Role of Modern Commentaries in Interpretation

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Bijal Ajinkya

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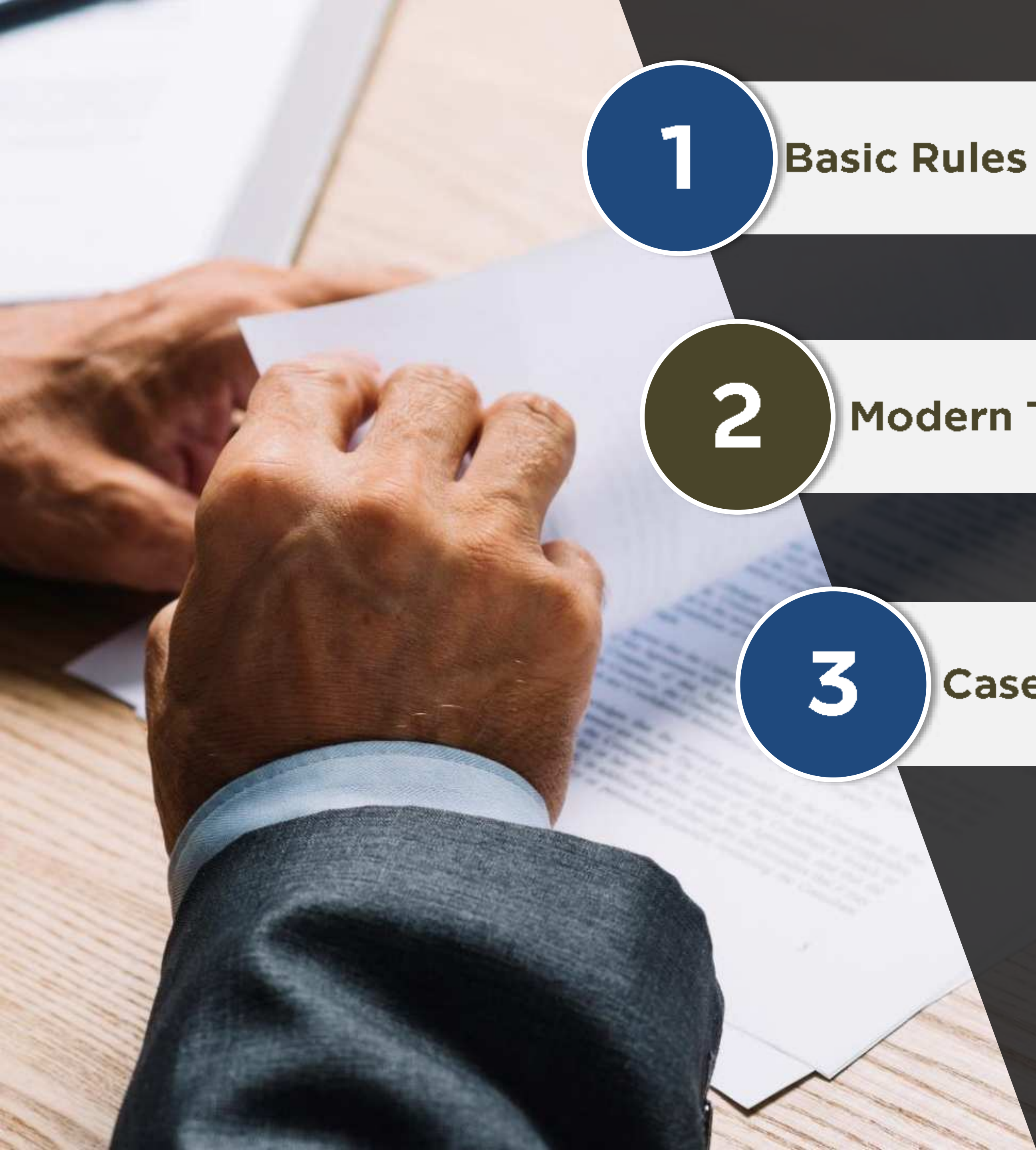
Speaker

Bijal Ajinkya
Partner
Tax and Private Client,
Khaitan & Co

: bijal.ajinkya@khaitanco.com



1. Basic Rules for Interpretation of Tax Statutes
2. Modern Tax Commentaries
3. Case Studies

Basic Rules for Interpretation of Tax Statutes

Rule of Strict Interpretation

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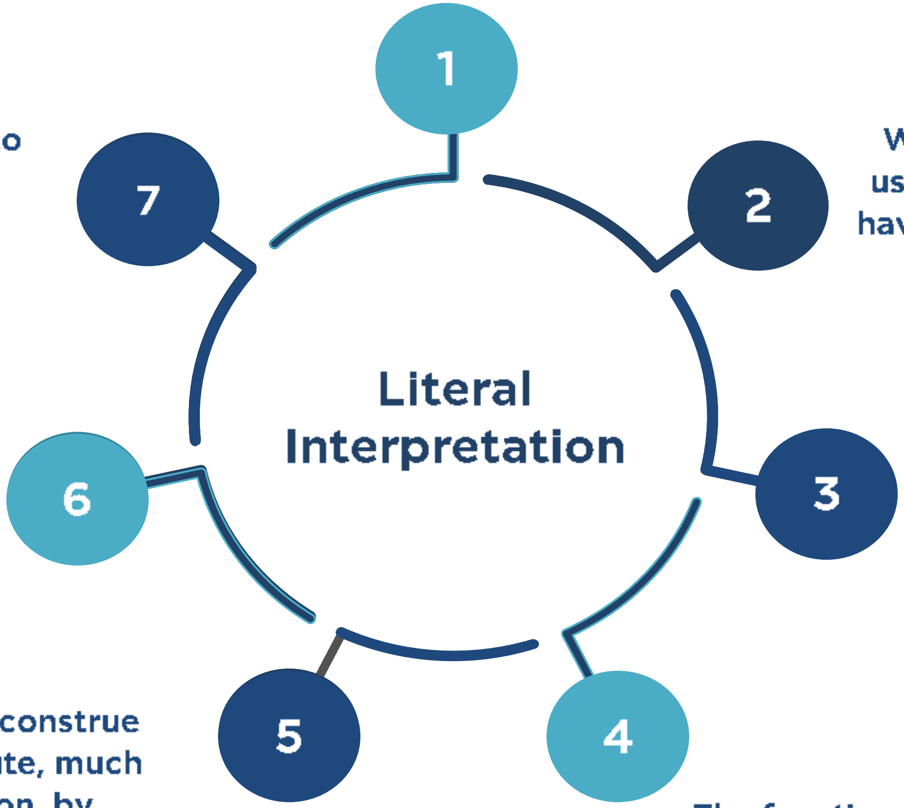
Strict Interpretation

1. Justified on the ground that imposition of tax is illustrative of penal/coercive powers of the state, and must be interpreted strictly
2. Plain, clear and direct meaning given to words which are used in common parlance. The interpretation should only be within the four corners of law
3. When language of the enactment is susceptible to two meanings, the one favourable to the assessee is to be preferred
4. No presumption to be made on the basis of 'intent of legislature'
5. A penal provision has to be construed strictly.
6. Equity considerations irrelevant while interpreting taxation statutes
7. Exception made for exemption provisions, which are to be interpreted liberally

Rule of Literal Interpretation



1. Pure, simple and grammatical sense of language used by Legislature
2. Words and phrases of legislation are used in their technical meaning if they have acquired one, or otherwise in their ordinary meaning
3. Where the statute is clear and unambiguous, words must be understood in their plain meaning
4. The function of the court of law is not to give words in the statute a strained and unnatural meaning
5. It is not permissible to construe any provision of a statute, much less a taxing provision, by reading into it more words than it contains.
6. There is no room for any intendment.
7. Nothing is to be read in, nothing is to be implied.

Static v. Ambulatory Approach

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Twin approaches

Static Approach

- The meaning of a particular term is fixed on the date of the agreement and cannot be changed unless the treaty is amended.
- Static interpretation refers to the interpretation according to the law prevailing at the time of signing of the treaty
- Easier to establish common intention of parties.

Ambulatory Approach

- The meaning of a particular term may vary depending on subsequent domestic legislations being introduced by the contracting states.
- Ambulatory or dynamic interpretation means interpretation according to the law existing at the time of application of the treaty
- Offers contracting states more flexibility in determining obligations under the treaty.

The Indian Position

1.

- Adoption of the ambulatory approach with certain limitations.
- Because of the changing nature of financial transactions, there is similar need for ambulatory interpretation for the DTAAs as well. However, DTAA being an agreement and not a statute, an approach for its ambulatory interpretation will have to be different.

2.

- Fundamental rule of the interpretation of the contract is that the intention of the parties must be gathered through the words they have used, which are key to open the mind of the makers.
- The ambulatory interpretation should be applied when contracting States themselves have provided for ambulatory interpretation in the words of the Article 3(2) of the tax treaty.

3.

- For example, Article 3(2) of India-Australia tax treaty provides for adopting meaning of the undefined term 'under the laws of that State from time to time in force'. Similarly, India's treaties with Armenia, Finland, Hungary, Luxembourg, Malaysia, Mexico South Africa, etc expressly incorporate the above principle in the Article 3(2).
- Therefore, intention of the contracting States to use ambulatory interpretation is clear when the expression 'time to time' is used in the treaty.

Examining some curious cases

CIT vs. Siemens

- Relies on the definition of 'Royalty' under domestic tax law to interpret the same in the context of Indo-German DTAA which is silent on the same.
- Perceived as supporting an 'ambulatory approach'. However, no explicit endorsement of such an approach given by the HC.

Sanofi Pasteur Holding vs. Department of Revenue

- Refuses to rely on the definition of 'alienation' and 'participation' in domestic tax law while interpreting the Indo-Thai DTAA. Absence of such a definition in the DTAA irrelevant.
- Perceived as supporting a static approach. However, no explicit endorsement of such an approach given by HC.
- Does not engage with Siemens.

Income Tax vs. New Skies Satellite BV

- Relies on the decision in Sanofi to hold that the term 'Royalty' as defined under the DTAA would be applicable and not the domestic law definition of the same.
- Distinguishes itself from siemens on facts as the term Royalty is defined in the relevant DTAA.
- Key test is determining whether the term is defined under the DTAA or not.

Formal Dualism v. Functional Monism

Formal Dualism	Functional Monism
The treaty attains the force of domestic law ONLY WHEN the same has been enacted by the legislature in question	International law attains the force of domestic law as soon as the treaty/convention has been signed by the authorized representative of the state

Jolly George Verghese vs. Bank of Cochin (SC):

An international law does not become binding in India unless it has been transplanted as law by the Parliament	Notwithstanding the dualist model, in case there is any ambiguity, Indian domestic law must be interpreted in a manner that is harmonious with international law and the country's international obligations

Vellore Citizens Welfare Forum vs. Union of India (SC):

Disregarded	All customary international law must be deemed to be incorporated in the municipal law of India unless there is a legislation to the contrary

Modern Tax Commentaries

External Aids to Interpretation

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Legislative history and background	Statement of Objects and Reasons	Commentaries
▪ Circumstances which prevailed at the time when the law was passed and which necessitated the passing of the law. ▪ The Court may consider the general history of the statute, including its derivation to ascertain the intention of the Legislature. ▪ S.P. Gupta vs. Union of India and Another (1982) AIR 149 (SC)	▪ These can be referred to by the Courts where the words used in statute do not have clarity. ▪ Construe the provisions of the Act as forming a code complete in itself and ascertain what their true scope is. ▪ Rao Bahadur Ravulu Subba Rao & Ors. vs. CIT (1956) 30 ITR 163 (SC)	▪ It can be used as an aid to understand the interpretation of terms from a national and international perspective. ▪ The same have persuasive value. ▪ International commentaries aid in interpretation of tax treaties based on the provisions of customary international law.

External Aids to Interpretation

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Circulars and Interpretations by Tax Authorities

- They can be used to understand a regulator's interpretation to provisions.
- The effect of the circular can be used to decide the constitutionality of a provision.
- ***Navnitlal Zaveri vs. K.K. Sen (1965) 56 ITR 198 (SC)***

Speech of a Minister

- It helps to ascertain the mischief which the Act seeks to remedy.
- It can be relied on to throw light on object and purpose of provisions.
- ***Kerala State Industrial Development Corp. Ltd. v. CIT (2003) 259 ITR 51 (SC)***

Reports of Commissions

- It can be used as an aid to understand the interpretation of Parliament in bringing about the change in the statute.
- ***CIT v. Smt. P.K. Noorjahan 237 ITR 570 (SC) 573***

Modern Tax Commentaries

VCLT

- The Vienna Convention on the Law of Treaties (VCLT) is an international agreement regulating treaties between states. Known as the treaty on treaties , it establishes comprehensive rules, procedures, and guidelines for how treaties are defined, drafted, amended, interpreted, and generally operated.
- It provides rules for customary International law.

OECD

- OECD inserts soft laws – non-binding instruments that often lead to binding treaties, especially between member countries.
- India is not a member of the OECD, however the OECD model is referred to for the purpose of interpretation.
- It forms a supplementary means of interpretation under customary international law.

Modern Tax Commentaries

UN Model Double Taxation Convention

- The United Nations Model Double Taxation Convention between Developed and Developing Countries (the United Nations Model Convention) is aimed at eliminating double taxation.
- India is not a member of the OECD and cannot influence the OECD Model, however it can influence UN Model, which gives more taxing rights to source countries and is also the template for many Indian tax treaties.
- It forms a supplementary means of interpretation under customary international law.

Accredited Authors

- Article 38(1)(d) of the statute of International Court of Justice recognizes teachings of the most highly qualified publicists of the various nations' as 'subsidiary means for the determination of the rules of law'.
- Can help ascertain what the 'rules of international law are', which would enable it to become a primary aide to interpretation of a tax treaty under Article 31(3)(c) of the VCLT.
- Not a source of international law. However, key participant in interpreting and influencing international law.
- Famously adopted in the landmark judgement by the US Supreme Court in the Paquete Habana case (175 US (1900) 677 at 700-1).

Vienna Convention on Law of Treaties (VCLT)

Article 31: General Rule of Interpretation

1. *A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

2. *The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:*
   a. *any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;*
   b. *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 to the treaty.*

3. *There shall be taken into account, together with the context:*
   a. *any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;*
   b. *any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;*
   c. *any relevant rules of international law applicable in the relations between the parties.*

4. *A special meaning shall be given to a term if it is established that the parties so intended.*

Interpreting Article 31

Clause (1) requires interpretation of agreement in 'good faith'.

Clause (2) sets out the scope of the Treaty, It includes:

i. Preamble
ii. Annexes
iii. Agreements related to the treaty made in connection with the conclusion of the treaties
iv. Instruments made by one more party and accepted by the other as an instrument related to the treaty

This clearly assumes that interpreters do more than just establishing the meaning of a treaty according to the relevant lexicon and grammar.

Clause 3(3) provides the following external aids to interpretation:

i. Subsequent agreements between parties regarding the interpretation of the treaty – Technical Explanation
ii. Subsequent practice between parties in application of the treaty – Parties intention | Common understanding | Should be used sparingly as it may conflict with domestic laws
iii. Relevant rules of international law applicable to parties – Law's true meaning | Application must be justified

Article 31(3)(c) provides an opportunity to justify the use of commentaries if an interpretative argument on other elements of article 31 proves to be unsuccessful.

Clause 4 over-rides above clauses in the event that the parties specifically assign a meaning to the terms

Presumptions to Article 31

Positive

- Parties are taken to refer to general principles of international law for all questions, which the treaty does not itself resolve in express terms or in different way.

Negative

- In entering into treaty obligations, the parties intend not to act inconsistently with generally recognized principles of international law or with previous treaty obligations towards third States.

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.

Interpreting Article 32

- Can be resorted to only if an interpretation under 31 not possible.

- Allows reliance on supplementary means of interpretation, which includes 'preparatory work' of the treaty and 'circumstances of conclusion'

- Can only 'confirm' the meaning, cannot be the source of the same

Three Main Approaches to Interpretation

1.

- The "**textual**" (or "ordinary meaning of the words") approach analyses the actual words in the text of the treaty to ascertain the meaning of the treaty.

2.

- The "**intentions of the parties**" (or "founding fathers") approach ascertains the parties' intentions. The treaty is then construed to give effect to such intentions.

3.

- The "**aims and objects**" (or "technological") approach ascertains the treaty's aims and objects. The treaty is then construed to give effect to these aims and objects.

Which approach is the most appropriate?

- Article 31(1) of the Vienna Convention settles the first issue (i.e. which approach is most appropriate) by adopting the "textual" or "ordinary meaning of the words" approach as the starting point for the general rule of interpretation.

What material should a court consider?

- Article 32 of the Vienna Convention settles the second issue by permitting the use of "supplementary means of interpretation." This permits the use of a far wider range of materials and authorities than may often be permissible under domestic interpretative principles.

Intention of the Parties

01 The Vienna Convention confers a specific purpose on the treaty interpretation process: to establish what is often referred to as the intention of the parties.

02 Limiting its use to the context of treaty interpretation, 'party intention' can mean many different things.

03 Party intention may mean the intended relationship between two separate instruments.

04 Party intention may mean the intended relationship between an existing document / treaty and a subsequent agreement.

05 It is the ultimate purpose of the interpretation process to establish the communicative intention of the treaty parties—the meaning that the parties intended the treaty to communicate.

06 The interpretation of a tax document is no different than the understanding of just any verbal utterance produced by a person or group of persons at a particular occasion, whether orally or in writing.

07 Interpreters can justify their use of the Commentaries based on this same law.

VCLT & OECD Commentaries

OECD Commentaries may come within the scope of application of Article 31, paragraph 2(b)

They may classify as 'relevant rules of international law', in the sense of Article 31, paragraph 3(c)

They may help establish the possible 'special meaning' of tax treaty terms, in the sense of Article 31, paragraph 4

They may come within the scope of application of Article 32 of the VCLT, whether or not they belong to any of the two means of interpretation explicitly allowed by this provision.

Key Provisions

VCLT & OECD Commentaries

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View 1- Article 31	View 2- Article 32
▪ OECD commentaries constitute 'rules of international law' under Article 31(3)(c) (albeit, non-binding rules) ▪ Amendments to OECD Commentary would constitute evidence of 'subsequent practice' under Article 31(3)(b), particularly so if it is between OECD Member nations ▪ Can also be used under Article 31(1) as good faith principle if evidence exists to demonstrate that the treaty was meant to be based on the OECD convention, particularly so if it is between OECD Member nations ▪ Primary source for determining the intention of the treaty ▪ Enjoy high persuasive value	▪ OECD commentaries constitute 'preparatory work' under article 32 ▪ Can be relied on only if recourse to Article 31 is unsuccessful. Can only be used to confirm a possible interpretation and cannot be the source of the same. ▪ Enjoy lower persuasive value ▪ Affirmed by Australian HC in Thiel vs. Federal Commissioner of Taxation, a landmark judgement routinely relied on by Indian Courts (SC included)

Organisation for Economic Cooperation & Development (OECD) Model Tax Convention & Commentary

Introduction

OECD

- The Organisation for Economic Co-operation and Development (OECD) is an international organisation that establishes evidence-based international standards.
- It has a total of 38 member countries across the globe.
- India is not a member but was granted an "observer status" in 2006 and is now engaged in "enhanced dialogue".
- India's ED dilemma
- The OECD has been at the forefront of addressing tax evasion, ending bank secrecy and tax havens, addressing tax avoidance and modernising the international tax architecture.

OECD Commentaries

- The OECD assumed a lead role in guiding the tax treaty system. The commentaries to the model treaties are generally used as a supplementary means of interpretation as per Article 32 of VCLT.
- The tax treaties of OECD countries are based on the OECD Model and Commentary, which is the centre-piece of the tax treaty system.
- OECD implements "soft law" — non-binding instruments that occasionally lead to binding treaties between member countries - The Model Tax Convention ("MTC"), which serves as a template for bilateral negotiations for coordination and cooperation and the commentary.
- OECD Commentaries go well beyond a mere explanation of the meaning of terms to provide the background of provisions and explain why certain provisions were considered desirable or necessary.

The Legal Status of OECD Commentaries

Binding

- There is a consensus among international tax experts that OECD Commentaries are legally relevant.
- There is a consensus among international tax experts that OECD commentaries are relevant.
- Even non-member states make use of such commentaries to serve as a means of interpretation under Article 31/32 of VCLT.

- OECD member states have no legal obligation to accept the provisions of Commentaries for the purpose of the interpretation of their tax treaties, not even in cases where treaty provisions were phrased based directly on the OECD Model, down to the last word.

Non-binding

India’s Application of OECD COmmentaries

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Formally not a member, functionally maybe

Persuasive Value

The Courts/Tribunals have placed extensive reliance on the OECD commentary while interpreting tax statutes *[Cases- Morgan Stanley (SC), New Skies Satellite]*

Courts rely on OECD commentary because the UN Model has in turn adopted large parts of the OECD commentary

India’s DTAA’s closely resembled OECD model till 1980s when the UN Model was published. Gradual shift towards demanding source country taxation ever since.

Case Study - Engineering Analysis Centre of Excellence Private Limited vs The Commissioner of Income-tax & Anr.

Facts

- Taxability (in India) for certain types of software-related income. The debate arose due to the position taken by India's tax administration and was further exacerbated by retrospective amendments to the domestic law.

Questions

- Was payment for software a royalty payment under India's Income-tax Act?
- Was payment for software towards royalty under the specified tax treaties?
- Withholding Tax for non-residents – If income not chargeable to tax in India under tax treaties, is withholding warranted? Supreme Court ruled in favour of taxpayers.

Key Findings

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Retrospectivity

- Parliament has sovereign power to legislate. However, the law cannot be made retrospective to result in absurd consequences (Technology came in 1990s, whereas retrospectivity was from 1976).
- Doctrine of impossibility (lex non cogit ad impossibilia) was applied to negate harsh consequences arising from retrospective amendments.

Definition of royalties as per DTAA V. Domestic law

- Definition in DTAAs are based on OECD Model Tax Convention.
- Treaty definition is narrower than domestic law definition.
- OECD Commentary will continue to have persuasive value for interpretation of the term royalties.

Key Findings

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VCLT

- VCLT is relevant for the Indian Treaty interpretation even though India is not a signatory.
- Good faith principle for Treaty interpretation was reaffirmed.
- The SC observed a Tax Treaty must be interpreted in the context of aiding commercial relations between treaty partners and as being essentially a bargain between them.

OECD Commentary

- The Court noted Indian tax administration taking a position has no meaning if the language of the bilateral Treaty does not depart from the OECD Model Commentary.
- If India executes treaties based on OECD Model despite such policy position, it must be ignored and OECD commentary to be given full effect.
- In the absence of bilateral renegotiation of Treaty, India's position would not impact existing treaties unless the Treaty is modified.
- OECD commentary will continue to have persuasive value.

OECD – Its Relevance for non-member nations

- Whether OECD model is important for interpretation of treaties executed between India, a Non-member of OECD, and another member or non-member.

- IFA 1993 General Report, paragraph II 4 (b) –

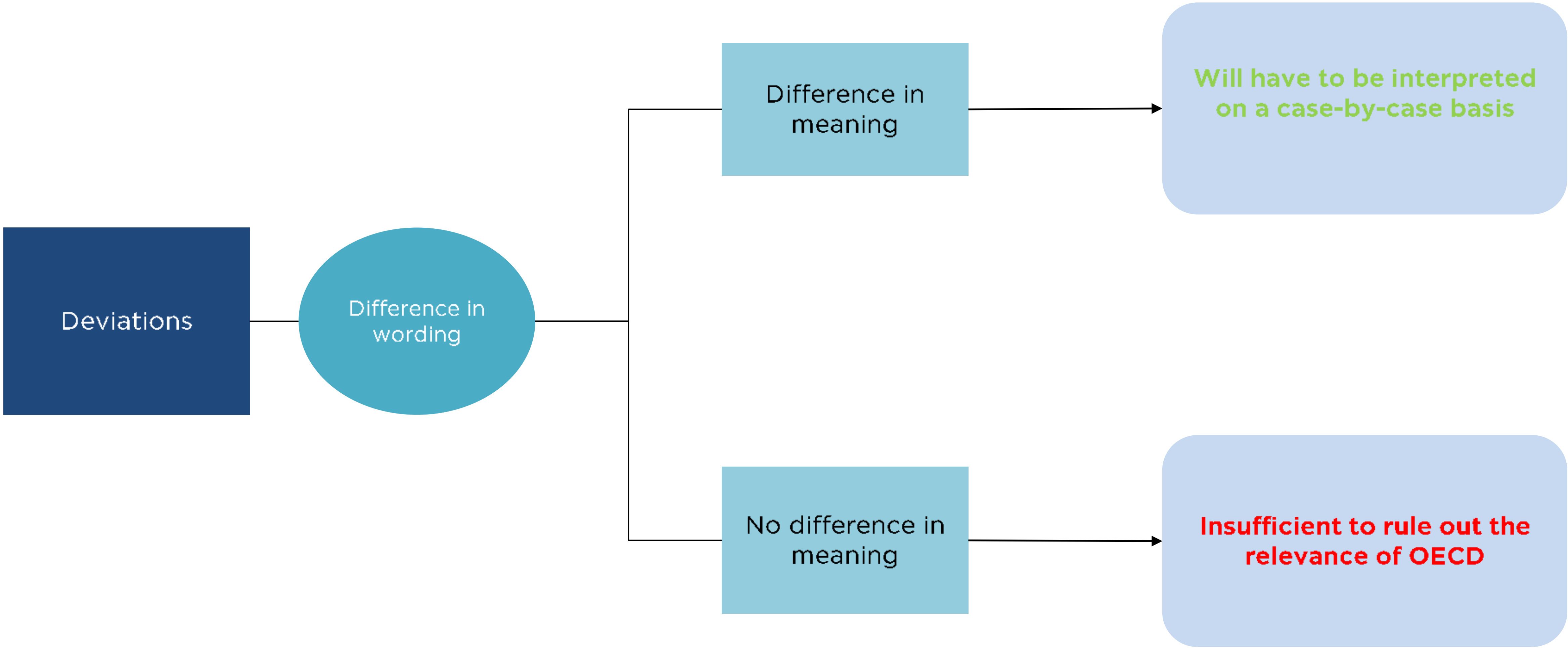
"The OECD commentary will be less significant for conventions between an OECD member and a non-member and between two non-members. In these cases, in as far as the OECD Model Convention served as a basis for the negotiations, it is in principle part of the context and hence can be taken into consideration. This is also true if the UN Model was the basis, since it builds on the OECD Model. The UN Model has been taken into consideration by a number of countries for the interpretation of treaty provisions".

Deviations from the OECD Model

Deviations

- The OECD Model Convention and the OECD Commentary carry significant weight in the interpretation process if the contracting states chose to follow the wording of the OECD Model.
- This does not necessarily apply, however, if the wording of a provision deviates from the OECD Model –
  - The difference in wording may also entail a difference in meaning – or the meaning of the provision may be similar to the OECD Model, despite the difference in wording. This problem cannot be solved in general but only through interpretation in each individual case.
  - If the wording of a provision deviates from the OECD Model, it is a matter of interpretation to determine whether the difference in wording also results in a different meaning.
  - Consequently, a difference in wording alone is insufficient to rule out the relevance of the OECD Commentary.
  - It is, however, also necessary to give reasons why the OECD Commentary should be considered under such circumstances

Reservations to the OECD Model



Reservations to the OECD Model

Reservations

- OECD member countries may enter reservations on provisions of the OECD Model Convention, which are recorded in the OECD Commentary.
- By entering a reservation, a member country indicates that it does not intend to follow the OECD Model with regard to a certain provision.
- Member countries entering reservations will thus try to include such modified provisions when negotiating double taxation conventions.
- The legal effects of reservations to treaties are regulated by Article 21 of the VCLT.
- If the wording of a provision suggests that a reservation was taken into account, the reservation in the OECD Commentary is relevant for interpretation.
- Consequently, the OECD Commentary has to be disregarded to the extent that the adopted provision deviates from the OECD Model.
- If, however, the wording follows the OECD Model despite the fact that a reservation has been entered by a contracting state, it may be assumed that the OECD Model Convention and the OECD Commentary are still relevant.

Reservations to the OECD Model

Reservations = Non-intention to follow the OECD Model on such provisions

Modified provisions in DTAAs

Reservation is relevant

OECD commentary is disregarded to that extent for the purpose of interpretation

Provisions continue to follow the OECD Model, despite a reservation

Assumed that the OECD Model convention and commentary are still relevant to interpretation

The Paradoxical Effect

- In principle, these reservations should be irrelevant because states are not bound by those instruments anyway.

- Reservations give the impression that states do not completely discard the possibility of being affected.
- This could be indirectly by means of interpretation or practice, and the result is that these reservations reinforce the idea that non-binding instruments could be legally relevant.

Key Reservations

Issue	OECD Model	India
E-commerce	▪ Mere attending or participating in negotiations (by an agent) should not give rise to a PE	▪ A website itself may constitute a Permanent Establishment ("PE") in certain circumstances and that depending on the facts of case, an enterprise can be considered to have a place of business by virtue of hosting its website on a server located in India
Business Meetings	▪ Mere attending or participating in negotiations (by an agent) should not give rise to a PE	▪ Mere presence in meetings where negotiations are taking place is sufficient to conclude that the person has exercised authority to conclude contracts and thus, a PE of the foreign enterprise is constituted
Leasing	▪ No PE is constituted unless the non-resident enterprise has a fixed place of business in the source state	▪ A mere dry lease (without presence of people) may constitute a PE of the lessor in certain circumstances
Services	▪ Taxation should not extend to services performed outside the source state; and only to the profits derived from such services	▪ Taxation should extend to the entire consideration received from services
Force of Attraction Rule	▪ Rejects the FOA Rule	▪ Incorporates the FOA Rule. ▪ Profits derived by an enterprise from business activities independent of its PE in the source state would also be deemed to be attributable to that PE
Alternate Dispute Resolution for transfer pricing	▪ Prescribed by OECD	▪ India does not follow the ADR approach

Observations to the OECD Model

Observations relate to particular passages of the commentary. It indicates the way a country understands the provision.

It indicates that a member country does not agree with the interpretation given in the OECD Commentary on a certain provision. Unlike a reservation, an observation does not express disagreement with the text of the OECD Model.

In such an event, the paragraph of the OECD Commentary commented on by the contracting states loses relevance.

Unless the contracting states have made similar observations, one has to rely on additional material (eg from the negotiation of the treaty) to determine the content of the treaty provision in question.

Only those reservations and observations existing upon conclusion of a double taxation convention may be taken into account.

Positions to the OECD Model

Position

- "Position" indicates a disagreement, by a jurisdiction that is not a member of the OECD, concerning the provisions of the articles of the OECD Model or the interpretations in the Commentary on these provisions.

- Paragraph 5 of the introduction to the section of the OECD Model which includes the positions of the non-OECD economies on the OECD Model indicates that these economies "generally agree with the text of the Articles of the Model Tax Convention and with the interpretations put forward in the Commentary," the areas of disagreement being reflected in the positions of these economies.

United Nations Model Convention

United Nations Model Double Taxation Convention between Developed and Developing Countries

Introduction

- Published in 1980 as a response to the OECD Model Tax Convention.
- Favours capital importing countries in contrast to the OECD model, which is perceived to favour capital exporting countries. As a result, it allocates greater taxing powers to the source country rather than the residence country.
- Commentary on the UN Model convention maintained by the "Committee of Experts on International Cooperation in Tax Matters" under the aegis of the United Nations Economic and Social Council (ECOSOC).
- Indian tax treaties are a combination of the OECD and the UN Model. India being a developing country has adhered to the provisions of the UN Model to prevent its own tax base.

Drawing a Borderline

Which OECD / UN Model version is relevant?

- The relevance of the OECD Commentary / UN Convention in the interpretation of tax treaties is based on the assumption that the contracting states, by following the wording of the OECD / UN Model in drafting a certain provision, intended such a provision to have the meaning it has in the OECD / UN Model as outlined in the Commentary.
- The relevance of a particular Commentary version depends on whether this assumption can be maintained.
  - Commentary sections remaining unchanged throughout the negotiation and ratification process have to be considered in the interpretation of a double taxation convention.
  - Commentary amendments adopted after the ratification of a double taxation convention may only be taken into account in exceptional cases.

Retrospective Application

Revised versions of the Model Commentary need to be considered while interpreting tax treaties in order to ensure compliance with Article 31(1)of the VCLT which suggest interpretation of a treaty in the light of its object and purpose.

Case Study 1 – Retrospective Interpretation

Lamesa Holdings BV v Commissioner of Taxation (1997) 35 ATR 239

- Facts: The issue raised was whether the 1977 version of the Commentary was relevant for the interpretation of the double taxation convention concluded between Australia and the Netherlands in 1976.

Conclusion

Held:

- The OECD model and commentaries are only applicable to those bilateral treaties subsequently concluded.
- Since “the text of the 1977 OECD Model and the Official Commentary thereto had been largely formulated and published before the conclusion of the Netherlands DTA in 1974”, it is held that “the Official Commentary to the 1977 OECD Model is relevant to the interpretation of the Netherlands DTA.

Conclusion:

- While it would not be convincing to use the 1977 version of the Commentary for the interpretation of the 1976 Australia/Netherlands convention, other material, such as reports or even draft versions of OECD documents may, in principle, be relevant.
- The relevance of such material, as well as the relevance of a certain Commentary version, can only be assessed on a case-by-case basis. It is decisive whether one may assume that the documents had already been available to the treaty negotiators and that they had understood the provisions in the light of these documents.

Case Study 2 – Current Interpretation

Matthews vs UK	▪ The convention is a living instrument, which must be interpreted in the light of the present day conditions. ▪ The mere fact that the drafters of the Convention did not envisage a body cannot prevent that body from falling within the scope of the convention.
Societies Est vs France	▪ It was of crucial importance to interpret the conventions in such a manner so that the interpretation becomes practical and effective and not theoretical.
Danish Supreme Court	▪ Revised versions of the commentary ought to be considered. ▪ Contrary to the views expressed by the minority of two judges who held that importance cannot be attached to the revised version when construing treaties that pre-date the commentary.

Case Study 3- Current Interpretation of the UN Model

1980: Concept of dependent agent

Definition was amended to determine cases when there will be a Permanent Establishment in India

Should countries follow the amended version of the UN Model for the purpose of interpreting earlier treaties?

Reliance placed on international foreign precedents

Follow the interpretation in the amended treaties even if the principal is not incorporated in retrospective treaties.

This will ensure compliance with Article 31(1) of the VCLT which suggest interpretation of a treaty in the light of its object and purpose.

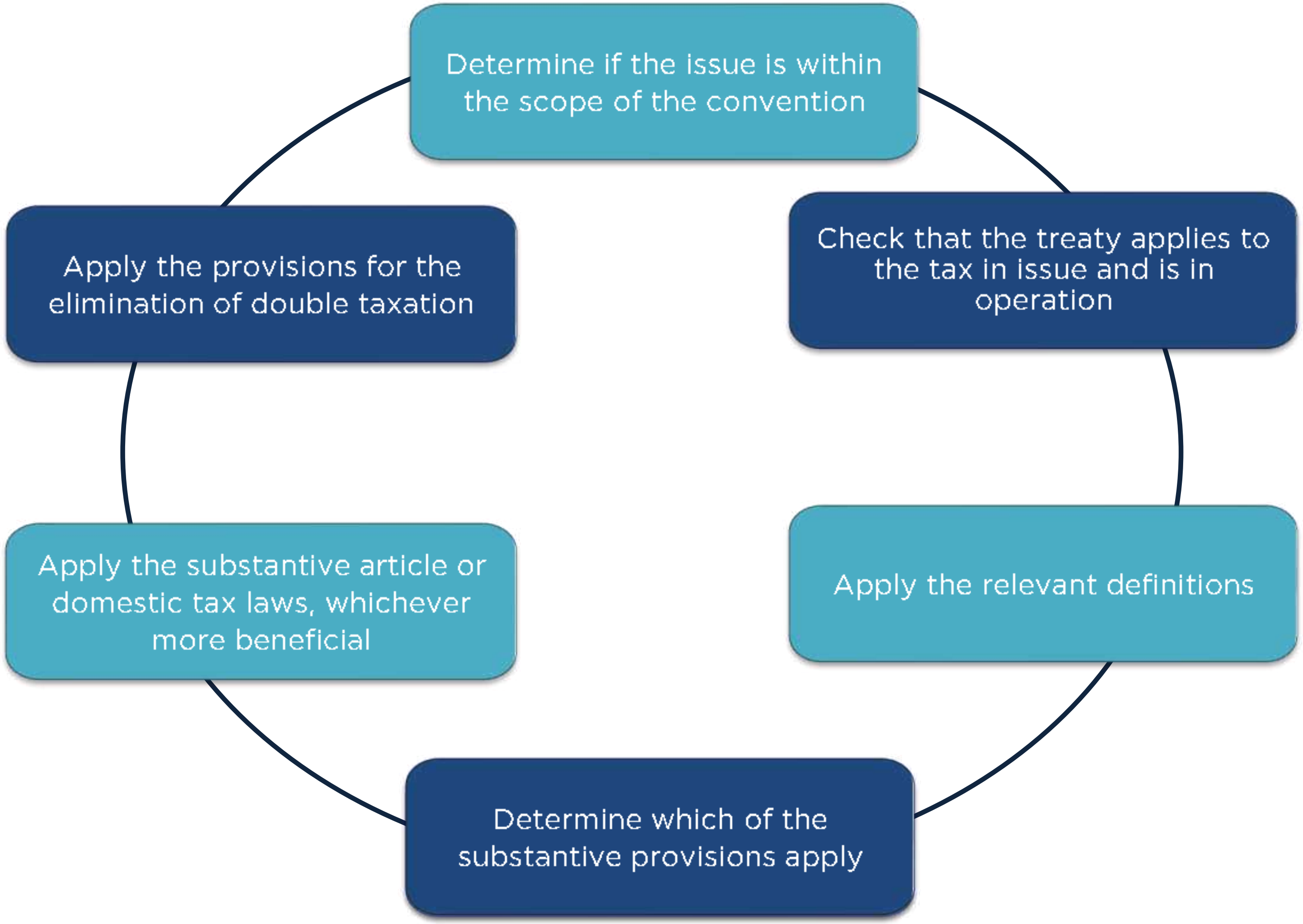
Tax Treaties

What are Tax Treaties?

Introduction

- DTAAs are bilateral contracts between two states, drafted on the basis of trade negotiations.
- It is an international agreement that incorporates the domestic laws of multiple jurisdictions, on provisions pertaining to international taxation.
- Many countries have entered into tax treaties with other countries to avoid or mitigate double taxation.
- When an individual or business invests in a foreign country, the issue of which country should tax the investor's earnings may arise.
- Both countries may enter into a tax treaty to agree on which country should tax the investment income to prevent the same income from getting taxed twice.
- Some countries are seen as being tax havens; these countries typically do not enter into tax treaties.

Process of Interpreting DTAAs



General Principles for Interpretation of DTAAs

Text of the DTAA is of primary importance

Wording of individual provisions are not to be read in isolation, but together with entire agreement and in the context to be considered

Reasonableness and consistency

Principle of effectiveness

Objective of tax treaty to be considered – UOI v. Azadi Bachao Andolan 263 ITR 706 (SC)

OECD Commentaries & DTAAs

01

- DTAAs are bilateral contracts between two states.
- DTAA is an international agreement that incorporates the domestic laws of multiple jurisdictions, which may have different interpretations of the same provision.
- Those applying the agreements follow the relevant domestic courts' guidance when interpreting conflicting clauses.

02

- The OECD commentaries are highly valued in practice as a tool for treaty interpretation, despite them not being a legally binding document.
- Courts in OECD member states as well as non-OECD member states have accepted OECD Commentaries and have published their positions on the same [Metchem Canada Inc. v. Deputy Commissioner of Income Tax, [2006] 100 ITD 251 (MUM Tribunal)]

03

- A Courts' role is to apply the treaty in a manner consistent with the initial intentions of both contracting parties.
- This should prevent the unlimited, automatic use of subsequent OECD commentaries.

Principle of Common Interpretation

CONSISTENT APPLICATION

Tax treaties are born out of trade negotiations and are meant to reduce double taxation and allocate tax claims equally between the contracting states.

FOREIGN COURT RULINGS

Reliance on such rulings is made based on similar facts of the case or even where concepts have been borrowed [anti-abuse provisions in India]

(Aberdeen Asia Pacific v DCIT, Bombay HC)

NO UNILATERAL POSITIONS

Uniform understanding of both contracting states has persuasive value, and not unilateral decrees or official positions.

(NGC Network Asia LLC v. DDIT, Mumbai Tribunal)

SUBSEQUENT PRACTICE

Article 31, VCLT, subsequent practice can determine common intention , but only if it is uniform

SUBJECT TO REVIEW

Common interpretation does not mean that the case law of the other state must be accepted without review *(Klaus Vogel and Prokisch)*

EXISTING OFFICIAL RESERVATIONS

The same will have to be considered

A Comparative

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Tax Treaty Interpretation	Domestic Statutes
Tax treaties are based on international customary law using international terms	
▪ Australia's Ruling TR 2001/13 - Treaties are drafted against the background of treaty negotiations, OECD and UN Model Tax Conventions, which being products of international consensus, are couched in comparatively broad terms.	▪ The terms of the DTAA cannot be expressed with the same precision as domestic tax legislation.
Tax Treaties are not drafted by legal professionals	
▪ The treaties are not drafted by lawyers but by diplomats, It is based on mutual understanding of states and used a common interpretation.	▪ The words are those of a legal professional drafted with precision and detail.
Treaties represent position of bargain and reciprocity	
▪ Each DTAA is a product of separate bilateral negotiation process. DTAAs are negotiated against the background of particular languages, legal systems, tax rules, tax treaty and wider economic policies and on reciprocity, hence drafted on wider terms.	▪ Domestic laws are very specific to a country and hence, are drafted in detail. ▪ In case of conflict between treaties and domestic laws, the assessee is free to apply whichever provision is more beneficial.

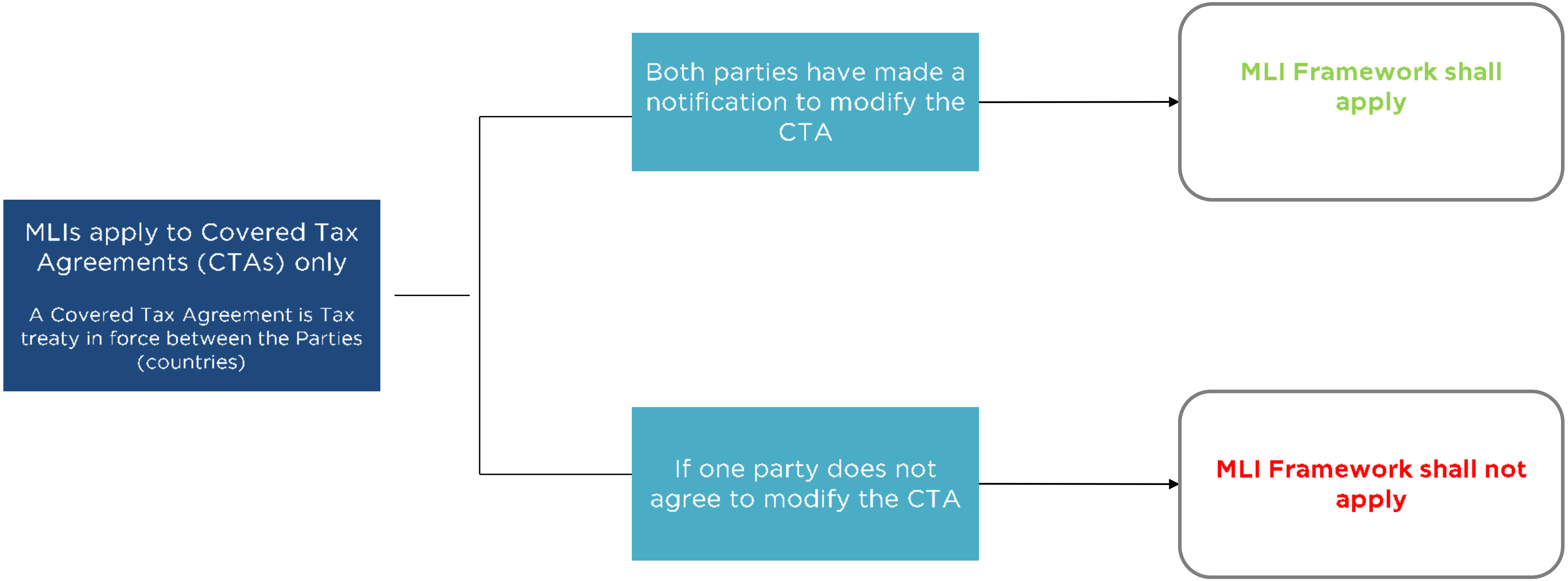
Multilateral Instruments (MLIs)

What are MLIs?

Introduction

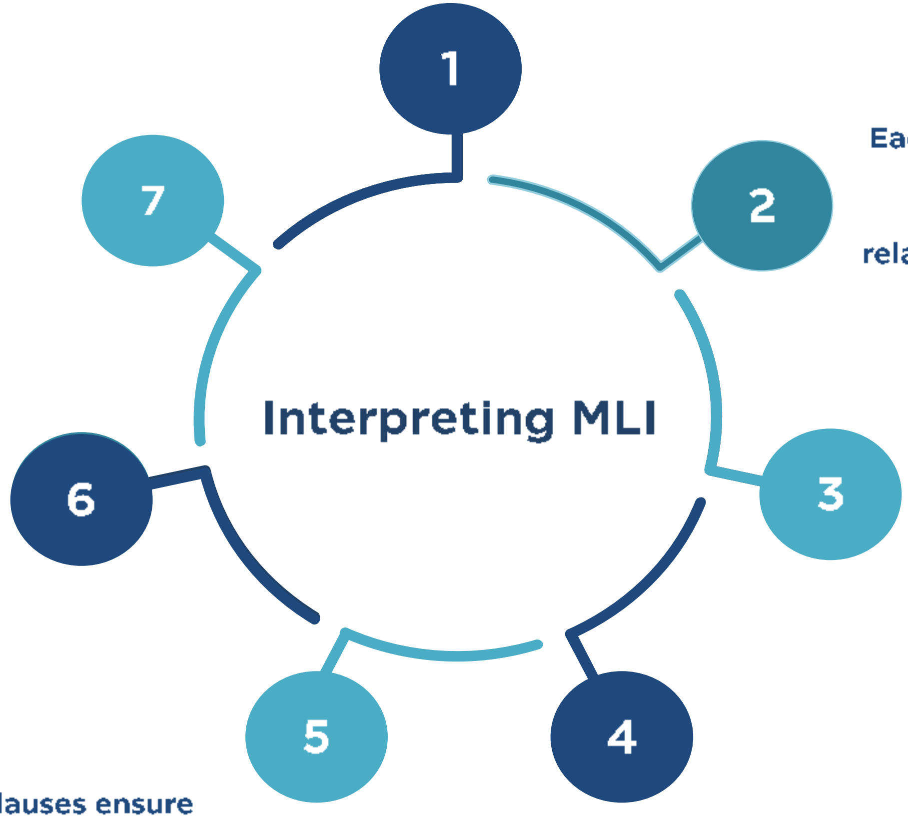
- The multilateral instrument is a treaty/ standard template, which is one element of the OECD Base Erosion and Profit Shifting (BEPS) project, designed to avoid tax treaty abuse.
- Countries will be able to use MLI framework to implement some of the BEPS action plans relating to double tax treaties.
- The MLI helps the fight against treaty abuse by implementing the tax treaty-related measures developed through the BEPS Project alongside existing bilateral tax treaties.
- The MLI will not replace the existing treaties completely. Instead, it will apply alongside existing treaties and either modify, supersede, supplement, or complement their application so as to bring them in line with the measures to address base erosion.
- India is still not a signatory to the MLI Framework.

Interpretation of MLIs



In case of disputes between MLI provisions and the OECD commentaries, the guiding principles to interpretation of MLI shall apply.

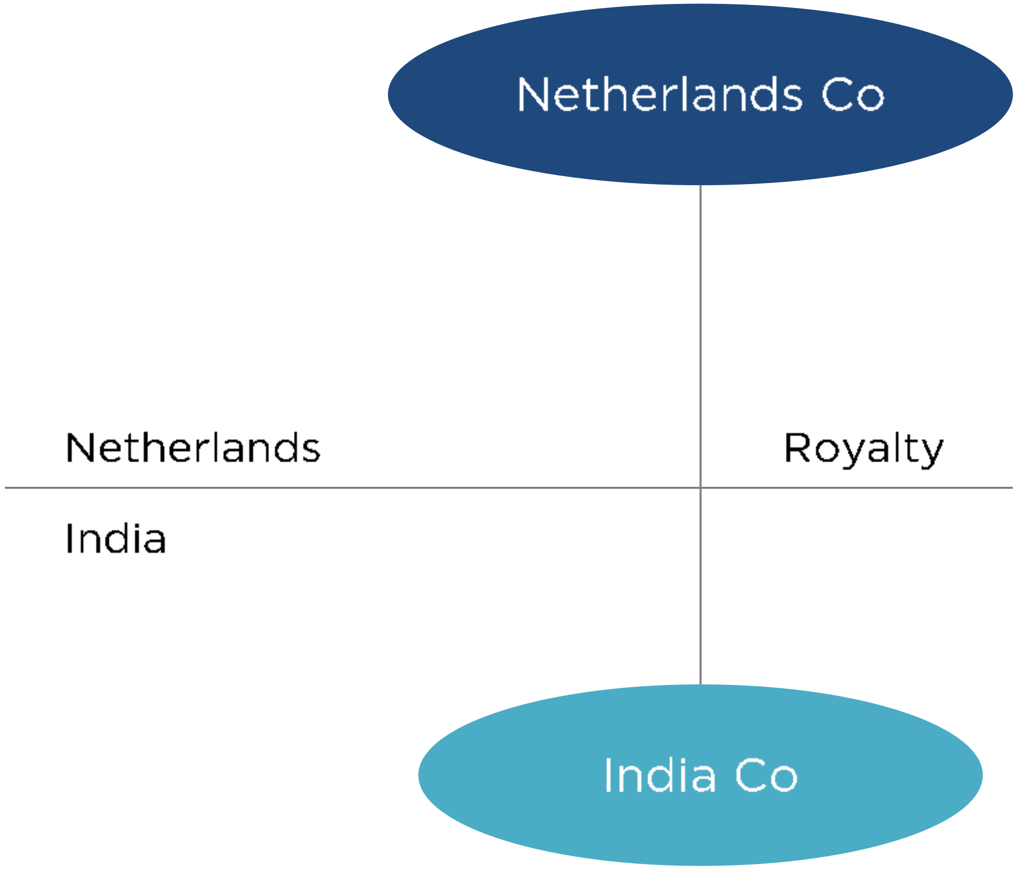
Guiding Principles to Interpreting MLI



1. The MLI should be interpreted in light of its object and purpose, which is to implement the tax treaty-related BEPS measures.
2. Each provisions should be interpreted and implemented in light of the policy objectives of the relevant tax treaty-related BEPS measure implemented via the MLI.
3. To the extent that they are incompatible, the provisions of the MLI prevail over the provisions of the Covered Tax Agreements.
4. It should be interpreted in light of the consent given by each Contracting Jurisdiction to modify their Covered Tax Agreement, as expressed in their MLI Positions and with the consequences set out.
5. The notification clauses ensure clarity and transparency about the existing provisions of Covered Tax Agreements that are modified by the MLI.
6. When a substantive MLI provision conflicts with specific existing provisions in Covered Tax Agreements covering the same subject matter, this conflict is addressed through a description in the compatibility clause of the existing provisions which the MLI is intended to modify, as well as the effect the MLI has on those existing provisions.

Case Studies

Concentrix Services Netherlands B.V v. ITO (TDS)



Protocol in the India-Netherlands DTAA

- The Delhi High Court had occasion to interpret the Most Favored Nation (MFN) clause of the India–Netherlands tax treaty (the tax treaty).
- The Delhi High Court was confronted with a question whether the benefits of the said MFN clause of the tax treaty would also apply in case of a treaty entered into by India with a third country which was not an OECD member on the date of signing of such treaty, but subsequently became one.
- The High Court ruled in favor of the taxpayer while placing reliance on the "common interpretation" approach as well as concluding that the effect of the MFN clause has to be seen at the time of application of the tax treaty and not when it was entered into with the third country.

The Most Favoured Nation (MFN) clause of the tax treaty provides that post signing of the tax treaty, if India signs a treaty with an OECD member country which provides for a scope more restricted or rate lower than that provided under the tax treaty, then such beneficial provisions would apply.

Examining some curious cases

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Azadi Bachao Andolan

- Purposive/liberal interpretation instead of "strict" or "literal" interpretation
- Principles to be adopted in interpretation of 'Statutory legislation' are not the same in interpreting treaties
- Treaties are negotiated at a political level and has several considerations at their base.
- OECD model commentaries have been accepted and referred to in multiple forums as an aid to interpretation of Treaties.

Ram Jethmalani vs. Union of India

- The words in the treaty are to be given their general meaning, general to lawyer and layman alike.
- Although India is not a signatory to the Vienna Convention of Law of Treaties, 1969 (Vienna Convention), it is well accepted that it contains many principles of customary international law, and the principle of interpretation as enshrined in Article 31 of the Vienna Convention provides a broad guideline as to what could be an appropriate manner of interpreting a treaty also in the Indian context (Ram Jethmalani vs. Union of India, 8 SCC 1). Also reiterated in the Sanofi case.

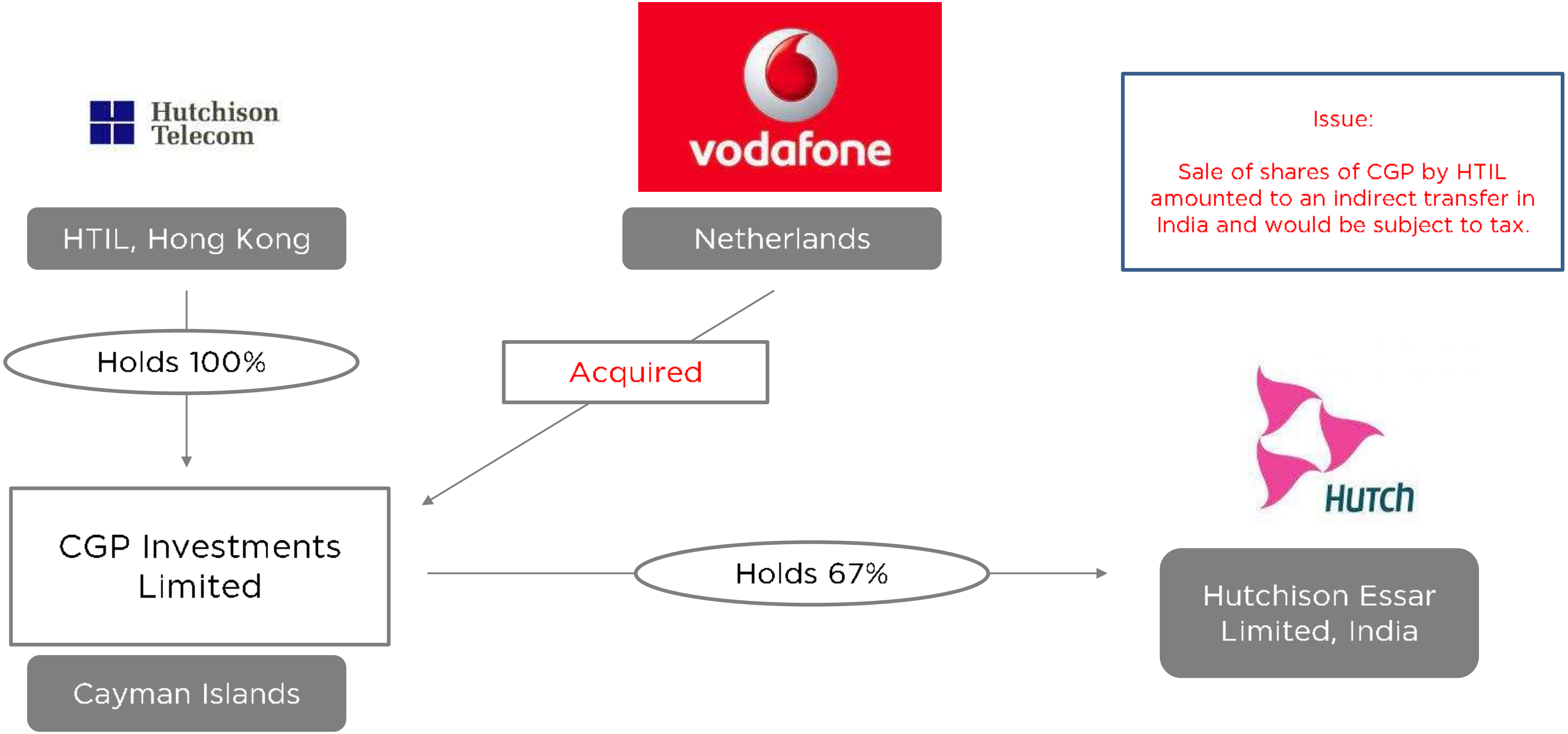
Thiel v. Federal Commissioner of Taxation, High Court of Australia

- Reference to the OECD model commentary is backed by Article 32 of the Vienna Convention, which allows recourse to be had to supplementary means of interpretation 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 leaves the meaning ambiguous or leads to an absurd or unreasonable result.

Important Cases on Interpretation of Treaties

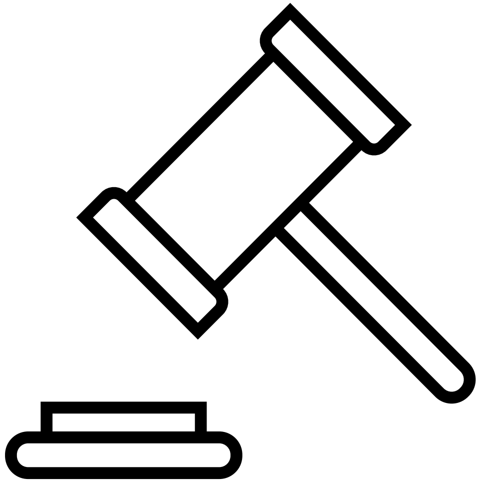
Raman & Co	1967	Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed, is not prohibited – Liberal interpretation
Mc. Dowell	1985	Dismissed observations of Raman & Co and blurred the distinction between "tax avoidance" and "tax evasion" – Narrower interpretation
Azadi Bachao Andolan	2003	Reinstated the position in Raman & Co with a liberal interpretation
Walfort	2010	Reaffirmed Azadi – tax planning without any motive to evade taxes through colourable devices not illegal. Concept of substance over form in interpretation of statutes
Vodafone	2012	No conflict between McDowell and Azadi. Courts can't go behind a genuine document to interpret a supposed underlying substance

Vodafone – Case Study



Vodafone India

- By acquiring CGP, a company based off a tax haven, Vodafone Netherlands was able to acquire Hutch India at ZERO tax liability.
- Indian Tax authorities used the substance over form principle to argue that the alleged substance of the transaction was tax avoidance and hence, Vodafone must be liable to deduct and pay TDS as the underlying asset (Hutch) was in India.
- The Court clarified that such observations extended only to artificial and colourable devices.
- The Supreme Court clarified that it is wrongful to understand that all tax planning is illegal, illegitimate, or impermissible. Every tax-payer is entitled to arrange his affairs so as to reduce the tax liability.
- HELD – Indian Income Tax Department had no jurisdiction to levy tax on overseas transaction between companies incorporated outside India and apply an interpretation in a manner to interfere with the commercial wisdom of the assessee.



Criticisms of the Interpretation

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The development of Double Tax Laws were framed to give relief to assessee's functioning in two or more countries but the interpretation in Azadi and Vodafone has led to several critiques -

01 Retrospective applicability of provisions

02 Assessee not completely accountable to income tax authorities of any single country

03 Concept of tax evasion being brought into every case of complex corporate structuring

04 Interpretation of DTAAs as being used to promote double non-taxation and treaty shopping

Yash Birla Offshore Trust

Can the trust corpus be linked to beneficiaries *vis-à-vis* beneficial owners?

Can beneficiaries be taxed if they receive no distribution from the trust?

Are beneficiaries liable if they appoint trustees?

Yash Birla Offshore Trust

With offshore trusts being allegedly used for money laundering, govt. imposed tax liability on beneficiary

The same was based on the wrongful classification of the assessee as a beneficial owner *vis-à-vis* beneficiary

Reference was made to Indian and Swiss anti-money laundering laws, local black money laws and clarifications to interpret the terms - beneficiary and beneficial owner

Based on such interpretation, a beneficial owner was distinguished from a beneficiary, being the assessee in the case

Held: The assessee, being a beneficiary ONLY, will not be subject to taxation on the entire corpus of the Trust

Linklater LLP v. Income Tax Officer (2010)

- Linklaters to pay taxes in India on fees its overseas employees earned if they worked for more than 90 days in India, despite Linklaters not having an office in India
- Wide ramifications on all sectors where foreign entities are providing services to Indian residents – higher costs for overseas law and accounting firms
- Indian tax authorities claim that such firms can however benefit from DTAAs.
- HELD – The entire fees for professional services earned by the assessee in connection with the projects in India and which is thus sourced from India, is taxable in India based on an interpretation of the domestic laws

Services not rendered in India are still attributable to India for the purpose of taxation

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THANK YOU

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