# PRINCIPLES OF INTERPRETATION OF FISCAL LAWS

# CONTENTS

- Overview of various rules of Interpretation.
- Pondering on the debates on methods of interpretation by jurists.
- Indian Interpretation of Tax Treaties.
- Significance of VCLT to interpret the inconsistencies in Tax Treaties.
- Analyzing how the courts have used VCLT to solve the ambiguities.
- Relevance of OECD/UN Commentary in interpreting treaties

# TOWER OF BABEL

- Hebrew Narrative in Genesis 11:1–9 is an origin myth meant to explain **why the world's peoples speak different languages.**
- According to the story, a united human race speaking a single language and migrating eastward, comes to the land of Shinar (שִׁנְעָר).
- There they agree to build a city and a tower with its top in the sky.
- And the LORD said, "Look, they are one people, and they have all one language, and this is only the beginning of what they will do; nothing that they propose to do will now be impossible for them. Come, let us go down and confuse their language there, so that they will not understand one another's speech."
- So the LORD scattered them abroad from there over the face of all the earth, and they left off building the city.

# GENERAL RULES OF STATUTORY INTERPRETATION

## FOR PARENT & SUBORDINATE LEGISLATIONS:

- Intention of the Legislature- unclear:
- Primary Rule/Literal construction/Golden Rule
- Strict Interpretation
- Purposive Interpretation
- Liberal Interpretation
- Mischief rule/Heydon's Rule- adopt that construction which "shall suppress the mischief and advance the remedy"
- Rule of Ejusdem generis (of the same species/kind)- specific words are all of one genus, in which case, the general words may be presumed to be restricted to that genus.
- Rule of reasonable construction (*Ut Res Magis Valeat Quam Pareat*)
- Rule of harmonious construction
- Noscitur a Sociis (i.e. it is known by its associates): meaning of a word should be known from its accompanying or associating words
- Expressio Unis Est Exclusio Alterius- express mention of one thing implies the exclusion of another.
- *Contemporanea Expositio Est Optima Et Fortissima in Lege*: the best way to give the meaning to a document or proposition of a law is to read it as it would have read when it was made.

# NEED & IMPORTANCE OF INTERPRETATION

- As the social, economic and political conditions of the society keeps on changing, interpretations of the laws also require change.
- legislature cannot anticipate/foresee every situation which might occur in future.
- Courts play the role to interpret the laws to adapt as per needs of the society.

# INTERPRETATION OF TAXING STATUES

# TAXING STATUTES-STAGES

1. Subjects on which tax is levied/imposed → Charging Provisions

- Charging provisions provide the extent and coverage of the subjects as to whom the tax is applicable.
- Must be clearly provided in the statute
- Interpreted strictly

2. Assessment of liability of the assessee
3. Recovery once the assessment is made

→ Machinery Provisions

- Machinery provisions provides for technicalities and procedure to be followed under the act to make it functional.
- Interpreted fairly and liberally to promote the intention of the legislature. In case of contradiction whereby two meaning are coming out then one which is reasonable, which will assist in fulfilling the intention of the legislature and solving the purpose for which law was enacted is preferred. They are to be interpreted in such a way so as to enforce and apply charging provisions smoothly.

# RULE OF STRICT INTERPRETATION

- Rationale for Strict Interpretation of tax laws- Statutes imposing taxes or monetary burdens are to be strictly construed.

"*In a taxing statute, one has to look at what is clearly said. There is no equity about a tax. There is no intention. There is no presumption as to tax. Nothing is to be read in, nothing to be implied*."

- Interpretation of words in statutes in its letter and spirit
- <u>direct meaning</u> given to words in the statute.
- Court cannot under the guise of possible or likely intention of the legislature, give meaning to the words which are not clear and where contextual meaning cannot be made out.
- In case of two possible interpretations of a provision - interpretation <u>favourable</u> to the taxpayer/assessee applies.

*"Until and unless, clear words are used in the statute which imposes the liability on the taxpayer, there can be no burden to pay tax."*

- a.k.a Rule of Original intent: ascertain the intent of the framers while drafting the document by considering what the language meant when used at that time.

# CONTD...

1. Charging Section

- The section that charges the tax must have clear words.  Before taxing any individual it must be clearly established that the person to be taxed falls within the purview of the charging section by clear words. There is no implication of the law. If a person cannot be brought within the four corners of the law, the person is free from tax liability.
- Calcutta Jute Manufacturing Co. v Commercial Tax officer **(SC):**

*"in case of interpreting a taxing statute, one has to look into what is clearly stated. There is no room for searching the intentions, presumptions or equity."*

- Mathuram Agarwal v State of Madhya Pradesh **(SC):**

"*words cannot be added or substituted to find a meaning in a statute so as to serve the intention of the legislature. Every taxing statute must contain three aspects; subject of tax, person to be taxed and the rate of tax."*

# CONTD….

**2. Strict and Favourable Construction**
Taxing enactment should be strictly construed and the right to tax should be clearly established. Equitable construction should not be taken into account.

<u>Saraswati Sugar mills v Haryana State Board (SC):</u>

"*every Act of the parliament must be read according to the strict natural construction of its words.*"

**3. Clear Intention to Impose or Increase Tax**

The intention to impose or increase tax or duty must be clear and in unambiguous language.

# CONTD…

**4. Prospective operation**

The cardinal principle of tax laws is that the law to be applied to assessee is the law in force in the assessment year unless otherwise provided expressly or by necessary implication.

No retrospective effect to fiscal statute is possible unless the language of the statute is very clear and plain.

Reliance Jute Industries Ltd v Commercial Tax officer: Fiscal Statute are generally not retrospective otherwise expressly provided or by necessary implications.

**5. Meaning in common parlance**

In finding out the meaning of a taxing statute, the meaning in common usage/parlance especially in commercial and trade circles must be considered.

Annapurna Biscuit Manufacturing Co. v Commissioner of Sales tax (SC): *S*tatute imposing a tax should be construed as they are understood in ordinary language in the area in which the law is applicable.

# CONTD…

**6. Imposition of Tax by authority of law**

The taxes and assessment can only be imposed by an authority established under a statute. The tax can be levied only by an Act of the parliament.

Atlas Cycles Industries Ltd v State of Haryana (SC): notification imposing a tax cannot be deemed to be extended to new areas in the municipality.

Legislature derives its power of imposing taxes from **Article 265 of the Constitution** which states that "No tax can be levied or collected unless it has the authority of law".

**7. No presumption as to tax**

As regards to imposition of tax, no presumption exists. It cannot be drawn by implication or analogical extensions.

***Mohammed Ali Khan v Commissioner of Wealth Tax:*** No tax can be imposed by inference, analogy or probing into the intention of the legislature

# CONTD…

**8. Fiscal statute to be read as a whole**

The entire provisions of a fiscal statute has to be read as a whole and not in piecemeal to find out the intent of the legislature.

Interpretation of exemption notifications:

- Grasim Industries Limited v State of Madhya Pradesh (SC) *:* any exemption notification in a fiscal statute must be read in its entirety and not in parts to find out the meaning.
- State of Jharkhand v. Ambay Cements

(a) Provision of exemption should be strictly construed. It is not open to Court to ignore the conditions prescribed in the exemption notification.

(b) Whenever the statute prescribed that a particular act is to be done in a particular manner and also lays down that failure to comply with the said requirement leads to severe consequences, such requirement is mandatory.

(c) It is the cardinal rule of the interpretation that where a statute provides that a particular thing should be done, it should be done in the manner prescribed and not in any other way.

# INTERPRETATION OF EXEMPTION NOTIFICATIONS

- liberal rule is applied.
- All the conditions under which exemptions are given must be clearly specified. Once the assessee has shown that all the conditions precedent required to claim exemptions are fulfilled then he is entitled to claim exemptions. Once the assessee falls within the category of exemptions, then such exemption should be allowed. It cannot be denied on the basis of assumed or likely intention of the authority making the law.
- The doctrine of Substantial Compliance is based on the principle of equity which is also applicable to taxation laws. According to this doctrine, if the conditions for claiming exemptions are met substantially or only a few minor procedural requirements are not fulfilled which does not hamper the purpose for which such law was made then in that case substantial compliance can also entitles one to claim exemptions.
- Applicability of such doctrine is based on case to case basis as its results are different depending on facts of each case, extent of compliance, whether partial compliance fulfils the essence, object and purpose of the law.

# INTERPRETATION-DEEMING FICTION

- It is well settled that a legal fiction is limited to the purpose for which it is created and should not be extended beyond its legitimate fields.
- Section 115 J of the IT Act which was operative for assessment years 88-89 to 90-91, where if the company's total income is less than 30 per cent of its book profit, 30 per cent of the book profits deemed to be the total income.

# STATE OF UTTAR PRADESH V. KORES INDIA LTD (AIR 1977 SC 132)

- Issue-inclusion of carbon paper in the definition of word “paper”.
- Supreme Court held that in common parlance word paper is one which is used for writing, packaging and printing whereas carbon paper is used entirely for different purpose. Moreover, manufacturing process of carbon paper is entirely different and complicated from that of normal paper. So, Court held carbon paper will not be included in normal paper so as to make it subject to taxation. It was held that meaning of paper is quiet clear and there is no need to interpret it so as to extend its meaning to include carbon paper. Thus, Courts are not required to extend the meaning to cover the subjects which on the face cannot be included in common parlance. It is only when specifically provided by statute then only it becomes subject to tax.

# TAX DISPUTES UNDER INDIA'S BIT / BIPA

# Brief History

- Tax Dispute with Vodafone on withholding tax on indirect transfer of Indian shares
- Supreme Court ruled in Vodafone's favour in 2012
- Post ruling, in 2012, government amended the law to clarify indirect transfers taxable
- The Income-Tax Act was amended in 2012 to retrospectively tax gains from indirect share transfers that derive substantial value from assets located in India
- Valuation Guidance and thresholds notified in 2015 (50% shareholding and value INR 100 Million)
- Carve-out for FPIs and 5% shareholding threshold applied to test indirect transfer tax provisions
- Validation law to override Vodafone ruling and all cases before the tax administration and judicial forums
- On this basis, the Revenue raised tax demands in 17 cases (involves MNEs such as Vodafone Group, Cairn Energy, Mitsui & Co., AT&T, WNS Genpact and Sanofi Aventis)
- Out of which, arbitration under BITs of UK and Netherlands were invoked in four cases

# India - Taxation of Offshore Indirect Transfer of Assets

1. Vodafone, Cairn and 15 other cases
2. Clarificatory retrospective amendment in 2012
3. Inclusion of thresholds Amendment in 2015
4. Currently, withholding tax regime applies to OIT in India
5. Example: India-Mauritius DTAA
6. Retrospective Amendment Withdrawn

# Vodafone and Cairn Disputes

BMR Legal
ADVOCATES

## VODAFONE CASE

2007
The Transaction

20th January 2012
Supreme Court Decision

1st April 2012
Retrospective Amendment (1962)

17th April 2014
Notice of Arbitration

25th September 2020
Arbitral Award

## CAIRN CASE

2006
The Transaction

1st April 2012
Retrospective Amendment (1962)

January 2014
Reassessment Proceedings

22nd December 2015
Notice of Arbitration

17th August 2017
High Court of Delhi

2016-2018
ITD sold shares for recovery of tax demand

21st December 2020
Arbitration Award

# JURISDICTION OF BIPA TRIBUNALS OVER TAX MATTERS

***Cairn v. India (PCA, 2020)***

"The issue at stake is not a matter of domestic tax law; it is rather whether the fiscal measures taken by the State, valid or not under its own tax laws, violate international law."

**Tax Dispute**

"In a tax dispute, the question is whether and how a particular transaction is taxable under the applicable (municipal) law or, possibly laws of several countries if the transaction is international."

**Tax-Related Investment Dispute**

"In tax-related investment disputes, the tribunal is tasked with determining whether the respondent State has breached substantive standards of treatment under the investment treaty through the exercise of its authority in the field of taxation, and whether liability arises as a result."

# INDIA'S OBJECTION TO TRIBUNAL'S JURISDICTION

***Cairn v. India (PCA, 2020)***

| Taxation measures are outside the scope of application of the BIT | Taxation disputes are not arbitrable as matter of international public policy. |
|---|---|
| **Tribunal response:**<br>▪ Interprets Article 9 (Settlement of Disputes between an Investor and Host State) of India-UK BIT in accordance with the VCLT provisions<br>- Ordinary meaning- no exclusive exclusion for tax-related investment disputes<br>- Object & purpose – guarantees of fairness of the taxation regime are in line with the objective of encouraging more foreign investment.<br>- Contextual – limited tax carve-out applicable only in the context of Article 4.<br>▪ No overlap between DTAAs and BITs - Different subject-matters. | **Tribunal's response:**<br>• Nothing under international public policy proposes that tax-related investment disputes are not arbitrable.<br>• Public policy rationale that tax disputes are exclusive jurisdiction of domestic courts does not apply to disputes related to violation of investment treaties by fiscal measures. |

# INTERPRETATION OF THE TAX CARVE-OUT UNDER INDIA-UK BIT

***Cairn v. India (PCA, 2020)***

Tax Carve-out under the India-UK BIT:

- Article 4 (National Treatment and Most Favoured Nation Treatment) – includes a limited tax carve-out that excludes application of the provisions on matters "mainly and wholly" relating to taxation.
- Article 3 (Promotion and Protection of Investment) - guaranteed fair and equitable treatment of investments.

- Government of India argued an "implied limitation" :

*"there are general limitations on the scope of the protection of investment treaties which are to be implied if not explicitly contained in the text of the Treaty".*

- Investors claimed that India-UK BIT consists of a limited tax carve-out under Article 4, making remaining provisions applicable in relation to fiscal measures.

- Tribunal agreed that it is a limited carve-out. That understanding of the carve-out as an "*implicit carve-out*" is unilateral since there is no evidence suggesting that UK agreed to this.

# Commonality – *Vodafone and Cairn*

The Arbitral Awards of 2020 by Permanent Court of Arbitration (PCA) related to -

i. Taxation of offshore indirect transfers
ii. Application of 2012 retroactive amendment
iii. Breach of India's Bilateral Investment Treaties

Operative part of both awards consistently reinforces 2 principles –

i. The Arbitral Tribunal has the "Jurisdiction" under BIT;
ii. The investors have been denied "fair & equitable" treatment under the respective BIT - FET clause includes the failure to offer a predictable legal framework by a country

Learnings -

i. Adherence to Rule of Law is indispensable
ii. Treaty obligations should be seen as a part of sovereign commitments by States in the spirit of investor protection

# Differences between the two rulings

**Vodafone**

a. **India-Netherlands BIT, 1995**

b. **Investor Claim: Breach of the guarantee of fair and equitable treatment**

c. **Impact on revenue outgo**

- Indian Government had given an undertaking not to enforce the tax demand on Vodafone until the close of arbitration and subject to the award
- $2 billion retrospective tax dispute
- Hence, no outgo from the Indian Treasury
- Only reimbursement of legal costs

**Cairn**

a. **India-UK BIT, 1994**

b. **Investor Claim: Breach of the guarantee of fair and equitable treatment & expropriation**

c. **Impact on revenue outgo**

- Indian Government had enforced the tax demand and attached Cairn's shares in Cairn India Limited as well as garnished its dividends
- Tribunal awarded 1.2 bn USD with interest and costs
- Likely to increase due to the appeal
- Punitive damages

# Withdrawal of Retrospective Taxation on Indirect Transfer Tax

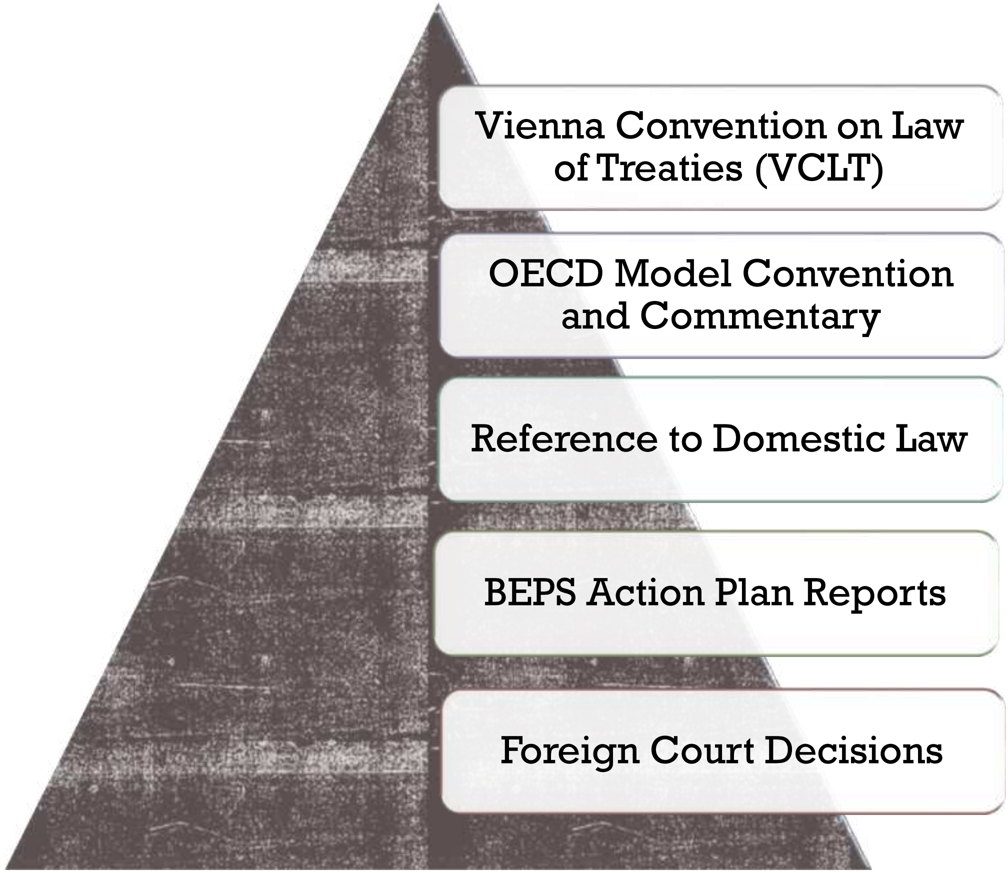
- The Taxation Laws (Amendment) Act, 2021 provides for withdrawals of tax demands made on transactions undertaken before May 28, 2012
- Taxes paid if any would be refunded without interest or any other incidental payments
- 14 cases settled, balance reportedly not reachable

## Conditions to be fulfilled

1. 1.Withdrawal of any appeals filed before the Indian judiciary
2. 1.Withdrawal of any proceedings or notices served for arbitration, conciliation or mediation under Indian laws or international agreements signed by India
3. 1.Submit undertaking waiving the right to seek any remedy

# INTERPRETATION OF TAX TREATIES

# AIDS TO INTERPRET TAX TREATIES



# VIENNA CONVENTION ON LAW OF TREATIES

Vienna Convention

**Article 31**: General rule of interpretation

**Article 32**: Supplementary means of interpretation

**Article 33**: Interpretation of treaties authenticated in two or more languages

# VIENNA CONVENTION ON LAW OF TREATIES (CONTD)....

**Article 31(1)**: General rule of Interpretation

- Treaty has to be interpreted in good faith
- Words to be given ordinary meaning
- In the context of the treaty and in the light of its object and purpose

**Context (Article 31 (2))**

- Preamble and annexes
- Any agreements in connection with conclusion of treaty.
- Any instrument in connection with the conclusion of the treaty and accepted by other parties.

**Article 31(3) provides three more elements**

- Any subsequent agreements regarding interpretation
- Any subsequent practice that established agreement of parties regarding interpretation
- Any relevant rules of international law

**Article 31(4)**

Special meaning shall be given if it is established that the parties so intended.

# VCLT (INDIA'S POSITION)

- While interpreting the word 'public court proceedings' in Art. 26 of India- Germany DTAA the SC observed*:

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

- Meanings of words in tax treaties, be the ordinary meaning in the context and in light of its object and purpose.**
- Treaties are not to be interpreted as statute, rather like an agreement***
- Literal/legalistic meaning to be avoided when the object is defeated; important to harmonize interpretation with the object and purpose****

# NEED FOR INTERPRETATION VIS-A-VIS VCLT

## CASE LAW- MODERN THREADS INDIA LTD. V. DY. CIT (1999) 63 TTJ (JP)(TM) 601

It is also necessary to bear in mind the principles governing the interpretation of tax treaties. These principles are somewhat liberal vis-a-vis the rigid principles of interpretation of statutes.

DTAAs are international agreements entered into between States. The conclusion and interpretation of such conventions is governed by public international law, and particularly, by the VCLT.

The rules of interpretation contained in the Vienna Convention,' being customary international law, also apply to the interpretation of tax treaties.

Article 31(1) of the Vienna Convention States that "A Treaty shall be interpreted in good faith in accordance with the ordinary meaning given to the terms of the Treaty in their context and in the light of its object and purpose".

We are in considered agreement with this school of thought which lays down the proposition that, strictly speaking the principles of literal interpretation do not apply to the interpretation of tax treaties which ought to be interpreted in good faith and ut res magis valeat quam pereat, i.e., to make it workable rather than redundant.

The school of thought emerging from the above discussions leads us to conclude that the principles governing interpretation of tax treaties can be broadly summed up as follows :

> A tax Treaty is an agreement and not taxing statute, even though it is an agreement about how taxes are to be imposed. The principles adopted in the interpretation of statutory legislation are not applicable in interpretation of treaties.

(Para 17)

# COMMENTARY ON ARTICLE 23 OF THE 1996 DRAFT CONVENTION

In *John N. Gladden* v. *Her Majesty the Queen* 85 D.T.C. 5188 the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed :

"Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated insofar as the particular item under consideration is concerned. (p. 5190)"

"The obligation must not be evaded by a merely literal application of the clauses."

- YBILC 1966 II, p. 211, par.2

# 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

# ARTICLE 33 INTERPRETATION OF TREATIES AUTHENTICATED IN TWO OR MORE LANGUAGES

1. 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.

2. A version of the treaty in a language other than 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.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of 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.

# TREATY- A POLITICAL BARGAIN

Treaties are negotiated and entered into at a political level and have several considerations as their bases

Dictum of Lord Widgery, C.J. that the words "are to be given their general meaning, general to lawyer and layman alike.... The meaning of the diplomat rather than the lawyer." The broad principle of interpretation, with respect to treaties, and provisions therein, would be that ordinary meanings of words be given effect to, unless the context requires or otherwise

# OECD MODEL & COMMENTARY-RELEVANCE FOR INDIA

- India: Non-OECD member but key partner
- Active contributor to a host of OECD standard-setting activities dealing with cross-border trade and investment and tax policies.
- Adheres to 14 OECD instruments and is a member of governing body of OECD's development centre.
- Actively participates as an observer in eight OECD Committees and their subsidiary bodies. India has been actively engaged as a member of 'Inclusive Framework on BEPS'.
- Co-chaired OECD/G20 initiative (2018) and played a leading role in the BEPS project.

- Despite India being a non-member country – OECD MC, Commentaries and TP Guidelines hold persuasive value in India

India is also a member of:

- Development Centre,
- the Global Forum on Transparency and Exchange of Information for Tax Purposes,
- the International Transport Forum,
- the Financial Action Task Force, and
- an Association Country of the International Energy Agency.

Engagement in the G20 context includes India's active role in the Global Forum on Steel Excess Capacity and its adherence to the G20/OECD Principles of Corporate Governance.

Indian ministers and officials have also attended the OECD Ministerial Council Meetings.

# RAM JETHMALANI V. U.O.I. [2011]

Facts:

1. Case related to revealing the names of the Indian Bank Account Holders in a small landlocked German speaking state Liechtenstein (Population~40K)

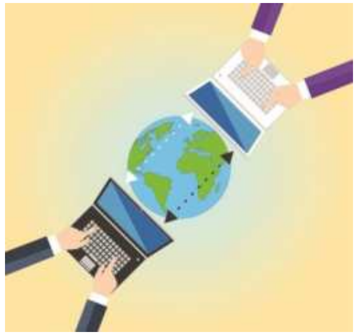
2. Germany offered the Government to disclose such names i.e. information in pursuance of Indo-Germany DTAA.

3. Article 26(1) of the Indo-German DTAA was in question.

3. The government of India, refused such offer calling it against the principles of DTAA

4. The petitioners approached the Apex Court and challenged the interpretation of the said treaty by GOI.





# INDO-GERMAN DTAA

ARTICLE 26-EXCHANGE OF INFORMATION

- 1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Agreement. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Agreement. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.
- 2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation :

  (a)to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State ;

  (b)to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

  (c)to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (order public).

## Government's Contention-

1. GOI secured the names of individuals with bank accounts in banks in Liechtenstein pursuant to Indo-German DTAA.
2. The said agreement proscribes the Union of India from disclosing such names before the court.
3. Such Disclosure would jeopardize India's Foreign relations.
4. Would Violate Right to Privacy of the individuals who have deposited their money in lawful manner.
5. Disclosure can be made with respect to those individuals with regard to whom investigations are completed, and proceedings initiated

OBSERVATIONS BY SC-

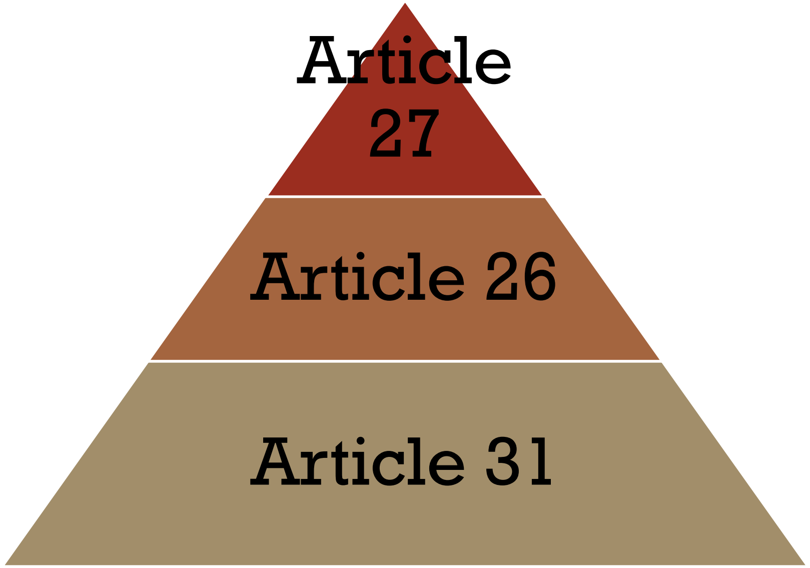
- In relation to, the taxes covered by this Agreement v. They may disclose the information in public court proceedings or in judicial decisions.
- The last sentence of Article 26(1) of the DTAA with Germany, is revelatory in this regard.
- If it were otherwise, as argued by UOI, then there would have been no need to have that last sentence in Article 26(1) of the double taxation agreement at all.

UOI ARGUMENTS

DTAA Interpretation- REJECTED

Right to Privacy- ACCEPTED

HELD:
That the UOI is exempted from revealing the names of those individuals who have accounts in banks of Liechtenstein, and revealed to it by Germany, with respect of who investigations/enquiries are still in progress and no information or evidence of wrongdoing is yet available



# RELEVANCE OF VCLT WHEN INDIA IS NOT EVEN A SIGNATORY?

*Deepti Kapur v. Kunal Jhulka*

“Even though India is not a signatory to the Vienna Convention, 'it contains many principles of customary international law' and the rules set out therein provides 'a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also’.

Therefore, the additional test that is required to be put, while adopting the ambulatory interpretation in such a situation, is whether the amendment is domestic law ends up unsettling a conclusion arrived at under the pre-domestic law amendment position, i.e., reversing the judicial rulings in favour of the residence jurisdiction, and, if the answer is in the positive, the ambulatory interpretation is to be discarded because that approach would patronise, and legitimise, a unilateral treaty override, and the outcome of ambulatory interpretation in such a case will be incompatible with the fundamental principles of treaty interpretation under the Vienna Convention.

The approach is justified on the first principles on the ground that when two approaches are possible for incorporation of domestic law provisions in the tax treaties and one of these approaches is compatible with Article 26 of the VCLT while the other is incompatible with the same, the approach compatible with the VCLT provisions is to be adopted. [Para 21]”

# CONTD.

ITATs and Courts have ruled both in favor and against relying on the OECD commentary for treaty interpretation

**Union of India v. Azadi Bachao Andolan (SC) [2003] 132 Taxman 373 (SC)]**

The Court referred to OECD MC and Commentary for the interpretation of term 'liable to tax' in Art. 4 of India –Mauritius DTAA (India has subsequently introduced definition of 'liable to tax' in its domestic tax law)

**Asia Satellite Telecommunications Co. Ltd. v. DIT, (Delhi HC)[2003] 85 ITD 478 (Del.)**

For better understanding of technical terms mentioned in treaty, OECD Commentary can always be relied upon. In *Metchem Canada v. DCIT,* Mumbai ITAT also followed a similar reasoning.

- **Contrary opinion**
- **CIT v. P.V.A. Kulandagan Chettiar [(2004) 267 ITR654 (SC)]**
- In the context of interpreting the word 'may be taxed' under Art. 7 of India - Malaysia treaty the SC held: Section 90 enables the government to formulate its policy through treaties; hence, to interpret a particular treaty it would be unnecessary to refer to the terms addressed in the OECD Commentary or in any of the decisions of foreign jurisdictions or in any of India's DTAAs.

# STATIC V. AMBULATORY APPROACH

- **Static Approach:** The interpretation of a tax treaty should be based on the provisions relevant at the time of finalization of the tax treaty.

- **Ambulatory Approach:** Tax treaty is interpreted on the basis of meanings prevalent in the current world, i.e. at the time of application of the tax treaty.*

*Certain Indian treaties signed with South Africa, Australia, Mexico, Hungary, Saudi Arabia and Kazakhstan provides for ambulatory approach

# CASE STUDY-1
# MOST FAVOURED NATION CLAUSE

# MOST-FAVOUR NATION PRINCIPLE – ISSUES

- Most Favoured Nation (MFN) clauses are often included in the tax treaties where one of the contracting party is obliged to grant the same preferential treatment (lower tax rate or restricted scope of income) to the other, if the former state agreed to grant the same benefits to a third state

Background:

- Abolition of Dividend Distribution Tax (DDT) in Finance Act 2020
- Whether the lower tax rate of 5% applicable on dividend income provided in the following three tax treaties –
  i. India-Slovenia tax treaty
  ii. India-Lithuania tax treaty
  iii. India-Colombia tax treaty
  can be imported to India-Netherlands tax treaty of 1988 even when all the three treaties were signed after the India-Netherlands tax treaty, but before Slovenia, Lithuania and Colombia became members of the OECD?
  If yes, is it applicable from the date of the Indian tax treaties with Slovenia, Lithuania and Colombia entering into force OR the date of their accession to the OECD?

# Most-Favour Nation Principle – India perspective

| Country | Treaty with India | | | OECD Accession |
|---|---|---|---|---|
| | Conclusion of Treaty | Entry into Force | Dividend % | |
| Netherlands | July 30, 1988 | January 21, 1989 | 10 | November 13, 1961 |
| Slovenia | January 13, 2003 | January 1, 2006 | 5 | July 21, 2010 |
| Lithuania | July 26, 2011 | April 1, 2013 | 5 | July 05, 2018 |
| Colombia | May 13, 2011 | April 1, 2015 | 5 | April 28, 2020 |

# MOST-FAVOUR NATION PRINCIPLE – INDIA PERSPECTIVE

- Concentrix Services Netherlands B. V. v. Income Tax Officer
  - Taxpayer invoked MFN provision under India-Netherlands Tax Treaty (10%) to benefit from lower dividend tax provided under Tax Treaty with Slovenia, Lithuania and Colombia (5%).
  - Delhi High Court held in favour of the taxpayer by invoking the MFN clause and applying the lower tax rate of 5% on dividend income.
  - Similar rulings rendered in – *Nestle SA v. Assessing Officer* (W.P.(C) No. 3243/2021 (2021)), *Deccan Holdings BV v. Income Tax Officer*, (W.P.(C) No. 11921/2021 (2021)).

# Most-Favour Nation Principle – India perspective

- Circular No. 3/2022 dated 3rd February 2022

*"On a plain reading of the MFN clauses in India's DTAAs especially with respect to the abovementioned countries, it is clear that there is a requirement that the third State is to be a member of the OECD both at the time of conclusion of the treaty with India as well as at the time of applicability of MFN clause. Therefore, it is clarified that for applicability of the MFN clause, the third State has to be an OECD member State on the date of conclusion of DTAA with India."*

- Imposes conditions to be fulfilled for invoking MFN clause:

(i) The second treaty (with the third State) is entered into after the signature/ Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first State;

(ii) The second treaty is entered into between India and a State which is a member of the OECD at the time of signing the treaty with it;

(iii) India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of the relevant items of income; and

(iv) A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State, as required by the provisions of sub-section (1) of Section 90 of the Income Tax Act, 1961

- Does not interfere with already decided court rulings.

# REFERENCE TO DOMESTIC LAWS-CONTD.

- Article 3(2) of OECD and UN Model Conventions:

- Before applying the domestic law meaning for a term which is undefined in the treaty, it is necessary to see whether such meaning is <u>consistent with the context</u> in which the term is used in the tax treaty, so that the purpose of the relevant provision of the tax treaty is not frustrated.

- While determining the meaning of words used in tax treaties, their ordinary meanings need to be seen in the context and in light of the objects and purpose of the tax treaty, so that the treaty is interpreted in good faith and it is workable rather than redundant.

# TREATY INTERPRETATION

- Treaty interpretation is not the same as domestic law. They must be interpreted liberally to implement the intention of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item is concerned.
- Courts must follow form where it is plain and admits no ambiguity. Courts are not concerned with how and why. It is for them to decide what the law is and apply it; not to make it.
- Intention of the tax statute must be obtained from the language of the provisions where the language is plain and unambiguous. Words cannot be added or substituted to give a meaning which will serve the spirit and intention of the legislature
- Provisions of the treaty in terms of sec. 90 would operate even if they are inconsistent with the act and would override the act on ascertainment of chargeability to tax and ascertainment of total income.

# TREATY INTERPRETATION (CONTD)...

- Vienna convention applies in treaty interpretation for the court to take a literal view and not a purposive view. The court applies the law as is and not what it should be.
- OECD commentaries are not binding, only persuasive (same as learned writings such as Vogel and Baker).