



GLOBAL TAX ADVISORY SERVICES

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Ninth International Tax Planning Conference – 2003

Tax Treaty Interpretations in India

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Guiding principles

- Neutrality
- Growth of trade
- International consensus





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2 Guides to interpretation

Extent of reliance on the OECD/UN MC* and Commentary



*Model Convention

Reliance on OECD/ UN MC and Commentary

*“Member countries**should confirm** to Model Convention as interpreted by the Commentaries thereon”...Para 3 – Introduction to OECD Commentary*

*“Worldwide recognition of provisions of MC and their incorporation into majority of conventions have helped make Commentaries a **widely accepted** guide to interpretation”...Para 15 - Introduction to OECD Commentary*

*“If negotiating parties decide to use in a treaty , wording suggested in UN MC, it is to be presumed that they would also expect to **derive assistance in interpretation** of that wording”...Para 36 of UN Commentary*

Reliance on OECD/ UN MC and Commentary

Indian perspective – What the judiciary has observed

The OECD/ UN MC and Commentary play a “**key role**” in interpreting tax treaties...CIT Vs Vishakapatnam Port Trust (AP)

They constitute “international tax language” & “**contemporanea exposito**” ... Graphite India Ltd (Cal ITAT)

The meanings assigned by OECD / UN Model and Commentary should be given “**due weightage**” ...ITC Vs DCIT (Cal ITAT)

Reliance on OECD/ UN MC and Commentary

Indian perspective

“*Favoring*” reference to MC and Commentary

OECD/ UN MC and Commentary have generally received “**due respect**” from judiciary in interpreting the treaties

Courts have frequently “**referred**” to the OECD/UN MC and Commentary

- to ‘reinforce’ / ‘confirm’ its conclusion
- to ‘draw support’ for its conclusion and [UOI Vs Azadi B Andolan (SC)]
- in certain cases, even ‘followed’ the MC and Commentary [Vijay Ship Breaking (Guj)]

Reliance on OECD/ UN MC and Commentary

Indian perspective

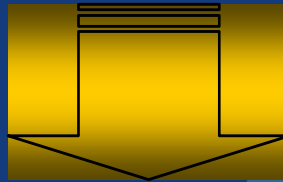
– “*Disapproving*” reference to MC and Commentary

In certain cases, judiciary ‘**refused**’ to follow the OECD Commentary observing that it is “contrary to the well-established principle of statutory interpretation” [P No 28 of 1999 – AAR]

Judiciary has given observations which may give an impression that reliance upon OECD Commentary is ‘**inappropriate**’ and ‘**unjustified**’ [CIT Vs SRM Firm (Mad)]

OECD/ UN MC and Commentary – Issues

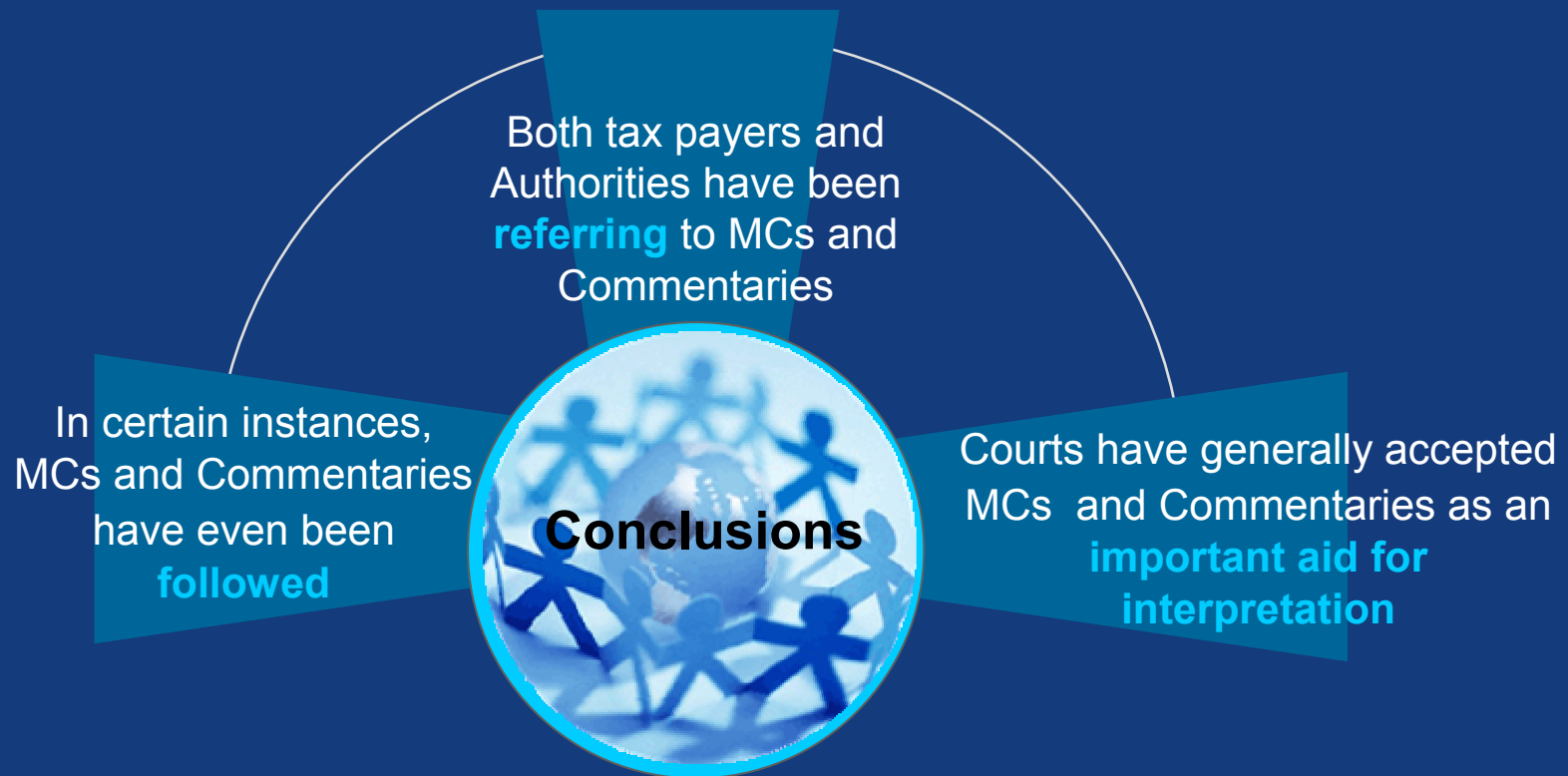
Relevance of the ‘revised OECD Commentary’ in construing a treaty signed prior to the revision??



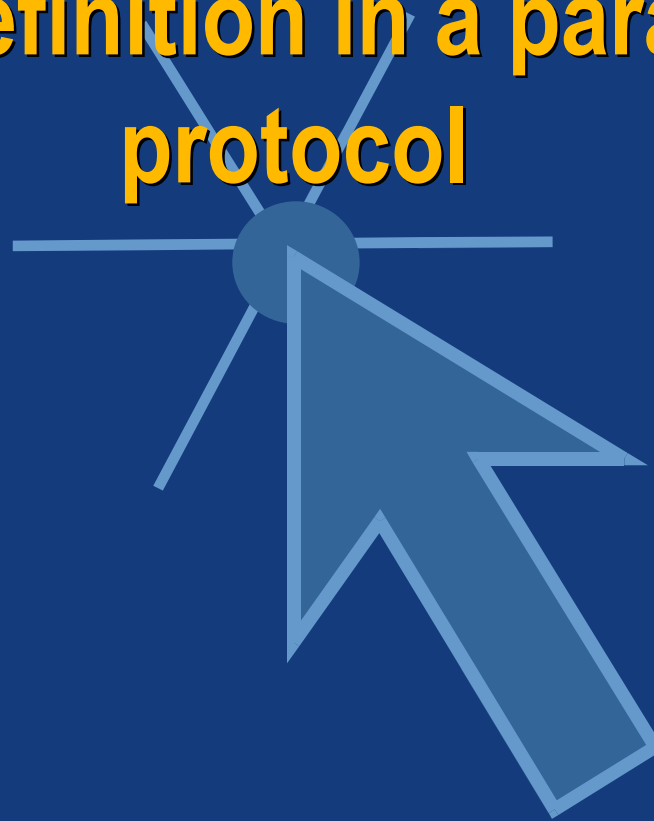
Observed by judiciary that a “*useful reference*” could be made to the revised OECD Commentary and that the tax treatment “*has to confirm*” to the revised Commentary “*to accommodate the emerging developments*”

Thoughts??

OECD/ UN MC and Commentary – Summing up



Reliance on definition in a parallel treaty or protocol



Reliance on definition in a parallel treaty or its protocol

“There is no reason why parallel treaties should not be referred to....but their value as aids to interpretation will generally be low”....Philip Baker

Reliance placed by Supreme Court on India-US treaty (Limitation of Benefit clause) while opining on treaty shopping

Indian judiciary has been placing reliance on definitions in parallel treaties and protocols...leading precedents being Raymonds Limited and CESC Vs DCIT

Classic example being definition of “Make available”... MOU to India – US treaty has been ‘looked into’ as an ‘aid’

Reliance on definition in a parallel treaty or its protocol – Issues from an Indian perspective

Applicability of principles enunciated in Raymonds and CESC in case the definition of term contained in another treaty or protocol fictionally extends or restricts normal meaning??

Whether the principle of these decisions hold good even if the interpretation accorded to the term by the other Contracting State is different??

To what extent would the ratio apply if an identical term were defined in the MOU/ treaty with another country that has been entered into subsequently??

Can one apply the ratio of these decisions to contend that if a particular tax treaty defines a particular term on the lines of OECD/ UN MC, the meaning of that term as explained in the OECD/ UN commentary should be necessarily applied??

Thoughts??

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Retrospective applicability of a protocol

What the Courts have observed...

Lack of jurisdiction

Any authority that has the power to make subordinate legislation cannot make law with retrospective effect unless authorized by legislature

Promissory Estoppel

- What is given under earlier treaty cannot be taken back retrospectively
- Tax payer acting on promise not to be placed in an adverse position

Tata Iron & Steel case...fact pattern

Fact pattern

- ✓ Tax treaty between India and Germany was notified on September 13, 1960
- ✓ Tax treaty contained no specific provision relating to FTS
- ✓ Amendments were made to the tax treaty to tax FTS arising in India
- ✓ As per the protocol, amounts that were exempt earlier were made taxable w.e.f FY 83-84
- ✓ Protocol ratified in August 1985
- ✓ Contracts entered into by assessee prior to August 1985
- ✓ Payments made during financial years 84-85 and 85-86

The issue...

Whether payments made after ratification of protocol but pursuant to a contract entered prior to ratification, chargeable to tax in India??

The verdict...

✓ Assessee cannot be fastened with any tax liability which was exempt under treaty and protocol at least till August 1985

✓ Notification invalid to the extent adverse/ retrospective

A comparison...Timken India Ltd (Cal)

Fact pattern

- ✓ Assessee entered into contract prior to date when India-US treaty was effective
- ✓ Consideration payable only after designs delivered
- ✓ Designs delivered after treaty came into effect

Issue



Whether assessee entitled to treaty benefit ??

Verdict



Assessee entitled to benefit of India-US tax treaty since payments accrued and became due only after treaty came into effect

Advantage tax payer...

TISCO Case
[ITAT Mum]

Advantage...

Timken India Ltd
[Cal]

✓ Protocol not applied even to subsequent payments on the basis that when contract was entered into, protocol had not been notified

✓ Treaty applied on the basis that when the amounts accrued, the treaty was effective

Retrospective applicability of a protocol

– Open issues

Applying TISCO's decision, there may be a situation where a taxpayer may not be taxed in both countries since the home country may forego its right to tax such income and allow India to tax it.
Can such a consequence be intended??

Will the ratio of this decision have any relevance in a case where certain income is exempted with retrospective effect by a protocol/ notification?? Can Authorities refuse to grant exemption on the grounds that such a protocol/ notification is "ultra vires" the powers of Government??

Will the ratio of this decision have any bearing on deciding whether revisions to the OECD Commentary also apply retrospectively??

Thoughts??

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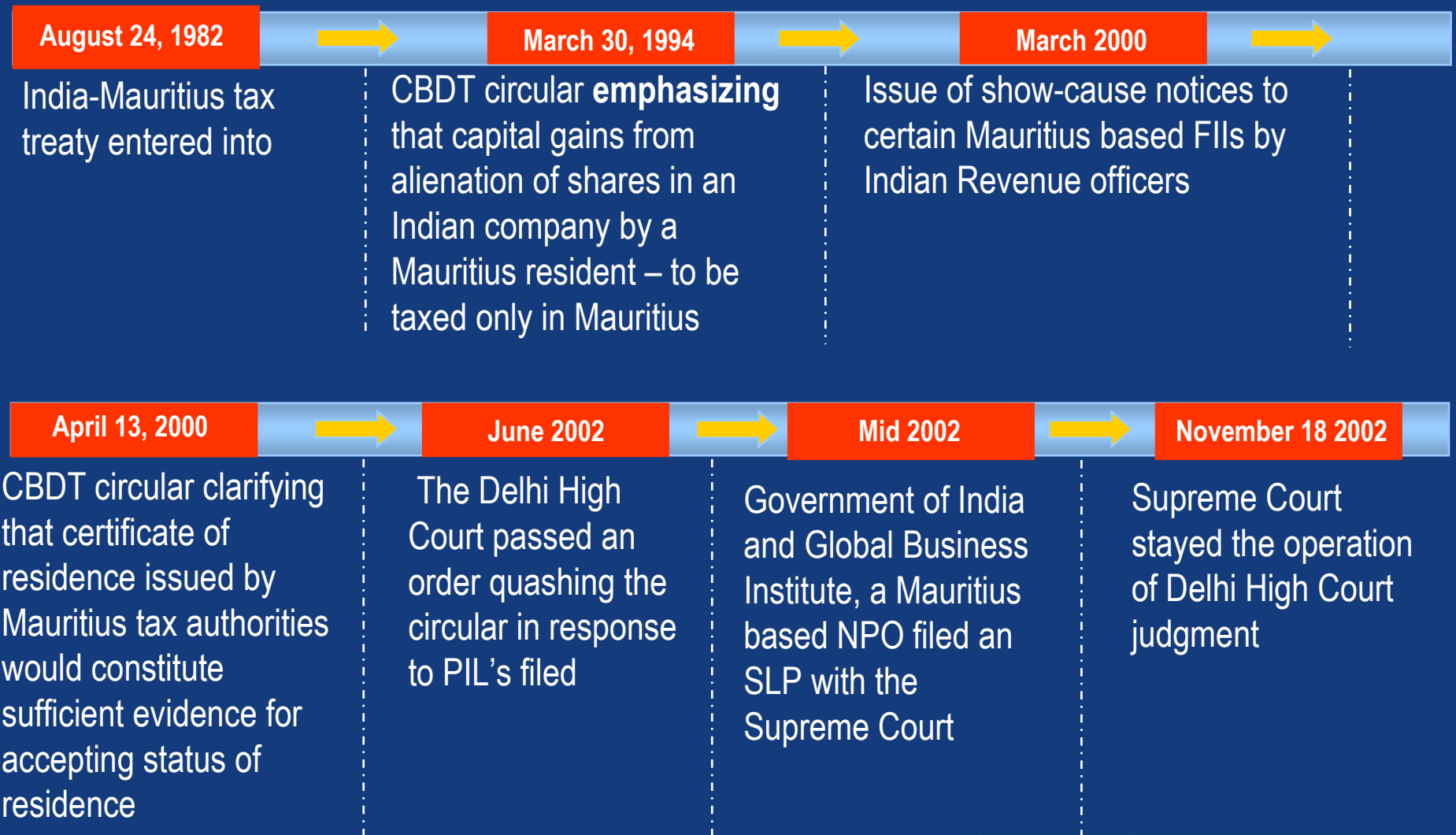
Recent developments

Guiding principles... **1**

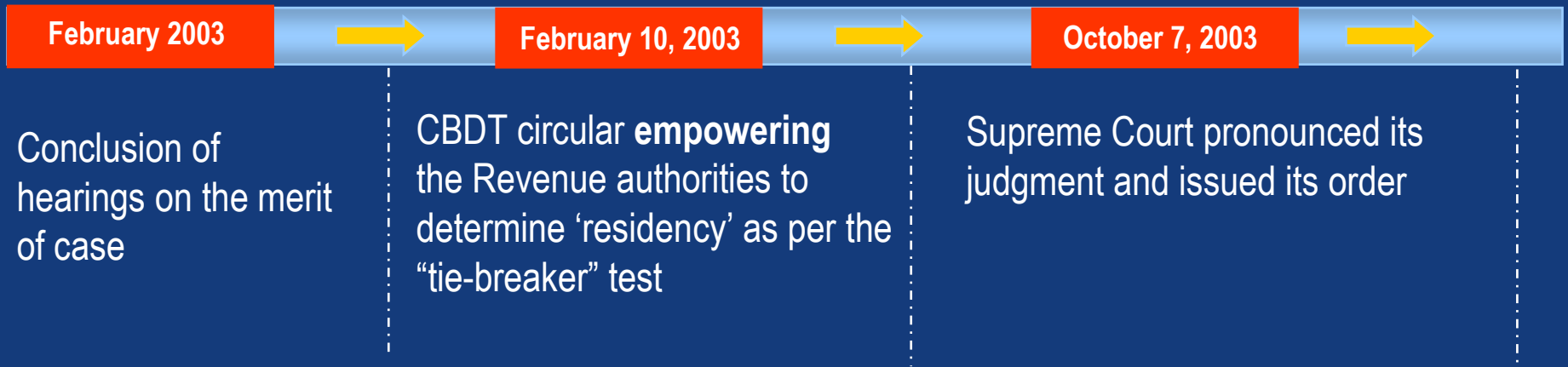
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Evolution of India-Mauritius treaty and controversies



Evolution of India-Mauritius treaty and controversies



Supreme Court Ruling on India-Mauritius treaty – Key issues

Act otherwise valid in law is not 'non-est' merely based on underlying motive

Principles adopted in interpretation of treaties not same as those adopted in interpretation of statutory legislation

Interpretation of tax treaties

Purpose of tax treaty is to ensure benefits available there under – even if inconsistent with provisions of domestic tax laws

Treaties are entered at political level and have several considerations

Supreme Court Ruling on India-Mauritius treaty – Key issues

Report of working group on Non-Resident
taxation and Joint Parliamentary Committee
Report signifies what the law ought to be!!
And not what the law is!!

Is treaty shopping illegal?

No express provisions in domestic
law or treaty against Treaty shopping

Motive wholly irrelevant and
Cannot affect the legality of
transaction

Developing countries often regard
'treaty shopping' as a tax incentive
to attract scarce foreign capital

Supreme Court Ruling on India-Mauritius treaty – Thoughts?

What would be required to establish 'residence' and 'beneficial ownership' under tax treaties in the context of 'treaty shopping'??

How relevant would implicit anti-avoidance provisions such as 'beneficial ownership' be in the absence of specific 'limitation of benefits' clause in tax treaties??

Whether tax residence certificate would be sufficient to justify that there is no violation of 'beneficial ownership' concept under a tax treaty??

Whether Authorities can still demand various details regarding management and other affairs of Mauritian entities?? What would be potential consequences of not submitting these details ??

Thoughts??

Supreme Court Ruling on India-Mauritius treaty – Thoughts?

Whether companies from other jurisdictions could migrate to Mauritius as a preferred route for investing in India??

Whether conduit companies from other jurisdictions can claim benefits under relevant tax treaties based on tax residency certificates??

Whether Supreme Court has overruled decision in Cyril Pereira's case wherein it was held that fiscal residence to be determined on the basis of liability to pay tax and liability has to be actual and not notional??

Thoughts??

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Thank You