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# ARTICLE 12- ROYALTIES



How to determine  
Taxability of Royalty ?

Understanding Meaning  
of Royalty?

Right of the Source  
State to tax Royalty ?

Right of the State of  
Residence to tax  
Royalties

Tax implications if  
Royalty is accrued, but  
not paid?

How does existence of  
Permanent  
Establishment ("PE")  
impact taxation of  
Royalty?

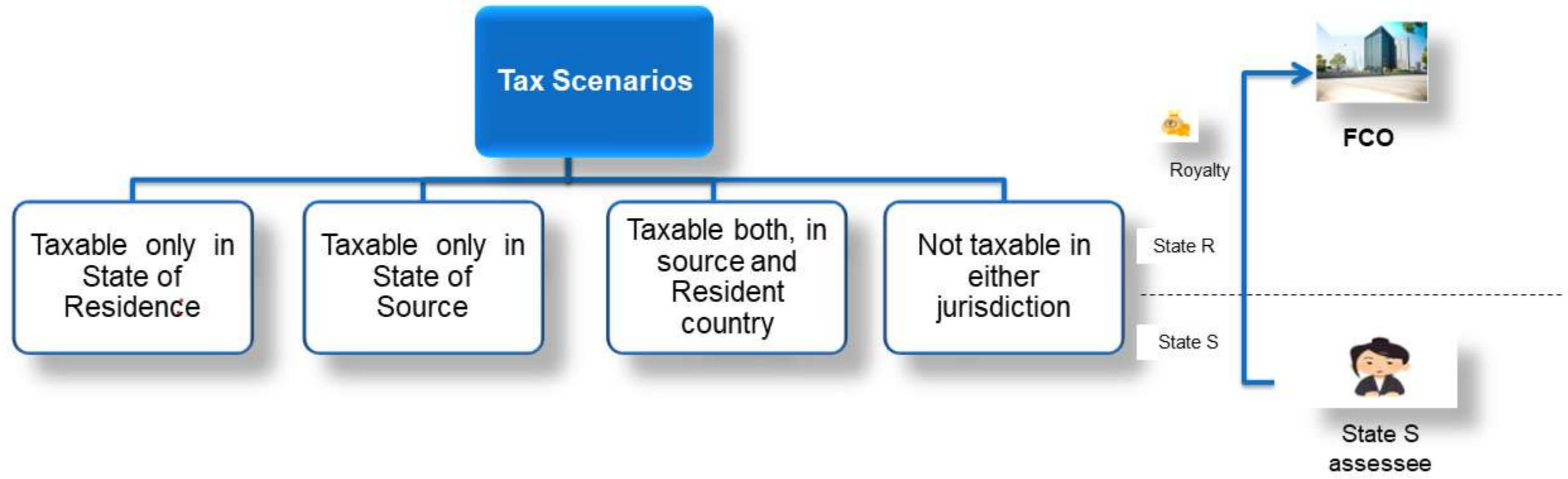
What if the Royalty paid  
is more than Arm's  
length ?



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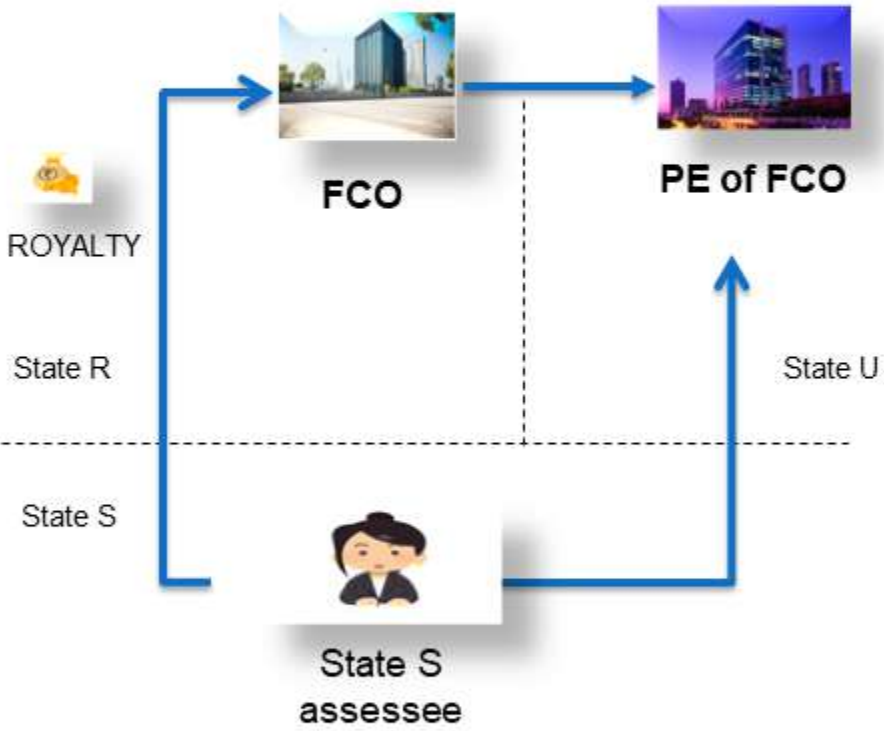


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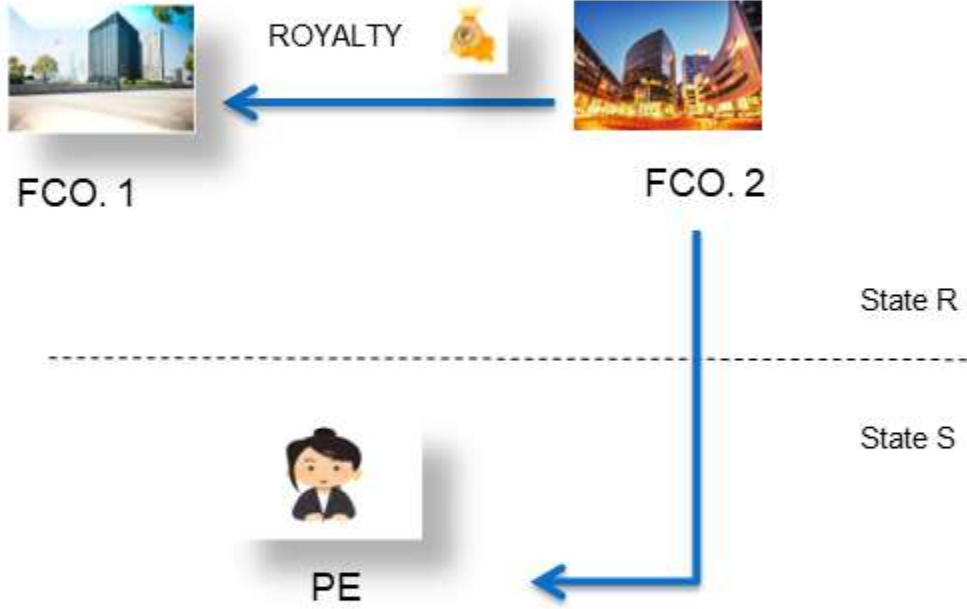
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# ROYALTY- SCENARIO OF TAXABILITY

A resident of State S pays Royalty to Resident of State R or PE of FCO in 3<sup>rd</sup> Country



NR with PE in State S , pays Royalty to another NR for State S business



Residential Status needs to be ascertained as per **Article 4** of the relevant Treaty

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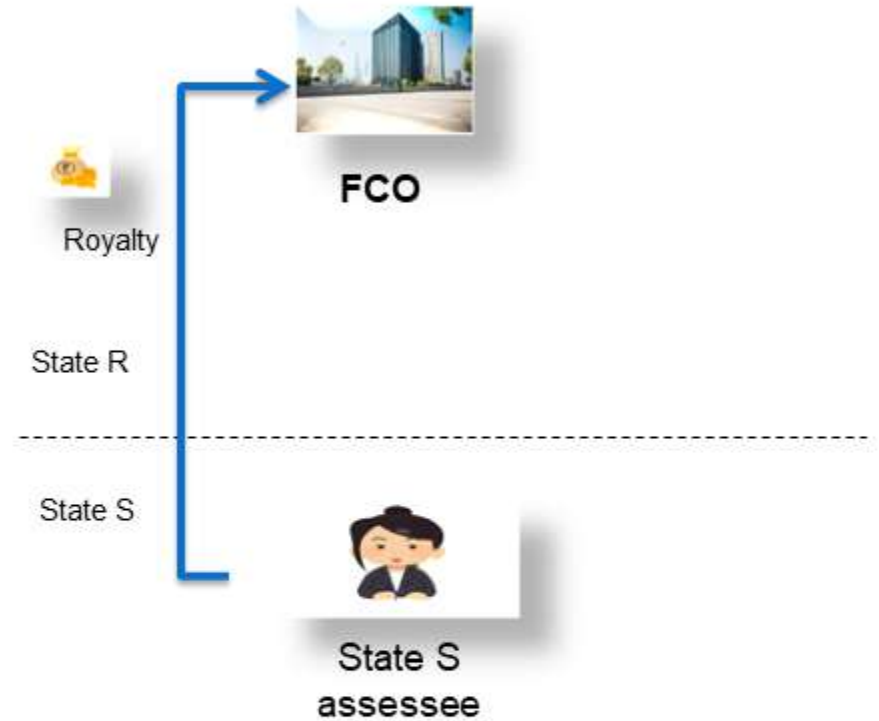
## ARTICLE 12 (1) – RIGHT OF THE STATE OF RESIDENCE TO TAX ROYALTY

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Royalties **arising in a** Contracting State  
and **beneficially owned** by  
a resident of the **other** Contracting State  
shall be taxable only in that **other** State



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APPLIES

Royalties should arise in a Contracting State

NOT APPLIES

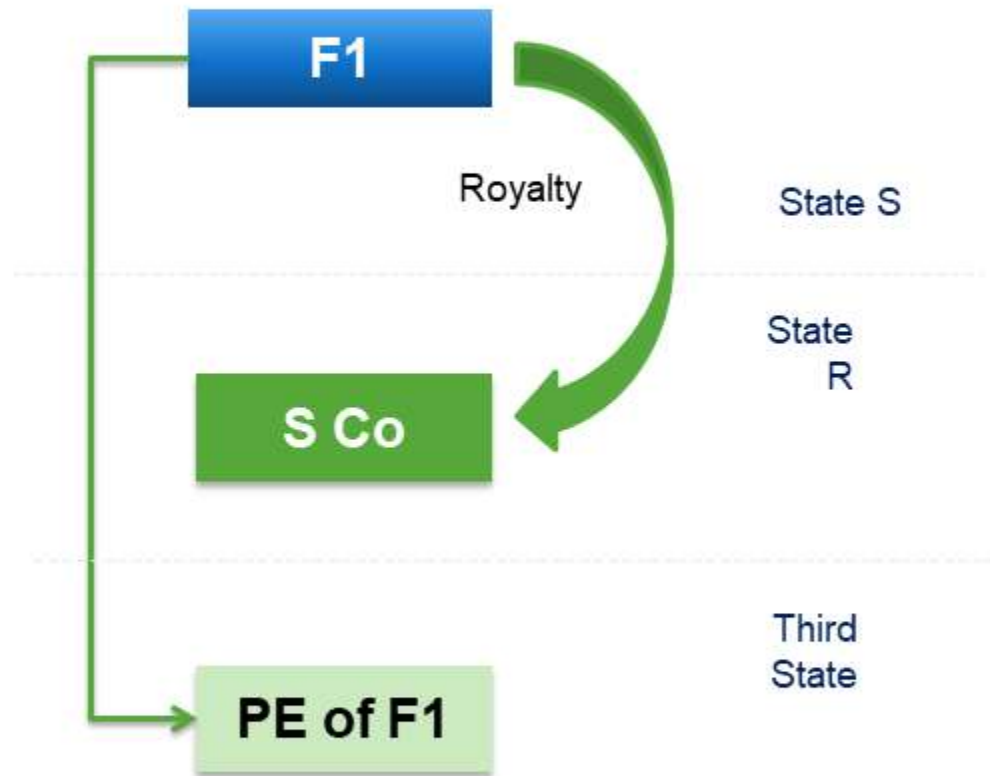
Royalties arising in a Third State

Royalties arising in a Contracting State which are attributable to a permanent establishment which an enterprise of that State has in the other Contracting State.

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- The term "beneficial owner" is not used in a **narrow technical sense**
- An agent , nominee or a conduit of beneficial owner shall not be entitled to Treaty benefits
- If **recipient is not taxed**, there is no Double Taxation and Source State should not give up its right to tax
- What if **beneficial owner is a resident of State R** ?



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- Deduction subject to taxability in State R ?
- Preferential tax treatment to FCO on taxation of royalty and FCO does not declare its profits in the form of dividend – BEPS example ?



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## ARTICLE 12 (2) – MEANING OF ROYALTIES

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The term "royalties" as used in this Article means  
payments of any kind  
received as a consideration for the use of, or the right to use, any  
copyright of literary, artistic or scientific work including cinematograph films,  
any patent, trade mark, design  
or model, plan, secret formula or process, or  
for information concerning industrial, commercial or scientific experience.

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## CONSIDERATION RECEIVED FOR USE / RIGHT TO USE OF

### Copyright of :

- Literary Work
- Artistic Work
- Scientific Work

- Cinematograph films,
- Patent,
- Trademark,
- Design

- Model,
- Plan
- Secret formula
- Process

### Information concerning:

- Industrial,
- Commercial
- Scientific experience.

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The rights may or may not be required to be registered in a public register

NA on payment to person who does not own right / right to use property

Payment for "transfer of all rights" not covered under Article 12

Software Payments – Limited period / Geography rights – Specific Facts and National law

Consideration for exclusive right to use information ?

Payment for use or right to use industrial/ scientific or commercial equipment - DELETED

Transponder Lease Agreement

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## PAYMENTS

Use of Radio Frequency Spectrum

Telecom Network Operator to another Operator - Roaming Agreement

Rent for cinematography films

Exclusive distribution right in a territory

Payment for development of a design , Model or plan

For use of know-how, the grantor does not need to play part

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## ARTICLE 12 (3) – ROYALTIES AND PERMANENT ESTABLISHMENT

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The provisions of Paragraph 1

shall not apply

if the beneficial owner of the royalties, being a resident of a Contracting State,

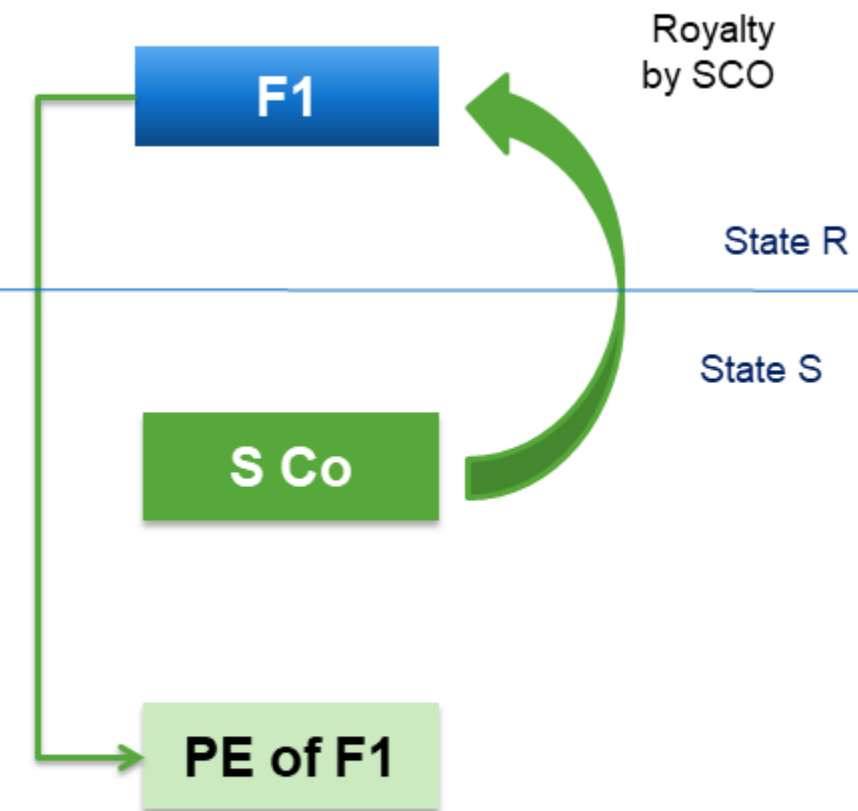
carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein

and

the right or property in respect of which the royalties are paid is

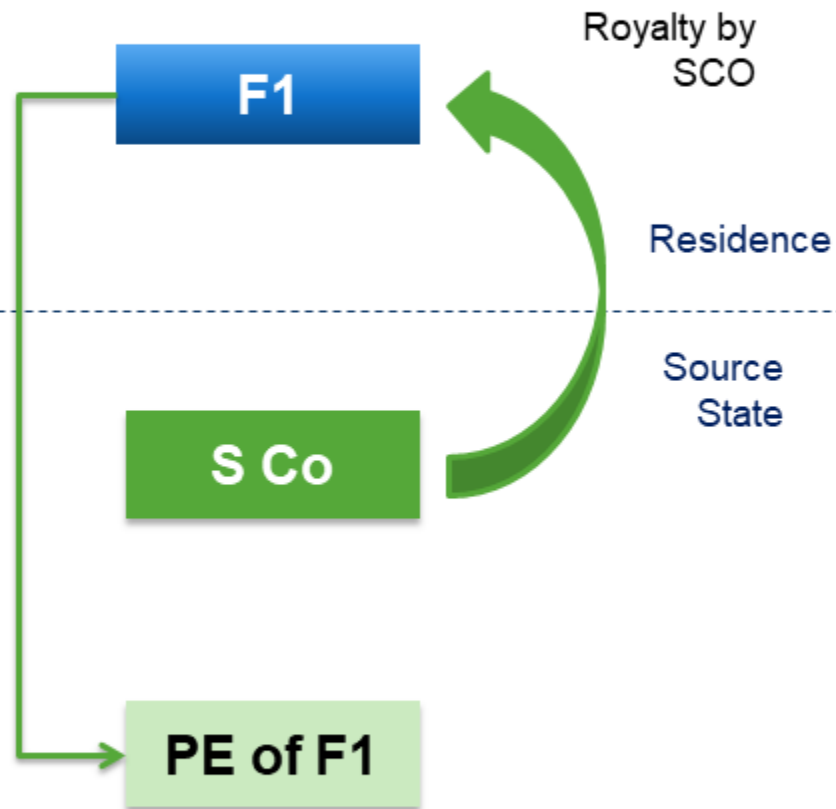
effectively connected with such permanent establishment.

In such case the provisions of Article 7 shall apply.



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## Fact :-

- Royalty paid by S Co to F1, which is effectively connected to PE of F1 in India :-
  - PE has exclusive right to patent shown as an Asset in PE books
- Royalty taxable as Business Profits after deduction of all expenses

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## KEY QUESTIONS

Whether a PE exists , through which business is carried on ?

Are royalties effectively connected ([attributable](#)) to the PE/ Fixed Base ?

Whether the condition of beneficial ownership of royalty is satisfied ?

Resident of Foreign country – Article 4

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## CRITERION

Whether the Asset for which the royalty is paid is of the PE or Head office ?

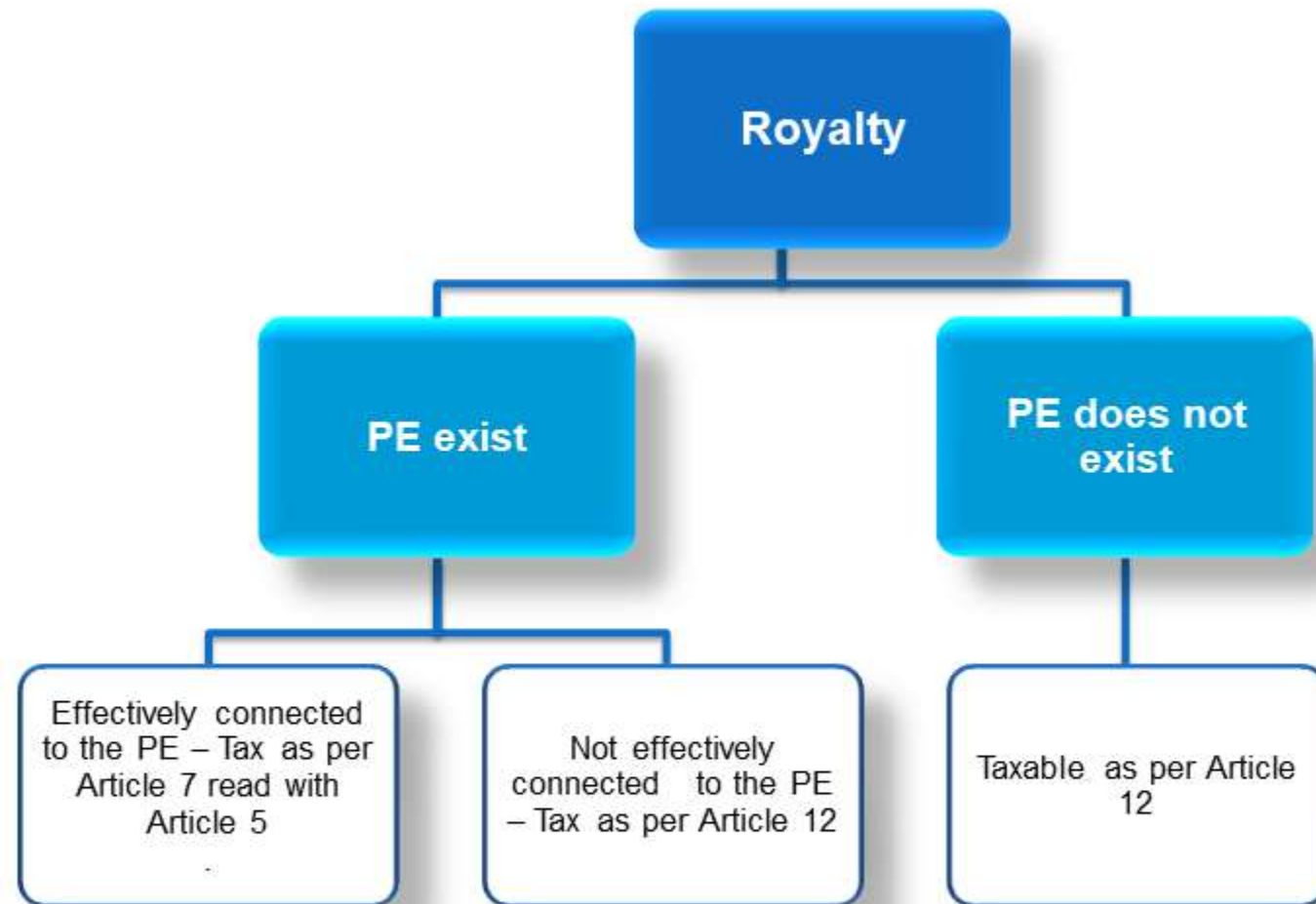
What is the business of the PE and do the royalty arise from such business ?

Is continuance of business required by PE for effective connection ?

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## ARTICLE 12 (4) – SPECIAL RELATIONSHIP

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Where, by reason of a **special relationship**  
**between** the payer and the beneficial owner or

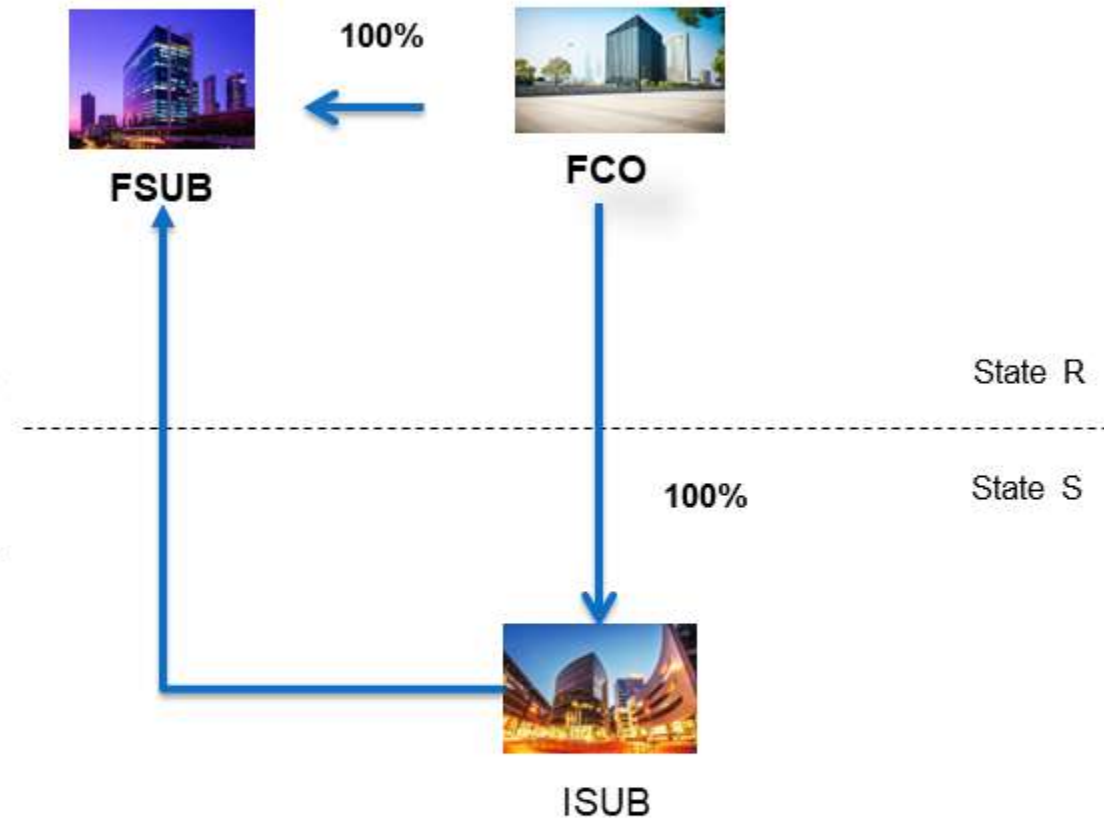
**between both** of them and some **other person**,

the amount of the royalties, having regard to the use, right or information for which they are paid,

**exceeds** the amount which would have been **agreed** upon by the payer and the beneficial owner in the **absence** of such relationship,

the provisions of this Article **shall apply only to the last-mentioned amount.**

In such case, the **excess** part of the payments shall remain **taxable** according to **the laws of each Contracting State**, due regard being had to the other provisions of this Convention.



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- With over 20 years of experience, Arinjay has helped Clients on International Tax , M&A Tax and Direct tax matters impacting their business in India and UAE . He has worked on International tax with over 750 transaction of Inbound Investment, Outbound Investments, Due diligence, Family Structuring and Succession planning across sectors ;
- Arinjay has worked with over 500 UAE companies on UAE Economic Substance Regulations advisory services, and UAE Corporate Tax (proposed to be introduced from June 1, 2023) ;
- Delivered Live Seminar and Webinar on Economic Substance Regulations and UAE Corporate Tax
- Author of various books in International Tax and Direct Tax ;
- Trained more than 2000 CA's in Live international tax course (With two of the largest global tax firms) and over 5000 students in International Tax
- Created India's first e learning course on International tax for professionals in 2016 with students from over 30 countries.
- Editor International Tax at Taxmann Publications, New Delhi - Handled the Journal on International Tax with Taxmann Publications, India's oldest Publishing house on tax and corporate law publications.
- Faculty at the International tax Course of ICAI during the year 2009 & 10



**CA Arinjay Jain**

**Faculty**

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## DTAA Double taxation avoidance agreement

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