

Current trends in the development of Case Law of Indian
Courts on the resolution of cross border tax disputes.
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Judicial methods of Interpretation of Tax treaties

Landmark Cases: Azadi Bachao, Ram Jethmalani

- ✓ India not a signatory of VCLT
- ✓ Treaties are to be interpreted differently from domestic law
- ✓ Treaties are to be liberally interpreted
- ✓ Absurdities should be avoided
- ✓ Where language used in the treaty is clear, there is no need to refer to Commentaries
- ✓ OECD commentary is contemporaneous exposition of law(Extreme View)
- ✓ Reference to foreign court rulings
- ✓ Two views regarding use of language in other tax treaties

Vienna Convention

- ✓ Article 31, "General Rule of Interpretation", of the Vienna Convention of the Law of Treaties, 1969 provides that 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."
- ✓ While India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also.
- ✓ However, the government cannot bind India in a manner that derogates from Constitutional provisions, values and imperatives.

Ram Jethmalani Vs. Union of India (2011-TII-05-SC-INTL)

Azadi Bachao

- ✓ Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1 a treaty is really an indirect enactment, instead of a substantive legislation, and that drafting of treaties is notoriously sloppy, whereby inconveniences obtain.
- ✓ 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.
- ✓ However, the fact that such treaties are drafted by diplomats, and not lawyers, leading to sloppiness in drafting also implies that care has to be taken to not render any word, phrase, or sentence redundant, especially where rendering of such word, phrase or sentence redundant would lead to a manifestly absurd situation, particularly from a constitutional perspective.

Impact of the commentaries

- ✓ Vishakhapatnam Port Trust- OECD MC as aid to interpretation
- ✓ “In view of the standard OECD Models which are being used in various countries, a new area of genuine ‘international tax law’ is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings world-wide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adaptation is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant.”

Impact of the commentaries

- ✓ Azadi Bacahao- relied on OECD MC for interpreting ‘liable to taxation’
- ✓ P- No 28-AAR rejected argument based on OECD MC that even in service PE, condition of fixed place PE, must be satisfied.(Para 11)
- ✓ Kulandagan Chettiar- ‘may be taxed’-“ Taxation policy is within the power of the Government and Section 90 of the Income Tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income Tax Act, it would be unnecessary to refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements.”
- ✓ UN –Model –James Macintosh& Co Pvt Ltd Vs ACIT- ‘more than casual’-merely because ship visits ports as and when required it cannot be said that the operation was no more than casual

Impact of the Indian Position

- ✓ Gracemac corporation Vs ADIT- Transfer of packaged software- held to be royalty- The Judgement mentions India's position that India does not accept the OECD position in this regard.

Contrary view-

- ✓ Income Tax Officer Vs Right Florist- Online advertisement revenue cannot be taxed in the absence of a fixed place PE- Website not a PE- India's Position to the contrary relevant only in respect of treaties entered into after July 2008 when India stated its position

Disputes concerning application of the concept of Residence

Residence- Individuals

- ✓ Domestic definition in case of natural persons depends only on period of stay
- ✓ Disputes mostly relating to manner of calculation of the period of stay
- ✓ Manoj Kumar Reddy Nare v. Income Tax Officer (2009) TIOL-486-ITAT-Bang
- ✓ The words 'from' and 'to' are to be inevitably used when ascertaining the period, despite the fact that these words are not mentioned in the Statute.
- ✓ As per General clauses Act, the first in a series of a day is to be excluded if the word 'from' is used.

Concept of residence

"6. Residence in India:- For the purposes of this Act,--

(i) An individual is said to be resident in India in any previous year, if he--

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more”

...

CIT Vs. Suresh Nanda [2015-TII-41-HC-DEL-INTL]

Forced stay- Suresh Nanda

Income Tax Act leaves the choice to the citizen to be in India and be treated as a resident for purposes of taxation or be not in India so as to avail the status of a non-resident.

It naturally follows that the option to be in India, or the period for which an Indian citizen desires to be here is a matter of his discretion. Conversely put, presence in India against the will or without the consent of the citizen, should not ordinarily be counted adverse to his chosen course or interest, particularly if it is brought about under compulsion or, (...) involuntarily.

There has to be, (...) something to show that an individual intended or had the animus of residing in India for the minimum prescribed duration. If the record indicates that – such as for instance omission to take steps to go abroad, the stay can well be treated as disclosing an intention to be a resident Indian. Equally, if the record discloses materials that the stay (to qualify as resident Indian) lacked volition and was compelled by external circumstances beyond the individual's control, she or he cannot be treated as a resident Indian.

Corporate residence-

Either incorporated in India or Control and management 'wholly' in India

Radharani Holding (P) Ltd vs ADI- (2007) TII-61-ITAT-DEL

Change in the recent budget, 2016

Concept of place of effective management introduced. Will come into force from April, 2017

Judicial approaches to the determination of the scope of tax treaties

Liable to pay

This Agreement (Convention) shall apply to persons who are residents of one or both of the Contracting States (Article 1)

For the purposes of this Agreement the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature...(Article 4)

Liable to pay

- ✓ Cyril Eugene Pereira (AAR)- no tax in UAE, therefore taxpayer not entitled to treaty benefits.
- ✓ Azadi Bachao (SC)- Argument- Conduit companies in Mauritius not entitled to benefits since they do not pay any tax in Mauritius. SC held 'liable to tax' is not the same as payment of tax
- ✓ Abdul Razzak A Meman (AAR)- 'liable to taxation' intended to act as words of limitation. Therefore taxpayer not entitled to (Treaty language with UAE subsequently changed)
- ✓ Green Emirates Shipping(ITAT)- 'liable to taxation' does not imply that the person should actually be liable to tax by virtue of an existing legal provision but would also cover cases where the State has a right to tax such persons whether or not such a right is exercised.

Transparent Partnership- Two views

Lniklaters LLP-(ITAT-Mumbai)

- ✓ UK partnership of lawyers allowed treaty benefit even when the partnership was not liable to be taxed in the UK in its own right so long as the entire profits of the partnership are taxable in the UK either in its own hands or in the hands of the partners

Schellenberg Wittmer (AAR)

- ✓ Income is received by the Partnership and Partnership- not a taxable entity under the Swiss law
- ✓ Person – Article 3(d)- the term person includes an individual, a company, a body of persons or any other entity which is taxable under the laws in force in either Contracting State.
- ✓ Not a person. Not entitled to treaty benefit

Disputes concerning procedural aspects of Application of Tax Treaties

TRC

- ✓ Earlier there was no statutory requirement of filing TRC
- ✓ In case of Mauritius, circular 789- TRC issued by Mauritius= proof of residence and beneficial ownership
- ✓ Domestic Law changed in 2012- certificate in prescribed form- changed in 2013- certificate only has to be obtained.
- ✓ Information to be provided in Form 10F
- ✓ Necessary but not sufficient condition- dropped.
- ✓ TRC given by foreign tax authorities cannot be ignored

Pramerica ASPF II Cyprus Holding Ltd[2016-TII-49-ITAT-MUM-INTL]

- ✓ Taxpayers while filing return of income have to submit details in respect of income to be taxed at special rate[Part SI of the Return form]. In this case, the taxpayer, a resident of Cyprus did not fill up that portion.
- ✓ Taxpayer had earned interest from CCDs and claimed the interest to be taxable at the concessional rate of 10% under Article 11(2) of the India-Cyprus tax treaty.
- ✓ Taxpayer had submitted a TRC from the Cypriot tax authorities
- ✓ Taxpayer's claim was accepted in the earlier tax year
- ✓ This was an inadvertent omission and the approach of the tax authorities was over-technical and untenable.

Foreign Tax credit

- ✓ Unilateral credit available u/s 91 of ITA
- ✓ Taxpayer must pay first and then claim credit.
- ✓ Treaties normally provide ordinary credit on a per country basis.
- ✓ Draft Foreign tax credit rules released in April, 2016 for public comments.

WIPRO Vs. DCIT [2015-TII-66-HC-KAR-INTL]

- ✓ WIPRO engaged in export of software services, had branches in USA/ Canada and other countries for rendering onsite . It paid taxes in the USA both at the federal and state level.
- ✓ It gets exemption of its income under the STPA scheme for a number of years u/s 10A of the ITA
- ✓ Its claim of tax credit was denied by authorities
- ✓ The HC examined the charging provision as well as section 90 and held that the income though exempt for some years under the provisions of the Act, qualifies as ‘income chargeable to tax’
- ✓ However, the relevant provision of the treaty has to be examined

In respect of India-USA treaty, the provision was:

25(2).(a) Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.”

Income tax paid in India is not a condition precedent.

23(2)(a)- The amount of Canadian tax paid, under the laws of Canada and in accordance with the provisions of the Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Canada which has been subjected to tax both in India and Canada shall be allowed as a credit against the Indian Tax payable in respect of such income but in an amount not exceeding that proportion of Indian Tax, which such income bears to the entire income chargeable to Indian tax.”

Income has to be subjected to tax both in Canada and India

91(1) If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (...), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Explanation-

(iv) the expression 'income tax' in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

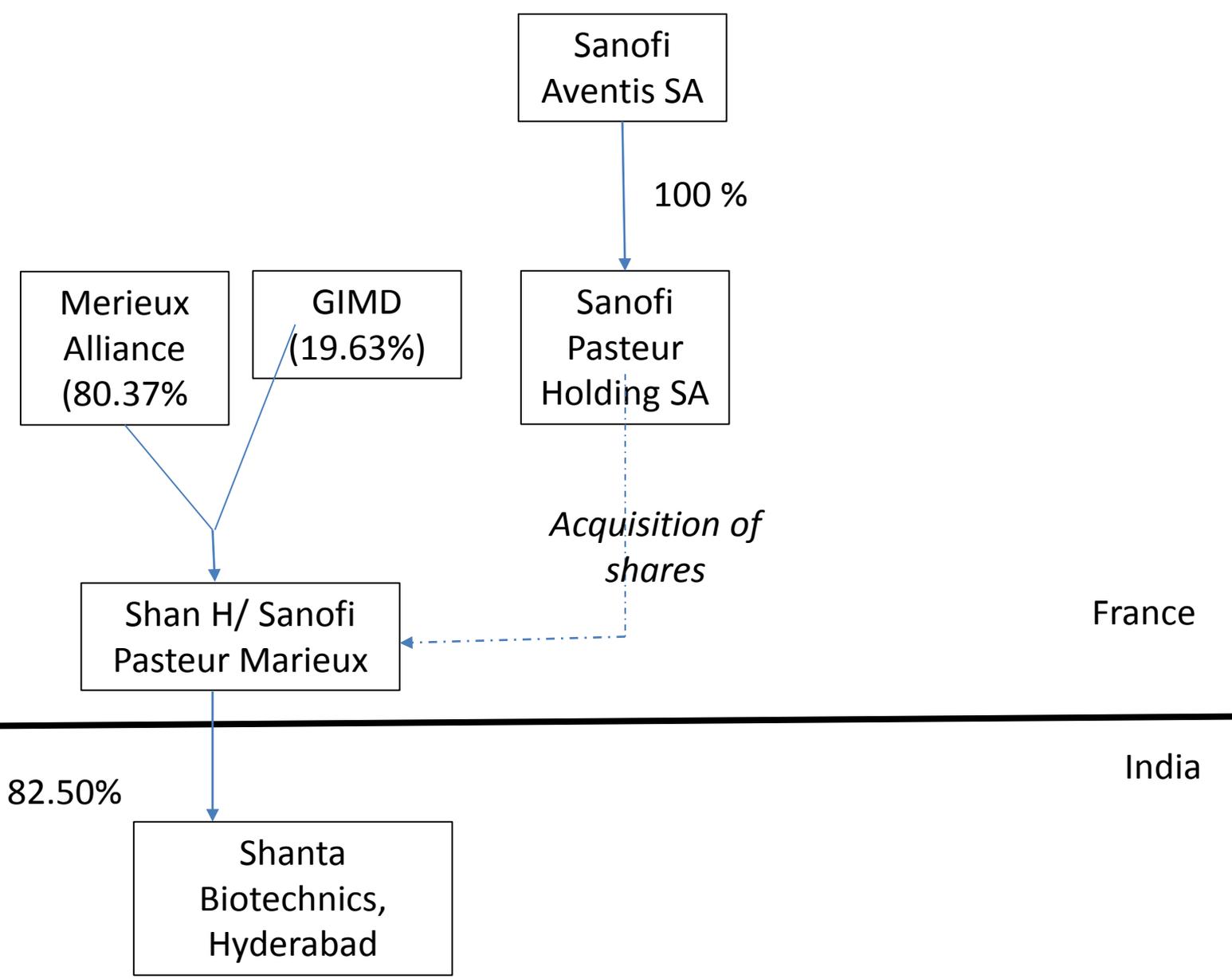
- ✓ The Income Tax in relation to any Country includes Income Tax paid in any part of the country or a local authority. It applies to cases where in a Federal structure a citizen is made to pay Federal Income tax and also the State Income Tax.
- ✓ Therefore, even in the absence of an agreement under Section 90 of the Act, by virtue of the statutory provision, the benefit conferred under Section 91 of the Act is extended to the income tax paid in foreign jurisdictions.
- ✓ Therefore, even though, India has not entered into any agreement with the State of a Country and if the taxpayer has paid income tax to that State, the income tax paid in relation to that State is also eligible for being given credit to the taxpayer in India.

Disputes concerning application of Anti-Avoidance Measures in cross-border situations

Anti Avoidance

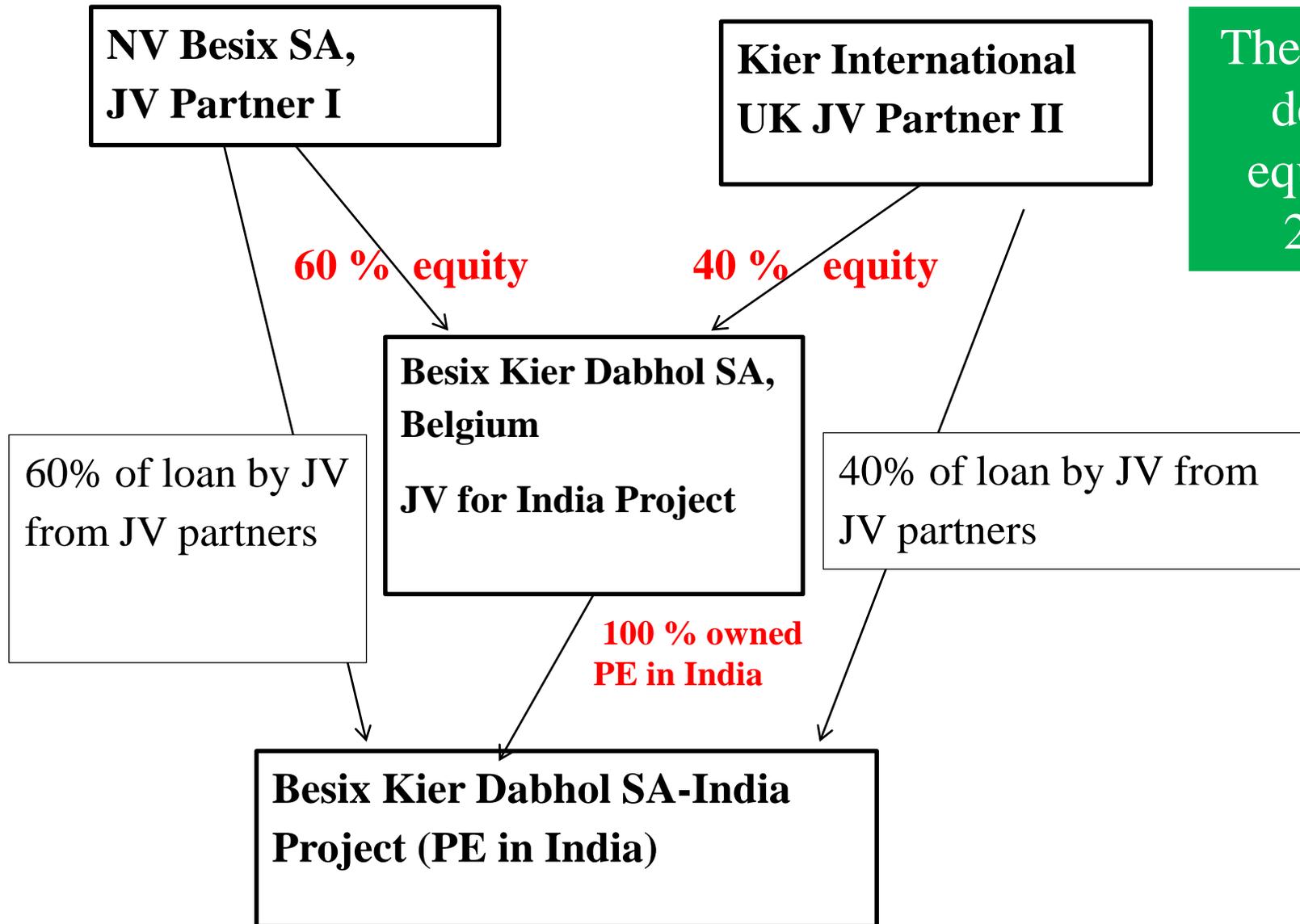
- ✓ GAAR still not in place in India
- ✓ Substance over Form doctrine-
Substantially diluted in Vodafone

Sanofi Pasteur Holdings SA- 2013-TII-HC-AP-INTL



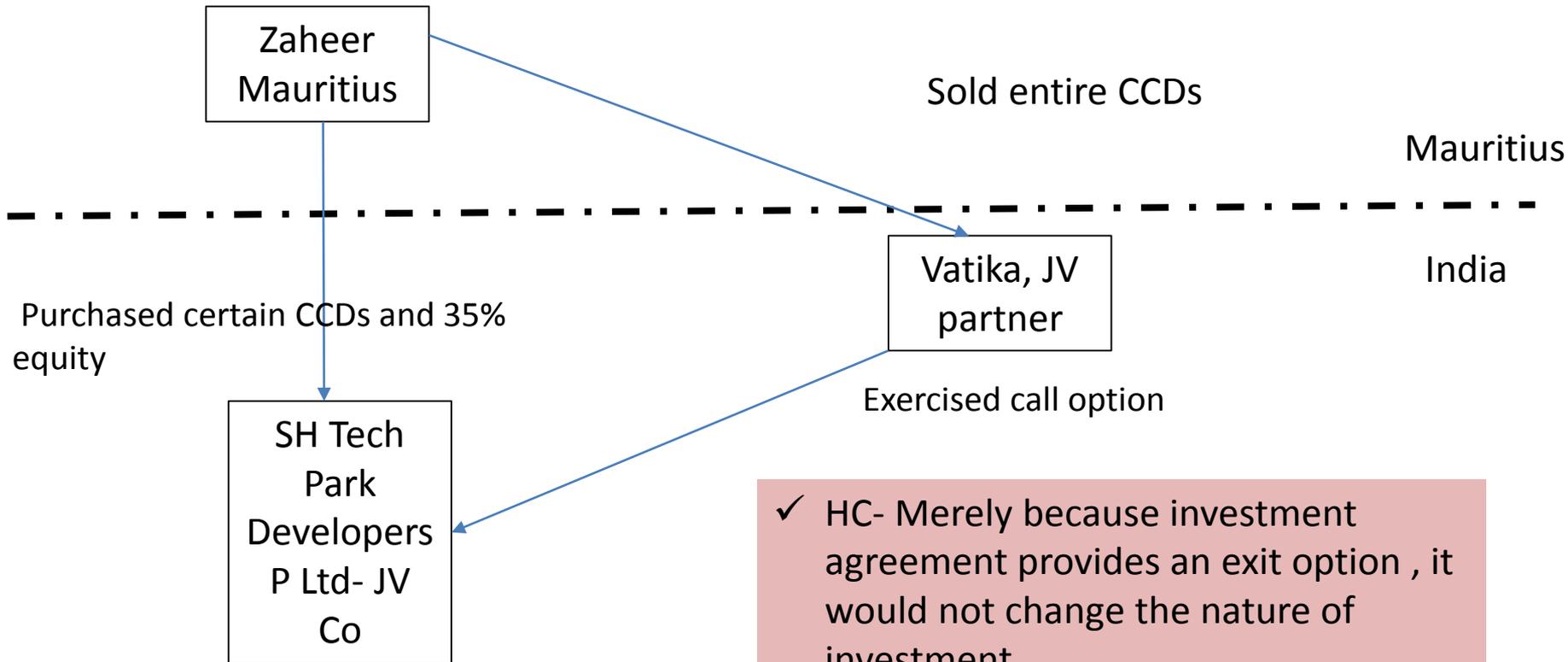
Disputes concerning Taxation of Passive Incomes

Besix Kier Dabhol, SA



The ratio of debt to equity is 248:1

Zaheer Mauritius (2014-TII-39-HC-DEL-INTL)

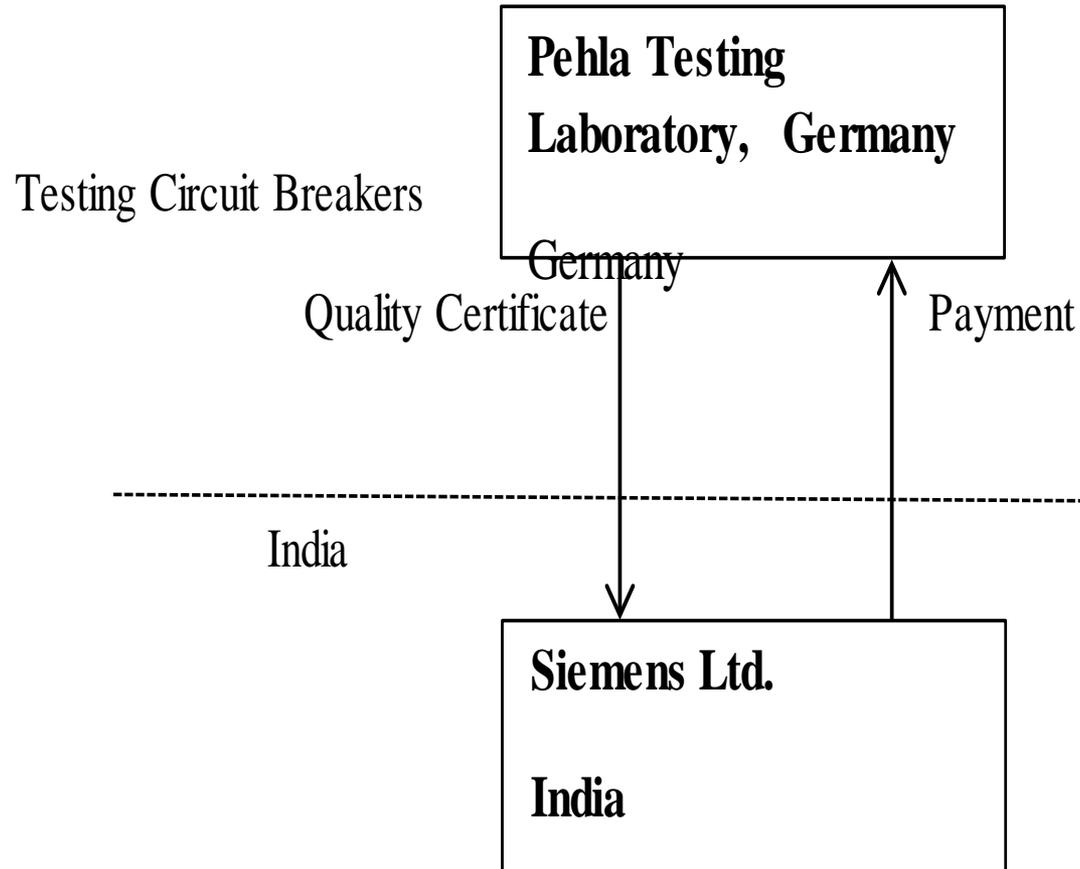


- ✓ AAR- Fixed rate of return
- ✓ JV company controlled by Vatika
- ✓ Transaction shown as equity to avoid tax

- ✓ HC- Merely because investment agreement provides an exit option , it would not change the nature of investment
- ✓ Affairs of JV company managed separately
- ✓ If gains considered as interest then would also qualify for deduction.

Siemens Ltd Vs. CIT

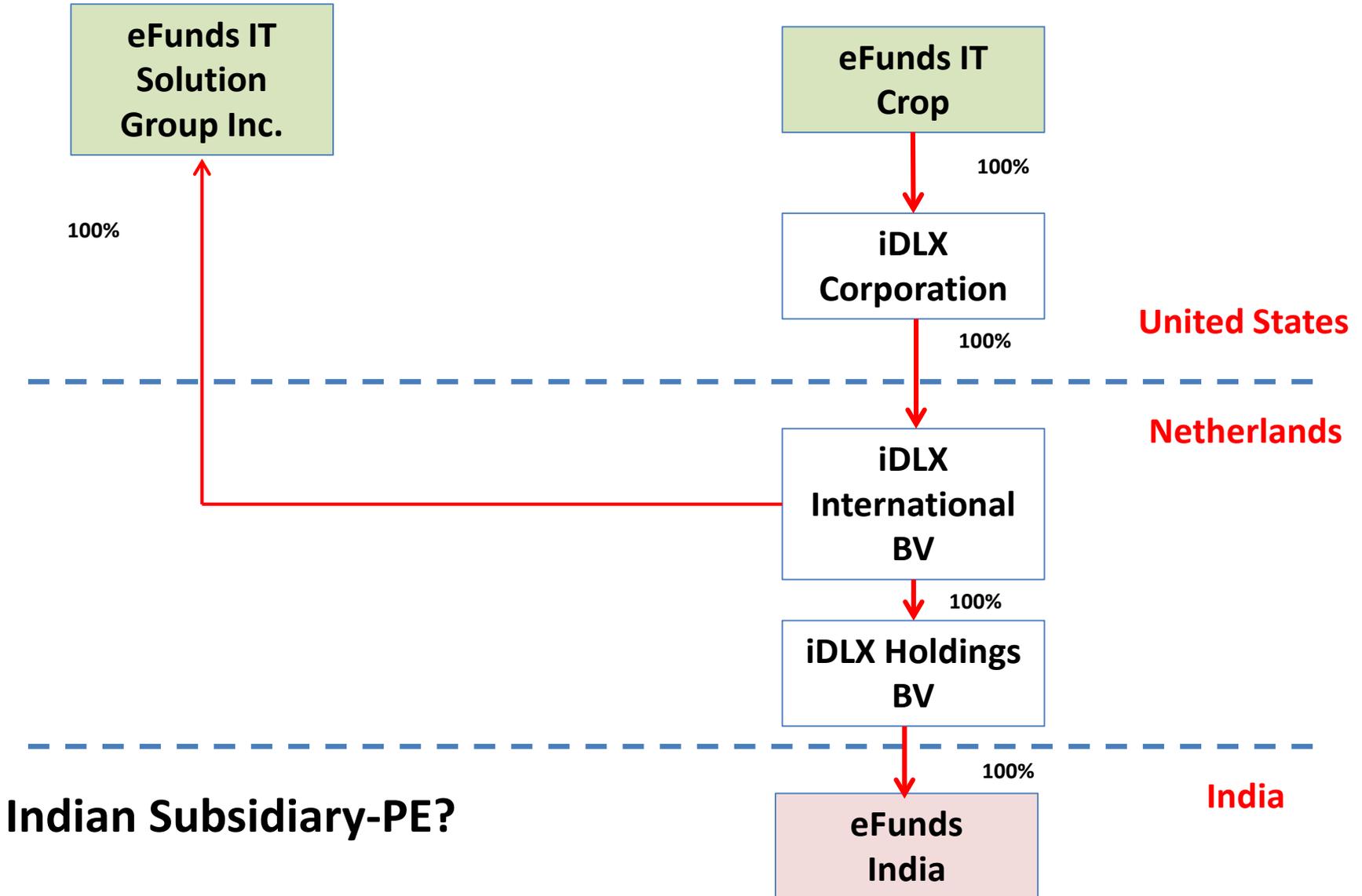
- Highly technical service
- Deduct tax @ 10%
- Tribunal- Usage of technology without human intervention not equal to technical services



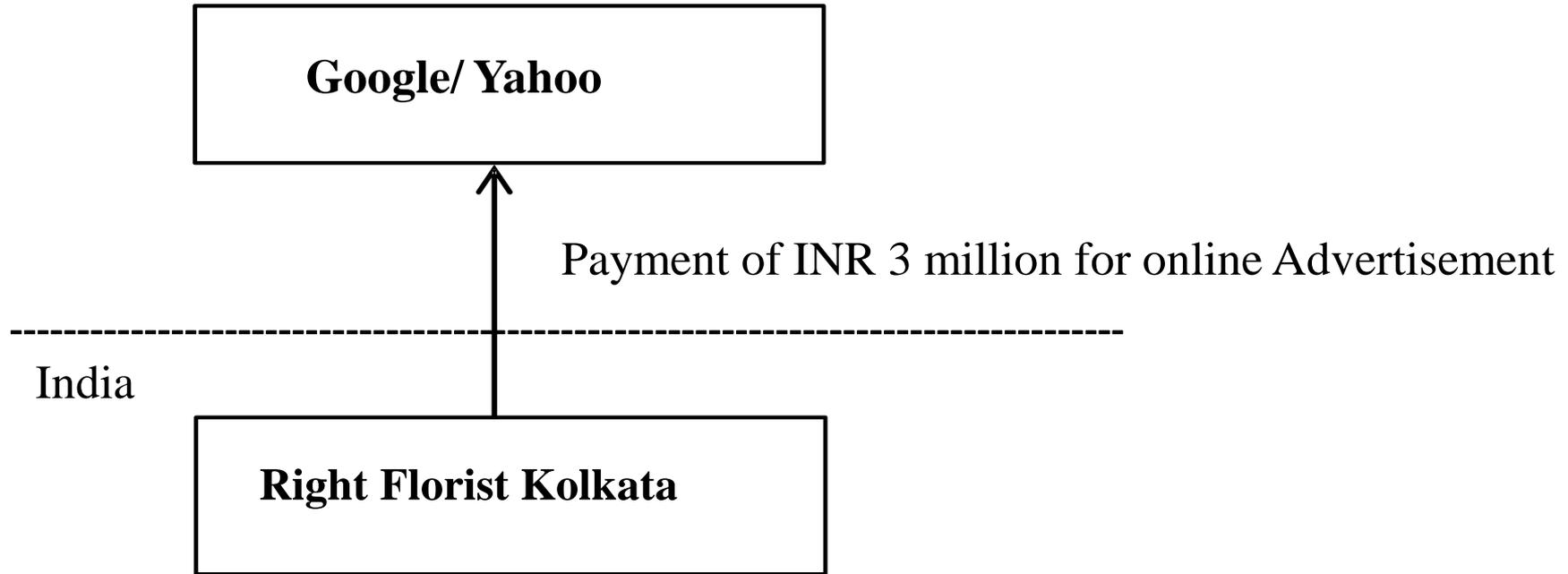
Application for No TDS

Disputes concerning Taxation of PE

eFunds



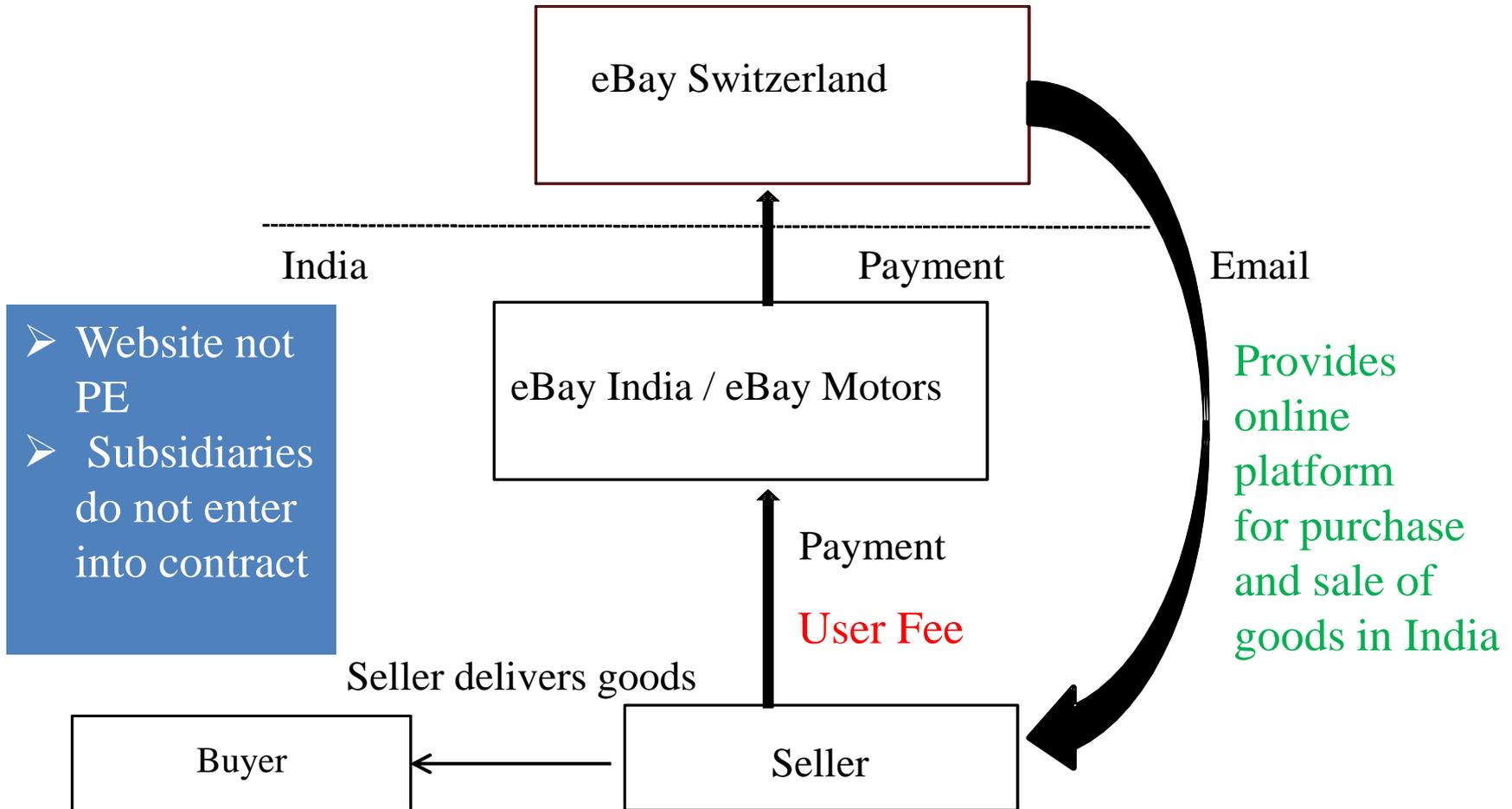
ITO Vs. Right Florists Pvt. Ltd



- Payment made without TDS
- Tribunal – No PE
- Service rendered without human intervention- no FTS
- Following OECD MC- website is not PE
- India's position ignored.

“Clearly, conventional PE test fails in this virtual world even when a reasonable level of commercial activity is crossed by foreign enterprise. It is a policy decision that Government has to take as to whether it wants to reconcile to the fact that conventional PE model has outlived its utility as an instrument of invoking taxing rights upon reaching a reasonable level of commercial activity and that it does fringe neutrality as to the form of commercial presence i.e. physical presence or virtual presence, or whether it wants to take suitable remedial measures to protect its revenue base. Any inertia in this exercise can only be at the cost of tax certainty.”

eBAY International AG



- Website not PE
- Subsidiaries do not enter into contract

➤ Revenue generated from operation of websites in India during the year was INR 49.42 million

Conclusions

Some concluding thoughts

- ✓ As economies become more and more integrated, disputes about interpretation are bound to increase.
- ✓ The problems get accentuated when revenue bodies charged with finding revenues come across obvious and often blatant but technically legal use of tax treaties and provisions of domestic laws.
- ✓ Some of these issues may be addressed in BEPS.
- ✓ However, the solutions may be more complicated and may require further elaboration and consensus building.
- ✓ Disputes will be there but the need is to manage the same.
- ✓ There is a need to look for common understanding of countries or groups of countries based on common interests to come to a common understanding on issues.
- ✓ Much greater interaction, particularly among the tax administrators, are required.