Sub-Committee feels that in granting relief by tax credit the scheme of relief should provide for giving credit for the tax *spared.* Certain countries give special tax concession by special incentive measures designed to promote economic development. If the countries of residence which tax foreign income at the ordinary rate of tax and then give credit only for the actual amount of the foreign tax charged in the country of source, the relief by way of tax concessions which the capital importing countries give to foreign capital invested in their enterprises merely enures for the benefit of the capital exporting countries, it is not fully enjoyed by the persons who invested the capital but is expropriated by their government. For example, the law in India contains provisions for reduction of tax as special incentive measures designed to promote economic development in that country, such as provisions relating to exemption from tax of interest payable on money borrowed abroad, provisions relating to development rebate or relating to partial exemption from tax of any newly established industrial undertaking or hotels. The agreement between India and Japan incorporates a scheme by which the amount by which the Indian tax has been reduced under the aforesaid provisions for promoting economic development is *deemed to have been paid* by the tax payer and credit for that amount is allowed against the Japanese tax. It appears to this Sub-Committee that this would be a useful pattern to follow in the future agreements between the participating countries.

SUMMARY OF CONCLUSIONS

To sum up, the Sub-Committee recommends :—

(1) that industrial and commercial profits accruing to the enterprise or one of the contracting States should be charged to tax only if that enterprise carries on trade or business in the other contracting States through a permanent establishment situated therein.

(2) Income from movable capital such as dividends declared and paid by companies, interests on bonds, loans, securities or debentures issued by governments, local authorities or other corporate bodies should be taxed in the country where the investment is made and not in the country of residence of the recipient of such income.

(3) Capital gains derived from the sale, exchange or transfer of immovable property or other capital assets should be taxed by the country in which such assets are situated.

(4) As a means of removing double taxation the contracting States may as for as possible adopt the exemption method in preference to the tax credit method.

(5) In cases where relief is preferred to be given by tax credit the scheme of relief should provide for affording credit to the tax *spared.*

In conclusion, the Sub-Committee wishes to place on record its appreciation of the work done by the Secretariat in collecting very useful material documented in the Second Volume of the Briefs of Documents which has been of great assistance to the Sub-Committee in its deliberations.

Sd/— R.M. Mehta
Sd/— Tadao Araki
Sd/— Wichian Watanakun

ANNEXURE

DEFINITION OF PERMANENT ESTABLISHMENT

The term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on;

(a) the term "fixed place of businesss" shall include a place of management, a branch, an office, a factory, a workshop, a warehouse, a mine, quarry or other place of extraction of natural resources;

(b) an enterprise of one of the territories shall be deemed to have a fixed place of business in the other territory if it carries on in that other territory a construction, installation or assembly project or the like;

(c) the use of mere storage facilities or the maintenance of a place of business exclusively for the purchase of goods or merchandise and not for any processing of such goods or merchandise in the territory of purchase, shall not constitute a permanent establishment;

(d) a person acting in one of the territories for or on behalf of an enterprise of the other territory shall be deemed to be a permanent establishment of that enterprise in the first-mentioned territory, but only if

1. he has and habitually exercises, in the first-mentioned territory, a general authority to negotiate and enter into contracts for or on behalf of the enterprise, unless the activities of the person are limited exclusively to the purchase of goods or merchandise for the enterprise; or

2. he habitually maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprise from which the person regularly delivers goods or merchandise for or on behalf of the enterprise; or

3. he habitually secures orders in the first-mentioned territory wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it;

(e) a broker of a geniunely independent status who merely acts as an intermediary between an enterprise of one of the territories and a prospective customer in the other territory shall not be deemed to be a permanent establishment of the enterprise in the last-mentioned territory;

(f) the fact that a company, which is a resident of one of the territories, has a subsidiary company which either is a resident of the other territory or carries on a trade or business in that other territory (whether through a permanent establishment or otherwise) shall not, of itself constitute that subsidiary company a permenent establishment of its parent company.

XI. FINAL REPORT OF THE COMMITTEE ADOPTED AT THE NINTH SESSION

The subject of Relief Against Double or Multiple Taxation was referred to the Committee by the Government of India under the provisions of Article 3 (c) of the Statutes of the Committee for exchange of views and information between the participating countries.

2. The Committee took up the subject for preliminary discussion during its Fourth Session held in Tokyo in 1961. A Sub-Committee was appointed at that Session to examine in what manner the Committee should treat the problem of avoidance of double or multiple taxation and fiscal evasion. The Committee at that Session on the recommendations of the Sub-Committee decided that the Secretariat should request the Governments of the participating States to forward to the Secretariat the texts of agreements on avoidance of double taxation concluded by them and the texts of the provisions of their municipal laws concerning the subject. The Committee also directed its Secretariat to draw up a questionnaire and the topics for discussion and send the same to the Governments of the participating countries.

3. In accordance with the directions of the Committee the Secretariat invited the Governments of the participating States to send answers to the quetionnaire and their views on the topics for discussion. The Secretariat also prepared a brief dealing with the topics mentioned in the questionnaire on the basis of the information supplied by the Governments of the participating countries as also on the general State practice as gathered from different sources, such as international agreements, municipal legislations of different countries and studies done by governmental and private organisations.

4. At the Sixth Session of the Committee held in Cairo in 1964 a Sub-Committee was appointed to examine the question on the basis of the information collected by the Secretariat. The Sub-Committee after a preliminary exchange of views recommended that though bilateral double taxation agreements provided a practical solution to the financial problems which arose from the economic intercourse of nations, it was desirable to have an exchange of views on the techniques employed by the participating States, their experiences and practices with a view to drawing up of a model multilateral convention. The matter was again considered by a Sub-Committee appointed at the Seventh Session held in Baghdad in 1965. That Sub-Committee reported that the conflicting interests of the countries, the varied patterns of their taxing laws, different tax structures and absence of a universally acceptable system of tax distribution among various countries would make the task of proposing any model agreement on this subject to be extremely difficult. Nevertheless,having regard to the vital importance of the subject to developing countries for economic co-operation, expansion of trade and business, exchange of technical knowledge and cultural activities, flow of capital and business enterprises, the Sub-Committee thought that certain broad principles should be formulated for consideration of the Governments of the participating States. The Sub-Committee therefore drew up certain general principles but excluded from the scope of its report the questions relating to tax on trade, business, industry and other related topics. The subject was further considered by another Sub-Committee appointed at the Eighth Session. That Sub-Committee was able to formulate certain general principles on the topics left over from the Seventh Session.

5. The Reports submitted by the Sub-Committees appointed at the Seventh and the Eighth Sessions were placed before this Committee for consideration at this Session. The Committee after general discussion of the reports of the two Sub-Committees have found the principles formulated by the Sub-Committees

generally acceptable. Having regard to the fact that the Committee's functions under its Statutes are of an advisory character, the Committee considers that the appropriate manner in which it could deal with this subject is to formulate the principles for avoidance of double or multiple taxation and it would be upto the Government of each participating State to decide as to how it would give effect to the Committee's recommendations whether by entering into multilateral or bilateral arrangements or by incorporating the principles formulated by the Committee in their own municipal laws. In this view of the matter the Committee has formulated the general principles on the subject which are set out in the *Annexure* to this Report.

Sd.- (C. K. Daphtary)
President.

ANNEXURE

General principles recommended for adoption in international agreements for avoidance of double or multiple taxation of income

PART I

GENERAL

1. Relief against double taxation of the same income by two or more countries is given either unilaterally or by the countries concerned entering into bilateral or multilateral agreements providing for such relief.

2. Bilateral agreements which take care of the special relations between the two countries afford the most practical method for providing relief against double taxation.

3. The laws of the Contracting States should contain provisions empowering their Governments to grant relief against double or multiple taxation unilaterally and also to enter into bilateral or multilateral treaties or agreements setting forth the principles for granting such relief on a reciprocal or non-reciprocal basis and to implement them.

4. The laws in force in each of the contracting States will govern the assessment and taxation of income in that State except where express provision to the contrary is made in the agreement.

5. The agreements should cover the taxes on income and capital gains imposed under the law of each of the Contracing States.

6. The agreements should provide that they will also apply to any other taxes of a substantially similar character imposed in each of the Contracting States subsequent to the date of the agreements.

7. The Contracting States shall not impose upon the nationals of other countries more burdensome taxes than they impose upon their own nationals.

PART II

DEFINITIONS

8. The agreements should contain definitions of important terms used therein, such for example as "person", "company", "enterprise of a Contracting State", "resident of a Contracting State", "permanent establishment" etc.

9. The term "person" includes natural persons, companies and all other entities which are treated as taxable units under the tax laws of the respective Contracting States.

10. "Company" will mean any body corporate or entity which is treated as a body corporate for tax purposes under the tax laws of the respective Contracting States.

11. "Enterprise of a Contracting State" will mean an industrial or commercial enterprise or undertaking carried on in that Contracting State by a resident of that State.

12. The expression "resident of a Contracting State" will mean any person who under the law of that State is a resident of that State for the purpose of taxation in that State and not a resident of the other Contracting State for the purpose of taxation in that other State.

13. A "company" will be deemed to be a resident of the Contracting State in which its business is wholly managed and controlled.

14. (i) The term "permanent establishment" will mean a fixed place of business in which the business of the enterprise is wholly or partly carried on and will include a place of management, a branch, an office, a factory, a workshop, a warehouse, a mine, a quarry or other place of extraction of natural resources and a permanent sales exhibition.

(ii) An enterprise of one of the Contracting States should be deemed to have a permanent establishment in the other Contracting State if it carries on in that other State a construction, installation or assembly project or the like.

(iii) The use of mere storage facilities will not constitute the place a permanent establishment.

OR

The use of mere storage facilities or the maintenance of a place of business exclusively for the purchase of goods or merchandise and not for the purpose of display or for any processing of such goods or merchandise in the territory of purchase will not constitute a permanent establishment.

(iv) A person acting in one of the Contracting States for or on behalf of an enterprise of the other

Contracting State will be deemed to be a permanent establishment of that enterprise in the first mentioned State if—

(a) he has and habitually exercises in the first mentioned State a general authority to negotiate and enter into contracts for or on behalf of that enterprise, or

(b) he habitually maintains in the first mentioned State a stock of goods or merchandise belonging to that enterprise from which he regularly delivers goods or merchandise for or on behalf of the enterprise, or

(c) he habitually secures orders in the first mentioned enterprise wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it.

v) A broker of a genuinely independent status who merely acts as an intermediary between an enterprise of one of the Contracting States and at prospective customer in the other Contracting State will not be deemed to be a permanent establishment of the enterprise.

(vi) The fact that a company is a resident of a Contracting State and has a subsidiary company which is resident of the other Contracting State or which carries on trade or business in that other State (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary company a permanen establishment of its parent company or shall not constitute either company a permanent establishment of the other.

PART III

ALLOCATION OF TAX JURISDICTION

15. Income from immovable property may be taxed by the State in which such property is situated.

16. Royalties and profits from operation of mines, quarries and of extraction and exploitation of other natural resources may be taxed by the State in which such mining or quarrying operations are carried on.

17. Profits derived by a resident of one of the Contracting States from operations of international shipping or flights may be taxed by the State in which the enterprise is registered or where its business is wholly managed or controlled unless the vessel or aircraft is operated wholly or mainly between places in the other Contracting State. In the alternative, if this allocation is considered disadvantageous to participating countries, this source may be allocated exclusively to the taxing jurisdiction of the State in which the profits are earned.

18. Industrial and commercial profits of an enterprise of one of the Contracting States should be taxed in the other Contracting State only if that enterprise carries on trade or business in that other Contracting State through a permanent establishment situated therein. Such taxes should be levied only on such profits of that enterprise as are attributable to the permanent establishment situated in the taxing State.

19. Income from movable capital, such as, dividends paid by a company, interests on bonds, loans, securities or debentures issued by Governments, local authorities, companies or other corporate bodies should be taxed in the country where the investment is made and not in the country of residence of the recipient of such income.

20. Capital gains derived from the sale, exchange or transfer of a capital asset, whether movable or immovable, should be taxed only in the State in which the capital asset is

situated at the time of such sale, exchange or transfer. For this purpose the *situs* of the shares of a company should be deemed to be the country in which the company is incorporated. (Capital assets would not include movable property in the form of personal effects like wearing apparel, jwellery and furniture held for personal use by the tax payer or any member of his family dependent on him).

21. Remuneration including pensions and gratuities paid in one of the Contracting States for services rendered therein, out of Government funds or funds belonging to a local authority, in the other Contracting State should not be taxed in the first mentioned Contracting State.

22. Profits or remuneration for professional services (including services as a director) derived by an individual who is a resident of one of the Contracting States may be taxed in the other Contracting State only if such services are rendered in the territory of that other State.

23. A professor or a teacher from one of the Contracting States who receives remuneration for teaching during a period of temporary residence not exceeding two years at a University, college, school or other educational institution in the other Contracting State should not be taxed in that other State in respect of such remuneration.

24. An individual from one of the Contracting States who is temporarily present in the other Contracting State solely as—

(a) a student at a University, college or school, or

(b) as a business apprentice, or

(c) as a recipient of a grant, scholarship or other allowance or award for the primary purpose of study or research, from religious, charitable, scientific or educational organisations—

should not be taxed in that other Contracting State in respect of remittances from abroad for the purposes of his maintenance, education or training, in respect of a scholarship and in respect of any amount representing remuneration from an employment which he exercises in that other territory for the purpose of practical training.

25. An individual from one of the Contracting States who is present in the other Contracting State solely as a student at a University, college or school in that other State, or as a business apprentice, should not be taxed in that other State for a period not exceeding three consecutive years in respect of remuneration from employment in such other State if the remuneration (a) constitutes earnings necessary for his maintenance and education and (b) does not exceed a certain sum to be settled by agreement between the Contracting States.

26. Royalties and profits earned as a consideration for the use of, or the right to use any copyright, patents, trade-marks, trade-names, designs etc. will be taxable in the State in which such property is used.

PART IV

MISCELLANEOUS

27. As a means of giving relief against double taxation of the same income the Contracting States may as far as possible adopt the method of exemption in preference to the tax credit method. Alternately, they may use a combination of both the methods.

28. If the tax credit method is used in preference to the exemption method, the agreements should provide that special tax concessions which are given by way of incentive measures designed to promote economic development, such as, tax holidays or development rebates, should not be taken into consideration in granting relief against double taxation and full credit should be given for the tax which would normally have been payable, but for such concessions.

29. The Contracting States should exchange such information as is necessary for carrying out the provisions of the agreements. The information so exchanged should be treated as secret and should not be disclosed to any persons other than hose concerned with the assessment and collection of taxes which are the subject of the agreement. No information should be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

30. If the action of the taxing authorities of one of the Contracting States results in double taxation contrary to the provisions of the agreement, any tax-payer may make representations to the competent authority of the Contracting State of which the tax-payer is a resident and that authority should be given the right to present his case to the appropriate authorities of the taxing State. Every effort should be made to come to an agreement with a view to avoiding double taxation and ensuring fair implementation of the agreement between the two States.

(i) *In regard to paragraph 19* :

The Delegation of Japan stated that the principal taxing authority should be vested in the country of residence of the recipient of income and, therefore, the tax to be charged in the country where the investment is made should be restricted to certain limits.

(ii) *In regard to paragraph 20* :

The Delegation of Japan stated that capital gains in regard to movable property other than those pertaining to a permanent establishment or to a fixed base may be taxed in the country of residence of the alienator.

(iii) *In regard to paragraph 28* :

The Delegation of U.A.R. pointed out that the U.A.R. tax laws grant certain exemptions on tax on profits of an industrial or commercial establishment in Free Zones and also on wages and salaries paid by such establishments in Free Zones to foreigners in their employment. The U.A.R. Delegation is of the view that such concessions also should not be taken into account in granting relief against double taxation.

ANNEXURES

I. RELEVANT CLAUSES OF SELECTED AGREEMENTS FOR THE AVOIDANCE OF DOUBLE TAXATION AND FISCAL EVASION CONCLUDED BY MEMBER COUNTRIES OF THE COMMITTEE

INDIA AND PAKISTAN

Agreement for the avoidance of double taxation of income between the Government of the Dominion of India and the Government of the Dominion of Pakistan. (Extracts)

ARTICLE IV

Each Dominion shall make assessment in the ordinary way under its own laws; and, where either Dominion under the operation of its laws charges any income from the sources or categories of transactions specified in column 1 of the Schedule to this Agreement (hereinafter referred to as the Schedule) in excess of the amount calculated according to the percentage specified in columns 2 and 3 thereof, that Dominion shall allow abatement equal to the lower amount of tax payable on such excess in their Dominion as provided for in Article VI.

ARTICLE V

Where any income accruing or arising without the territories of the Dominions is chargeable to tax in both the Dominions, each Dominion shall allow an abatement equal to one-half of the lower amount of tax payable in either Dominion on such doubly taxed income.

ARTICLE VI

(a) For the purposes of the abatement to be allowed under Articles IV or V, the tax payable in each Dominion on the excess or the doubly taxed income, as the case may be, shall be in such proportion of the tax payable in each Dominion as the excess or the doubly taxed income bears to the total income of the assessee in each Dominion.

(b) Where at the time of assessment in one Dominion, the tax payable on the total income in the other Dominion is not known, the first Dominion shall make a demand without allowing the abatement but shall hold in abeyance for a period of one year (or such longer period as may be allowed by the Income-tax Officer in his discretion) the collection of a portion of the demand equal to the estimated abatement. If the assessee produces a certificate of assessment in the other Dominion within the period of one year or any longer period allowed by the Income-tax Officer, the uncollected portion of the demand will be adjusted against the abatement allowable under this Agreement; if no such certificate is produced, the abatement shall cease to be operative and the outstanding demand shall be collected forthwith.

ARTICLE VII

(a) Nothing in this Agreement shall be construed as modifying or interpreting in any manner the provisions of relevant taxation laws in force in either Dominion.

(b) If any question arises as to whether any income falls within any one of the items specified in the Schedule, and if so, under which item the question shall be decided without any reference to the treatment of such income in the assessment made by the other Dominion.

THE SCHEDULE

(See Article IV)

Source of income or nature of transaction from which income is derived.	Percentage of income which each Dominion is entitled to charge, under the Agreement		Remarks
1	2	3	4
1. (a) Salaries paid by employers other than Government.	100 per cent by the Dominion in which the salary is earned by service.	Nil by the other.	
(b) Salaries paid by Government	100 per cent by the Dominion which pays the salary.	Nil by the other.	
2. (a) Interest on Government Securities.	100 per cent by the Dominion where the Securities are enfaced for payment of interest and principal.	Nil by the other.	

1	2	3	4
(b) Interest on Securities other than Government Securities.	100 per cent by the Dominion on which the investment is used.	Nil by the other.	
3. Income from Property	100 per cent by the Dominion in which the property is situated.	Nil by the other.	
4. Income from profession or a vocation	100 per cent by the Dominion in which professional service is rendered.	Nil by the other.	
5. Income from "Business" or "Other Sources".			
(a) Rent or royalty from lease renting or hire of property.			
(b) Rent or royalty or Licence Fees or any like consideration from rights conceded in respect of property.	100 per cent by the Dominion in which the property is situated.	Nil by the other.	
(c) Rent or royalty or any like consideration from any intrerest in property.			
(d) Profits or gains from dealings in property growing out of the ownership or use of or interest in such property.	100 per cent by the Dominion in which the property is situated.	Nil by the other.	
(e) Rent or royalty for the use of or for the privileges of using patents, copyrights, goodwill, trade marks and other like property.	100 per cent by the Dominion in which the assest is situated.	Nil by the other	

1	2	3	4
(f) Income derived from any money lent at interest and brought into a Dominion in Cash or in kind.	100 per cent by the Dominion into which the money is brought.	Nil by the other.	
(g) Transport Ship, Air, Road.	100 per cent by the Dominion in which the traffic originates.	Nil by the other.	
6. Capital gains: (a) From sale, exchange or transfer of an immovable capital asset and any rights pertaining thereto.	100 per cent by the Dominion in which the capital asset is situated.	Nil by the other.	
(b) From the sale, exchange or transfer of other assets.	100 per cent by the Dominion in which the sale, exchange or transfer take place.	Nil by the other.	

1	2	3	4
7. (a) Goods purchased in one Dominion and sold in the other in the same condition without any manufacturing process so as to change the identity of the goods.	10 per cent of the profits by the Dominion in which goods are purchased provided there is a branch or regular purchasing agency in the Dominion.	90 percent by the other.	If there is no regular purchasing agency, 100 per cent shall be chargeable by the Dominion in which goods are sold and Nil by the other.
(b) Goods, merchandise or commodities manufactured in one Dominion and delivered by the manufacturer to a buyer in the same Dominion.	100% by the Dominion in which the goods are manufactured.	Nil by the other.	
(c) Goods, merchandise or commodities manufactured in one Dominion and sold by the manufacturer in the other without any further	75% by the Dominion in which goods are manufactured.	25% by the Dominion in which goods are sold.	

1	2	3	4
process and without having a selling establishment or regular agency in the latter Dominion.			
(d) Goods merchandise or commodities manufactured in one Dominion and sold by the manufacturer in the other through a selling establishment or a regular agency.	50% by the Dominion in which goods are manufactured.	50% by the Dominion in which goods are sold.	
(e) Goods, merchandise or commodities manufactured by the assesses partly in one Dominion and partly in the other.	50% of the profits by each Dominion.	50% of the profits by each Dominion.	

(f) Metal ores, minerals, mineral oils and forest produce extracted in one Dominion and delivered by the extractor to a buyer in the same Dominion.	100% by the Dominion in which the minerals are extracted.	Nil by the other.	
(g) Metal ores, minerals, mineral oils and forest products extracted in one Dominion and sold in the other without any further manufacturing process and without selling establishment or a regular agency.	75% of the profits by the Dominion in which minerals are extracted.	25% by the Dominion in which goods are sold.	
(h) As above but sold in the other Dominion through a branch or	50% of the profits by the Dominion in which minerals are extracted.	50% of the profits by the Dominion in which goods are sold.	