VIENNA CONVENTION ON LAW OF TREATIES

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AGENDA

- What is VCLT
- Relevance of VCLT in interpreting treaties
- Judicial rulings
- VCLT & MLI

INTERPRETATION OF TAX TREATIES

DTAAs - Introduction

- DTAAs are international agreements and part of public international law
- The interpretation of the treaty would be in accordance with the principles used for interpreting international law.
- The treaty has to be interpreted according to its plain meaning.
- Source of International law – Article 38 Statute of ICJ
- The Court, whose function is to decide in accordance with international law … shall apply:
- International Conventions
- International customs
- General principles of law recognized by civilized nations;
- Judicial decisions and teachings …as subsidiary means for the determination of rules of law.

Vienna Convention on Law of Treaties

- The Vienna Convention on the Law of Treaties came into effect from 27-1-1980
- It codifies the customary principles of international law.
- VCLT embodies principles of interpretation of tax treaties
- India has not signed VCLT, however, since it is an important interpretative tool, Courts in India have been referring to the principles enshrined under VCLT
- IFA 1993 Report
- *"It is widely accepted that Article 31-33 of VCLT codifies already valid customary law and hence all international treaties would – as they are already based on this customary law be governed by the rules of interpretation of VCLT in an unrestricted manner."*

While India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also"

Ram Jethmalani Vs Union of India [(2011) TII 5 INTL]

Part III – Observance, Application And Interpretation Of Treaties

- **Article 26 of VCLT – Pacta sunt servanda**
- Every treaty in force is binding upon the parties to it and must be performed by them in good faith.
- **Article 27 of VCLT – Internal law and observance of treaties**
- A party may not invoke the provisions of internal law as justification for its failure to perform a treaty.

When a domestic tax jurisdiction is allowed to amend settled position with respect to a treaty provision by amendment in domestic law to nullify domestic judicial rulings, it cannot be treated as performance of treaties in goods faith, i.e., in effect, it amounts to a unilateral treaty override which is contrary to scheme of Article 26 of Vienna Convention on Law of Treaties. Such an interpretation is to be discarded because such approach would patronise and legitimise a unilateral treaty override and will be incompatible with fundamental principles of treaty interpretation under Vienna Convention
ACIT v. Reliance Jio Infocomm Ltd. [2019] 111 taxmann.com 371 (Mumbai - Trib.)

Judicial Rulings

- India and Cyprus entered into an agreement to avoid double taxation of income and prevention of fiscal evasion since December 1994
- Section 94A(1) was enacted by India as there was no information flow from Cyprus
- Revenue in this case made an argument that the Union of India cannot invoke the provisions of the Internal Law namely Section 94A as a justification to annul a bilateral Treaty.

- **T. Rajkumar v. UOI [2016] 68 taxmann.com 182 (Madras)**

- One of the four purposes for which, an agreement could be entered into by the Central Government under section 90(1), is for the exchange of information.
- If one of the parties to the treaty fails to provide necessary information, then such a party is in breach of the obligation under article 26 of the Vienna Convention.
- The beneficiary of such a breach of obligation by one of the contracting parties cannot invoke the Vienna Convention to prevent the other contracting party (India in this case) from taking recourse to internal law, to address the issue.

Application of treaties

- **Article 28: Non-retroactivity of treaties**
- Unless a different intention appears from the treaty or is otherwise established, *treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty* with respect to that party.
- In DCIT v. ITC Ltd. (2002) 82 ITD 239 (Kol.)(Trib.) it was held that notification of Central Government amending the treaty cannot affect the right of taxpayers with retrospective effect.
- Similarly, in Tata Iron Steel & Co. Ltd. v. DCIT (1998) 69 ITD 292 (Mum.) (Trib.), it was held that Protocol notified in year 1985-86 for amending the Indo-German tax treaty of 1959 will not affect the contract entered prior to assessment year 1985-86 even if it provides for retrospective application.
- **Principal Purpose test under the MLI?**

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- **Principal Purpose test under the MLI?**
- **Article 29- Territorial Scope of Treaties:**
- Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- A treaty shall be interpreted in **good faith in accordance with the ordinary meaning** to be given to the terms thereof in the **context and in the light of its object and purpose**.
- Textual approach to treaty interpretation & the starting point
- The ordinary meaning of the terms has to be in accordance with the object and purpose
- This is a basic principle. It states that treaties should be interpreted by first giving the ordinary meaning to the language.
- It is only if the ordinary meaning is ambiguous or leads to illogical results, that the purpose may be considered.

Mumbai Tribunal in Hindalco Industries Ltd. v. Asstt. CIT [2005] 94 ITD 242 (Mum.) had held that
"A tax treaty is to required to be interpreted as a whole, which essentially implies that the provisions of the treaty are required to be construed in harmony with each other", that "the words employed in the tax treaties …… need not be examined in precise grammatical sense or in literal sense" and "even departure from plain meaning of the language is permissible whenever context so requires, to avoid the absurdities and to interpret the treaty ut res magis valeat quam pereat. i.e., in such a manner as to make it workable rather than redundant"."

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Delhi ITAT has held that treaties should not be interpreted as a statute but instead be interpreted as agreements. Hence, ordinary meanings given to words in a treaty, within their context, and object and purpose of treaty, should be used for interpretation, as held in New Skies Satellites N.V. v. ADIT [2009] 121 ITD 1 (ITAT Delhi).

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Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Object & purpose
- The primary purpose of a tax treaty to avoid
- international juridical double taxation, in order to facilitate the international exchange of goods, services, capital, technology and persons.
- Prevention of fiscal evasion through the exchange of information
- Assistance in collection of taxes
- To avoid double non-taxation through tax avoidance or treaty shopping arrangements

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Object & purpose - Section 90 of the Income-tax Act
- The Central Government may enter into an agreement with the Government of any country outside India-

(a) for the granting of relief in respect of income on which have been paid both income-tax under this Act and income-tax in that country, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Article 31(2) - The context for the purpose of interpretation of a treaty shall comprise, in **addition to the text, including its preamble and annexure**
- Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
- Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Importance of preamble in interpreting the tax treaties –
- In Kesavanada Bharati v. State of Kerala held that:

A. Preamble to the Constitution of India is a part of Constitution

B. Preamble is not a source of power nor a source of limitation

C. Preamble has a significant role to play in the interpretation of statues, also in the interpretation of provisions of the Constitution.

- SC in the case of Azadi Bachao Andolan, wherein a circular issued by the Central Board of Direct Taxes, India to accept certificates of residence issued by the Mauritian Authorities as final proof of residence of taxpayer without any question was challenged. The moot question was whether India-Mauritius tax treaty was misused by virtue of a mere certificate of residence issued by the Mauritian tax authorities. For which the SC answered in negative and thereby holding that treaty shopping is valid.
- The SC has considered the preamble of the India-Mauritius DTAA has one of the factors for its judgement. The relevant text is reproduced below:

"Based on these observations, counsel for the appellants contended that the preamble of the Indo-Mauritius DTAC recites that it is for the "encouragement of mutual trade and investment" and this aspect of the matter cannot be lost sight of while interpreting the treaty"

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- Importance of preamble in interpreting the tax treaties –
- Preamble after MLI
- " Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- **Importance of protocol in interpreting the tax treaties**
- Delhi HC in Steria (India) Ltd. [2016] 72 taxmann.com 1 (Delhi) held that where the Government had not notified the protocol to India-France DTAA, the protocol to the DTAA forms an integral part of the tax treaty and there is no need for the Protocol itself to be separately notified
  - Similar conclusion was also arrived in Apollo Tyres Ltd. [2018] 92 taxmann.com 166 (Karnataka)

Interpretation Of Treaties

- **Article 31 – General Rule of Interpretation**
- **Article 31(2) – Supplementary means of interpretation**
- The following shall be taken into account, together with the context in that:
- Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
- Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- Any relevant rules of international law applicable to relation between the parties.
- Article 31(4) - A special meaning shall be given to a term if it is established that the parties so intended.

Interpretation Of Treaties

- **Article 32 - Supplementary means of interpretation**
- Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.

- Material falling under Article 32 VCLT is only accorded a secondary role in the interpretation of treaties.
- It is to be resorted when the meaning of the terms is ambiguous
- Therefore limited role of material under Article 32

Interpretation Of Treaties

- **Reference to OECD Commentary**
- If it can be established, by reference to the text of the treaty, that a treaty is, in principle, based on the OECD Model, an interpretation in good faith requires that the OECD Model Convention and the OECD Commentary are consulted in the interpretation process.
- If the contracting states chose to follow the wording of the OECD Model in drafting a certain provision, it is only reasonable to assume that they intended such a provision to have the meaning it has in the OECD Model, as outlined in the version of the OECD Commentary that existed at the time when the treaty was negotiated.
- **Whether OECD Commentary is subsequent agreement or practice**
- Tax administrations of both contracting states consistently apply an interpretation introduced through a Commentary, therefore, it may become relevant through "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" under Article 31 (3) (b) VCLT.
- MOU in India-US DTAA
- Decrees or notification
  - Concentrix Services Netherlands B.V. [2021] 127 taxmann.com 43 (Delhi)
- **Whether OECD Commentary is supplementary means of interpretation**
- OECD Model and Commentary could qualify as "supplementary means of interpretation" under Article 32 VCLT if that is used for treaty negotiation.
- High Court of Australia in Thiel, which held that "the Model Convention and Commentaries […] are documents which form the basis for the conclusion of bilateral double taxation agreements of the kind in question and […] provide a guide to the current usage of terms by the parties. They are, therefore, a supplementary means of interpretation to which recourse may be had under Article 32 of the Vienna Convention" Thiel v Federal Commissioner of Taxation (1990) 171 CLR 338 at 350.

Interpretation Of Treaties

- **Article 33 - Interpretation of Treaties authenticated in two or more languages:**
- When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.
- A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
- The terms of the treaty are presumed to have the same meaning in each authentic text.
- Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

- In India, the treaties are notified in English and Hindi and it provides that "all texts are authentic. In case of divergence of text, English text shall be operative one."

VCLT & MLI

- Unlike protocol, MLI has to be read along with tax treaties
- VCLT since it embodies customary international law, can be used to interpret MLI
- Tax treaty vs MLI
  - Lex Posterior - If provisions of MLI are in conflict with tax treaty, MLI will prevail over treaty, to the extent of conflict.
  - Lex Specialis - For MLI, in case of a conflict between MLI and tax treaty, the rule is "specific" prevails.
- Ordinary meaning in light of object and purpose for MLI?
- **Supplementary means for interpreting MLI**
  - Explanatory statement to MLI - Reflects an understanding of negotiators as to how each provision in intended to affect and modify the articles covered by the convention
  - BEPS Action Plan reports
  - Country positions

Thanks !

THANKS !

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