derived from operation of ships or aircraft

Ceylon is in agreement with sub-para. (2) in this paragraph and has embodied in some of the Double Taxation

Relief Agreements entered into, the principle that at least 50 per cent of the profits arising in Ceylon on shipping and aircraft should be taxed in Ceylon.

(g) **Income from movable capital**

The general principle adopted by Ceylon is that the country in which the income arises has a right to retain the tax whilst the other country gives the relief. Ceylon being a capital importing country, her interests are best served by taxing income from capital at the home of the debtor or beneficiary.

(h) Income from royalties

The internal legislation in Ceylon is that Ceylon has the right to tax the income from royalties that arise in Ceylon. In the Double Taxation Relief Agreements entered into by Ceylon, Ceylon has endeavoured to retain the full tax or at least part of the tax on such income.

(i) **Earned income from personal services**

Ceylon agrees with the principle that remuneration for personal services is taxable in the country where the services are rendered. In the Double Taxation Relief Agreements Ceylon has entered into, certain exemptions have however been provided for. For instance, profits or remuneration paid to an individual for personal or professional services are not subject to tax in the country where the services are rendered if—

(a) his stay there does not exceed 183 days;

(b) the services are performed for or on behalf of a resident of the other country;

(c) the profits or remuneration are subject to tax in the other country.

This exemption, however, does not apply to artists, musicians, public entertainers, etc., who are liable to tax, whatever the period of their stay is.

(j) Private pensions and life annuities

The principle that the right to tax this income belongs to the 'country of source', i. e. the country from which the income is derived, is embodied in our Double Taxation Relief Agreement with India. But in our agreements with the United Kingdom and Sweden, we have conceded that such income should be taxed by the country of the residence of the recipient.

(k) Public salaries and pensions

Ceylon argees with the principle that remuneration including pensions paid by Government should be taxed by the country which pays the salaries or pension and exempted by the other.

(l) Capital gains

Under the Double Taxation Relief Agreements with the United Kingdom and Sweden, a resident of one country who does not carry on a trade or business in the other country through a permanent establishment is exempt from tax in other country on gains from the sale, transfer or exchange of capital assets.

(m) Technical methods of avoiding double taxation, i. e. the taxation method and the tax credit method

In the Double Taxation Relief Agreements entered into by Ceylon, certain special exemptions are prodvided for, but some incomes come under a system of tax credits. Under this system of tax credits, the country where the income arises retains the right to tax the income whilst the othe country gives relief in the form of a tax credit. Ceylon, however, favours the provision of tax exemptions to the system of the tax credits.

PAKISTAN

Extract from Letter No. F. 23 (1) P/63- III Dated March 27, 1963 from Mr. M.B K. Babar, Third Secretary, Pakistan High Commission, New Delhi, addressed to the Secretary, Asian-African Legal Consultative Committee, New Delhi,

*** *** ***

I am desired to refer to your letter No. F. (Res.)-7/62 dated November 29, 1962, regarding Laws relating to avoidance of double taxation and fiscal evasion, and to state that the Government of Pakistan have no comments to offer.

THAILAND

Extract from Letter No. 464/2506 dated May 1, 1963, from Mr. S. Bamrungphong, First Secretary, Royal Thai Embassy, New Delhi, addressed to the Secretary, Asian-African Legal Consultative Committee, New Delhi.

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With reference to your letter No. F. (Res.)-7/62 of November 29, 1962, which, together with copies of the Topics of Discussion prepared by the Secretariat, was forwarded to the authorities concerned for consideration, I have the honour to inform you that reply has now been received from Bangkok stating that the matter is receiving due attention and, since it is a technically complicated and important subject, the Thai Member of the Committee reserves the right to make a verbal comment during the next session of the Committee.