

**Principles of Jurisprudence**  
**With Special Reference to the decision in**  
**Chettiar's case.**

Double Tax Avoidance Agreement  
Between India & Malaysia

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## 1. Preface:

1.1 In this article, I propose to have a look at some **principles of Jurisprudence**. I am not a lawyer. Hence I am not competent to comment on principles of jurisprudence. Fully understanding my limitations, I am expressing my humble views on some principles. I will be obliged if experts in Jurisprudence can guide me.

The focus of this article is on judicial decisions on International Tax.

The need for the close examination of these decisions has arisen because of the following circumstances. **In 1991**, the Government of **India started liberalising** & opening up the Indian economy. Until then, there were few cases on international taxation in India. Even the tax laws were not developed to meet with the challenges of International taxation. Most of the concerned people were ignoring international tax aspect of the law. Now international tax has become a prominent subject.

Simultaneously, **globally** all the technologies regarding computers, internet, telephones, satellites and mobile phones etc. developed rapidly & converged. This created methods of doing business where the physical presence of the businessman became unnecessary at the market place. Global business has grown tremendously in totally unexpected manners & areas. This has thrown up challenges at global level. Even the **OECD & U.N. models** of Double Tax Avoidance Agreements are found to be **inadequate** to deal with the current situation. This has caused considerable confusion.

As per normal human instincts, change, though inevitable, is resisted. The resistance is highest in the field of law. This has created a situation where some persons & authorities seem to be confused about Double Tax Avoidance Agreements. Can we try & reduce some confusion! **Let us see - the system of Double Tax Avoidance Agreements, some judicial decisions, and principles of jurisprudence**. In other words we analyse the problem, try to understand the root causes; and see if a solution can be worked out.

1.2 I have spoken about "concepts" & "philosophy" from different stages at different conferences. In this article I am discussing these words - 'Concepts', 'Ahimsa' & 'UnEkantVad' at a deeper level.

This is a talk on taxation. About Interpretation of DTA, Interpretation of Law. What is the relationship between Philosophy & Law?

**Jurisprudence is defined as Philosophy of Law**. If one doesn't know jurisprudence, he is not entitled to interpret law. Hence legal

practice should start with a study of philosophy of law. All lawyers have studied it.

Chartered accountants do not have jurisprudence as part of their CA syllabus. So they don't study it. As a CA, my competence to discuss these issues is limited. I do hope to learn from the debate that may be generated by this article.

This discussion is on concepts rather than interpretation of one word or sentence. **Conceptual thinking** grows slowly like a tree. In one article, the thinking cannot be completed. Even if we can start thinking on some of the concepts, we would have achieved some thing. It will be a continuous process.

### 1.3 Consider an illustration of a "Concept".

Ahimsa. It is a concept.

Some people know the concept, some don't. Though every one knows the meaning.

For people who know, the mention of "Ahimsa" is enough to remind them of Mahatma Gandhi, Bhagwan Mahavir & Bhagwan Buddha. They see the picture of Gandhiji with just one dhoti on the body, and a walking stick in his hands. With the only weapons of Truth & Ahimsa, he drove out the Britishers who had just conquered Hitler.

That is the strength of Ahimsa.

Another aspect of Ahimsa. It means - not even hurting the feelings of people - whether directly or indirectly.

Now think of a person who has no mercy at heart, no love for people. He is totally unaware of how one may feel love for strangers.

If two people (i) with advanced evolution in philosophy; and (ii) a person with no inkling of principles of Ahimsa were to discuss & debate "How Gandhiji got us independence"; what would be the quality of the discussion!

**Issue: One cannot discuss an issue unless he is good at the concepts involved in the particular subject.**

In practice, it is a professional ethic - not to speak on a subject on which one is not an expert. For example, if I have not studied excise, customs law & service tax, I cannot give an opinion on these matters. If a client comes to me for an issue on Service tax, I cannot say: "I will study

the subject tonight and I will discuss it with two experts. Come tomorrow for the opinion.”

**1.4** I am quoting some principles that I have heard during discussions with senior professionals as well as some judicial members. These principles are not discussed in Salmond’s book on Jurisprudence; or if discussed, the emphasis is different from what seems to be prevalent in India.

**1.4.1** It is said that “**Judge needs to know no law**”. It is for the advocates of the two sides to educate the judge. If any judgement has any errors, it is the fault of the advocates.

**1.4.2** It is held in several cases that if the language of the law is clear, there is **no need to consider** the **intention** of the legislature, or to consider the **reference to the context** etc.

**1.4.3** A judge’s duty is to **interpret the law**. He is not to concern himself about the consequences. It is not his duty to ensure justice.

**1.4.4** **Discretion** has no place in law.

In this discussion let us examine these principles & the consequences of following the same in the field of Double Tax Avoidance Agreements (DTA).

**1.5** Honourable Chief Justice of The Bombay High Court, Mr. Swatanter Kumar when speaking at the International Tax Conference, organised by IFA (International Fiscal Association) India and the OECD (Organisation for Economic Cooperation and Development), in Mumbai on Wednesday the 23<sup>rd</sup> January, 2008 said as under:

*“International taxation has become complex.  
“All the controversies relating to international taxation are about interpretations of the provisions of domestic law and the treaties and conventions concerning double taxation avoidance.*

*“Complex tax laws pose problems both in interpretation and implementation. Which is why tax legislation and treaties should be simple and understandable to the common man and those in trade.” International taxation has become too complex an issue. It has made the legal circles rethink the jurisprudence of tax jurisdiction...*

*“Innovation in applying settled legal dictum is the need of the hour”.*

(Quotation completed.)

Let us analyse in this presentation the problem of interpretation of DTA. Is there any thing special about International Taxation! Why should it be more complex than any other law in India!

- 1.6 I am trying to analyse the Supreme Court decision in Chettiar's case and the current legal situation with regards to Double Tax Avoidance systems. My position is described below:

Great Poet – Kavi Kalidas had written a beautiful piece of literature: “Raghuvansh”. He has written about the family of Bhagwan Ram – The Raghukul. In the beginning of the poem, with all humility he says the following:

- (a) “To learn better, the association between language and its meaning; I am saluting parents of the universe - Parvati & Parmeshwar - who are themselves as associated with each other as the language & its meaning are associated.”
- (b) He says further “How can I, a small man write about such great people! It is like a man with a raft wanting to cross the ocean”.

With my limited capabilities, I am borrowing Kavi Kalidas's words to clarify that I have undertaken a task which is too big for me. But being ambitious, I am trying to do some thing beyond my capability. If I fall short in the task, please pardon me.

I also make an abundant clarification that what ever I am saying in this article is entirely my own statement. For all the errors in this article, I am the sole person responsible for the same.

(Preface to the article completed.)

## 2. Summary of the Article.

### 2.1 Refreshing DTA.

Let us refresh our understanding of Double Tax Avoidance Agreement System (DTA) from plain basics to a controversy. There are some **basic concepts** on which this system of **Eliminating Double Tax (EDT)** is based. Normally, the phrase “Elimination of Double Tax” is not used too often. Hence there are no popular short forms for the same. I am using this phrase in the current presentation too often. Hence the short form: EDT.

Any conceptual discussion becomes easy & interesting if we take an **illustration**. So we will take the illustration of the Chettiar's case decided

by the Honourable Supreme Court. The Chettiar HUF, an Indian Resident had incomes from Malaysia. Honourable Court has held that once the income is taxed in Malaysia, Indian Government loses its rights to tax the income again. India has almost always adopted the **“Credit System” of Elimination** of Double Tax. Honourable Supreme Court has **converted it into the “Exemption System”**.

**The Issue: Is this decision correct!**

**Does any Court have the power to change a legal system!  
Especially in the given circumstances!**

If we agree on the principles of Jurisprudence stated above, then the decision appears to be correct. Is it correct!

To examine the matter we have to understand the system of Double Tax Avoidance as understood by the tax administrators & practitioners in India & in the rest of the world.

## **2.2 How does one determine what is the correct interpretation of an agreement & what is incorrect!**

There is no way to determine unless we determine the purpose of the agreement or the **intention of the parties**. For example, is it right to go in the North or South! Well, both directions are right. However, if you want to go from Mumbai to Delhi, then going north is the right thing to do. If you want to go to Chennai, it is right to go south. Similarly an agreement between two parties has to be interpreted based on the **intentions of the parties** who executed the agreement, and with **reference to the context**.

## **2.3 Consequences:**

If the Court decision is contrary to the intentions of the parties to the agreement, what may be the consequences! Are the consequences of the decision fair to both parties! In other words, **has justice been done!** If not, how serious are the consequences!

If some one says, “The duty of the judge is only to interpret the law; and not to give justice”; is it acceptable! If it is accepted, what are the consequences! Who is responsible to remedy the situation!

## **2.4 Suggestions:**

In case, the consequences are seriously unfair, what is the solution available to the Government/ Parliament! It is a constructive philosophy of serious deliberations that: “If you do not have a constructive suggestion, you have no right to criticise”. I am presenting a proposal. There are



bound to be many objections to the suggestion. Can we have a serious dialogue & offer a workable solution to the problems! This article may only be a beginning for a dialogue leading to a resolution.

(Summary of the article completed.)

### 3. **Chettiar's Decision Details:**

In the case of CIT Vs. P. V. A. L. Kulandagan Chettiar (267 ITR 654) facts were as under. The facts as given by the Honourable Supreme Court (SC) are not very clear. One has to make some basic assumptions. One can get more facts by referring to the decisions by the Honourable High Court (HC) and the Honourable Income-tax Appellate Tribunal (ITAT) in the same cases. At all appellate levels, batches of cases have been considered simultaneously.

ITAT order states that all the assesseees are Hindu Undivided Families (HUFs); and are Indian residents. The cases are referred to by the name of: P.V.A.L. Kulandayan Chettiar Vs. ITO 003 ITD 0426S [1983]

Madras High Court decision in the case is referred to as CIT. Vs. S. R. M. Firm. 208 ITR 400. [1914]. Karnataka High Court decision is referred to as CIT Vs. R. M. Muthaiah 202 ITR 508 (1993).

As per the facts stated in the Supreme Court decision, the assessee is a partnership firm from India. The assessee had a plantation in Malaysia. It amounted to a Permanent Establishment in Malaysia, owned by an Indian resident. It had several incomes from Malaysia. Under the DTA system, Malaysia would restrict its taxation to the specific percentages prescribed in the Indo-Malaysian treaty. Indian tax department would levy the normal income-tax and give credit for the taxes paid in Malaysia.

However the assessee claimed that since it had paid taxes in Malaysia, it was not liable to pay any tax in India. If it had to pay further taxes in India, where is the elimination of double taxation! The case moved from first appellate authority to second, to the High Court and ultimately to the Supreme Court. The Honourable Supreme Court of India accepted Mr. Chettiar's claim and "held" that he did not have to pay any taxes in India.

In this case, an Indian resident has income from Malaysia. Hence the **Country of Residence (COR)** is India; and the **Country of Source (COS)** is Malaysia.

Honourable Supreme Court and the Honourable High Courts have given decisions on following issues:

System of International Taxation,  
Use of "Semantics",  
Permanent Establishment,  
Residential Status,  
System of Elimination of Double Tax (EDT), and  
Treaty Override.

Let us consider all these issues and some more relevant issues.

**4. Basic Concepts:** Following are some basic concepts of International Taxation generally accepted world over.

**4.1** A Government acquires its taxing **jurisdiction** by its **domestic legislation**. The DTA neither grants/vests/nor allots such jurisdiction. It is a simple principle of law that no outside authority can grant jurisdiction to a sovereign Government. And yet, some judgements & noted authors have written suggesting as if DTA vests jurisdiction. Late Professor Klaus Vogel has, in his treatise "Double Taxation Conventions", clearly stated that this is not correct. (Page 26, paragraph 45.)

OECD recognises the fact that neither the OECD, nor the DTA can grant any jurisdiction to tax a person or an income if the domestic legislation does not provide for it. Hence, nowhere in the model convention, it makes any mention of granting a tax jurisdiction.

**4.2** DTA is not an independent outside authority to grant any rights etc. to a nation. DTA is an **agreement between two Sovereign Governments**. Agreement between two nations is totally different from an agreement between two businessmen. The businessman can be governed by a law. Nations are not governed by any law. And hence compliance with an agreement acquires a different colour.

**4.3** By the DTA, the Governments **accept restrictions** on their taxing rights in a manner that attempts to eliminate double taxation. Governments may or may not succeed in this attempt. Because real facts at ground level can be so different; that no draftsman can imagine the whole range of circumstances. So the DTA **provides a guideline to eliminate** double tax. It then leaves the implementation to the income-tax departments of the two Governments.

**4.4** **Vienna Convention** provides as under:

*"Article (31)(1) -General rule of interpretation*

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

.....

*“Article (31)(3)(b) -*

*“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.*

(Quotation Completed.)

Is it true that "Good Faith" and all such restrictions apply only to the Government! Do they not apply to the professionals and the tax payers!. Can taxpayers resort to "aggressive planning" under DTAs!! Why is it that none of the appellate authorities - in this particular matter - have considered the Vienna Convention?

It is the law of nature that in a **partnership** of three (the assessee, COR & COS) if even one partner does not behave properly, the partnership collapses. I will not discuss further Vienna Convention. I have, a few years back, presented a full paper on the subject. It is available on my website. <http://www.rashminsanghvi.com> Today, it is not the main focus.

**4.5 Connecting Factors:** For taxing jurisdiction, there are **two Connecting Factors** internationally accepted.

As far as the **taxpayer** is concerned, the **Residence** of the tax payer is the connecting factor. In other words, the residence of the tax payer provides jurisdiction to the Government to tax him. When a person is resident of India, Government of India has a right to tax his **Global income**.

As far as the income is concerned, the connecting factor is the **source of the income**. If the income is sourced in India, then the Government of India has the right to tax the same irrespective of whether the earner of the income is an Indian resident or a non-resident. In other

words, if the Income is sourced in India, income earners from the entire **globe** can be taxed in India.

Conversely, if none of the two Connecting Factors are available, the Government cannot levy income-tax.

This is the **classical system** of taxation which India & most countries in the world have adopted. It lays down the **taxing jurisdiction** of a country. Where ever Government of India has tried to cross these limits of the jurisdiction, the Supreme Court has held such attempts to be *ultravires* in several cases.

**4.6** The problem with this system is that **Double Tax is built-in** in the system. By the very nature of the Classical system of taxation; moment, there is a cross border income; two or more countries will claim the right to tax the same.

It is also understood that if double tax is allowed, either the international trade will not take place, or it will **go under ground**. In other words, there will be more **smuggling & black money**. Ultimately, the Governments will lose their tax revenues in more ways than one.

Hence most Governments have entered into Double Tax Avoidance Agreements (DTAs).

OECD has taken the lead in continuous development of the model agreement. U.N. which was the pioneer is now following OECD. Almost all nations essentially follow one or the other model. All Indian agreements are so far, following these two models. It is learnt that now India is developing its own model. Hopefully, it will be published for public comments soon.

## **5. The system of Model conventions:**

These model conventions (OECD & U.N.) have adopted the following system of DTAs.

**5.1 Applicability:** Articles (I) to (V) provide for (i) applicability of the DTA (circumstances in which the DTA will be applicable), and (ii) give certain definitions.

**5.2 Categories:** Articles (VI) to (XXII) provide for different categories of income: like the income from immovable properties (Article VI); Business income (Article VII); shipping & air line income (Article VIII); royalty income (Article XIII) etc. This is also called "Categorisation of Income".

5.3 **COR tax capability:** It is accepted that the Country of Residence (COR) has an inherent jurisdiction to tax its resident's **global income**. **This need not/ cannot be stated in the treaty.** As we have seen earlier, it is not the DTA that grants this taxing right.

5.4 **COS** accepts different kinds of restrictions on its rights to tax. The kind of restriction depends upon the category of the income. We will see some illustrations in paragraph (6) below. Articles (VI) to (XXII) are for the COS.

[Notes (1) The EDT by COR is provided under Article XXIII. It is discussed in paragraph (8) below. (2) For a more detailed discussion, see OECD Commentary - first chapter- "Introduction" especially, the paragraphs on "Broad Lines of the Model Convention".]

## 6. **COS taxing restrictions:**

6.1 For income from **Immovable properties**, the COS accepts no restrictions. Full tax will be levied on the income from immovable property situated within its territory.

6.2 For **business income**, the COS will normally levy nil tax. In other words, primarily, it is accepted that the business income is always considered to be sourced in the COR. Hence, it will normally, not be taxed in the other country from which the tax payer may be receiving the sales price.

6.3 However, if the assessee establishes a **Permanent Establishment (PE)** in the other country, then it will be considered that he has crossed a **thresh hold of presence** in the other country. Hence the **income attributable** to the PE will be **fully taxable** in the COS. (Discussed also in paragraph No. 11.)

6.4 Income from **shipping, airlines** etc. will be taxable **only in the COR**. (The provisions in the Malaysian treaty are different from standard OECD model. Here I have considered the OECD model provision.)

6.5 For **dividends, interest, royalty & technical know-how fees**, the COS will levy a smaller percentage of tax on the gross income.

6.6 The COS relief for elimination of double tax is completed in this manner.

## 7. **Legal Terminology:**

7.1 The important issue arising out of the above discussions is as follows. Under the treaty, the COS has different methods of EDT. Hence

different phrases have been standardised for each method of EDT. These methods vary with categories of Income. Consider for example:

- (a) For Article (VI) the phrase will be: The profits “**may be taxed**” in the COS.
- (b) For Article (VII) the phrase will be: The profits “**shall be taxable only**” in the COR.
- (c) For Article (VII) where the tax payer has a PE in the COS, the phrase is: The profits attributable to the PE “**may be taxed**” in the COS.
- (d) For Article (X) the phrase will be: the dividend income “**may be taxed**” in the COS. However, “**the tax so charged will not exceed 10%**”.

These phrases have been explained in the OECD commentary at appropriate places.

**7.2** As can be seen **each phrase has a specific meaning**. There is a lot of consideration that has gone in before these phrases are developed & used. All draftsmen understand the same. All tax practitioners are expected to understand the same. One has to only look at massive reports generated by OECD. Several committees discuss the drafts. Then the drafts are published for public comment. After due consideration, these drafts are finalised & incorporated in the DTAs.

It is understood internationally that different people may make different meanings from the same words. This is not restricted to law & treaties. Even **collaboration agreements** may be interpreted by the parties in different ways. To avoid such confusions, different authorities have come out with publications on Commercial Terms. **International Chamber of Commerce has published a book called “INCOTERMS”**. U.N. & several other authorities have published similar books. These are not dictionaries. These books explain the meanings of different commercial terms. And very often, collaboration agreements specify that the parties adopt a particular publication as the guiding book. Both parties accept the terms with their meanings given in a particular book.

In the same manner, DTAs have some specific technical terms. These are not semantics. These terms are used by all three famous models of DTAs & used by all Governments signing the DTAs.

Honourable Supreme Court has ignored all these reports and commentaries by stating: “We need not enter into an exercise into semantics...”

Can the most important judicial authority in this country, The Supreme Court of India write off all the legal phrases & concepts; all high level discussions & reports; especially in DTAs, by just one short sentence?

## 8. **COR Taxing Restrictions: Article (XXIII):**

Now it is for the COR to give the relief for **Elimination of Double Tax (EDT)**. It provides the relief by either **one of the two known methods**. These two methods are discussed below:

### **Systems for Elimination of Double tax:**

Two countries sign a DTA in an attempt to **eliminate Double Taxation**. The elimination is achieved at the COR level by one of the two methods: (i) Tax **Credit** Method; or (ii) Tax **Exemption** Method. Language of both sub-articles is different. Selection of the method - "Exemption" or "Credit" can be ascertained by reading the language of the Article. Article 23A (in the OECD model) provides that the COR .. "shall...**EXEMPT** such income (income taxed by COS) ... from tax". While Article (23B) provides that COR "shall allow ...as a **DEDUCTION** from tax....an amount equal to the tax paid in" COS.

8.1 Under the **tax exemption method (Article 23A)**, the country of residence exempts the income which has been taxed in the country of source. When both Countries to the Agreement have accepted the Exemption method of EDT, the COS would levy its normal tax on the income sourced in its territory; and COR will exempt the income taxed in the COS.

8.2 Under the **tax credit method (Article 23B)**, the Country of Residence (COR) has an inherent right to tax its residents on their global income. The Country of Source (COS) has a right to tax the income sourced in its territory. However, the COS restricts its rights to levy the tax. These restrictions depend upon the categories of the income. We have seen categorisation in paragraph (4.2) Above; and COS restrictions on taxing rights in paragraph (5). COR gives credit for taxes paid in COS.

It may be noted that the COR will levy full income-tax on the whole of the income earned by its residents. It will eliminate the double tax by deducting from its tax, the tax paid in the COS. (Please see OECD Commentary on article 23. Especially, paragraph 16 explaining the meaning of "Credit system" of elimination of double tax. Further, see the commentary under Article 23B.)

For COR under Article (23), the category of income is not important. Whatever tax is paid in COS, is available as relief in the COR.

Tax levied by COS will vary depending upon the category of income. However, for COR, it is a passive relief to be given depending upon the tax levied by the COS.

9. **India has adopted the “Credit Method”.** What is the source for this statement? A simple question. It can be answered by simply reading the language of the Article (23) in the DTAs signed by India and comparing the same with the language given in OECD Model – Article 23A & 23B. However, all the appellate authorities – in this case – have ignored the OECD & the U. N. models of DTA. The most important guidance available to the authorities has been ignored.

9.1 This statement (India has adopted Credit Method) is understood & accepted by almost all international tax practitioners. It is derived from the interpretations of the terms used by OECD in its commentary. These terms have been seen above.

Honourable Court decided that OECD commentary is not binding on the Indian courts. This is accepted by all. There is no dispute. However, the Honourable Court did not even consider any persuasive value for the OECD Commentary. Now what is the other source for the statement that India has adopted the “Credit System” for elimination of Double Tax?

9.2 **Section 90** of the Indian Income-tax Act does not clarify that India has adopted Credit Method. It leaves the entire system of EDT to the DTA.

**Section 91** of the Act provides for “**Unilateral Relief**” in cases where India has not signed a DTA. This section makes it abundantly clear that India will eliminate the Double Tax by the Credit method. However, can section 91 be guide for the agreements entered under section 90!

Assuming that section 90 had provided for credit system of double tax elimination, when Court has decided the issue of Treaty Override, will it be of any help!

**Conclusion:** Under the present circumstances, except for: (i) the OECD model & its commentary and (ii) the practice followed by the tax department & most of the assesseees and professionals; there may be no other factor based on which we can say that India has adopted the “Credit Method” of EDT. By ignoring the OECD commentary, in my humble submission, the Honourable Appellate Authorities have committed error.

Please see paragraph (23) for a probable solution.



## 10. **Treaty Override:**

It is very common & understandable that the language & the provisions of the Income-tax Act and the DTA are different. At times, they may even sound contradictory. In such a case, which provision will prevail over the other!

**U. S. government** has taken a stand that domestic laws will override the DTA. Things are not as clear as this sentence looks. However, since Treaty Override is not the focus of the present article, we may accept this brief statement instead of an elaboration.

**Indian Government** has taken a stand that the DTA will override the ITA. Specific provision is made in S. 90 (2). This provision is not perfect. However, it is adequate to declare the Parliament's intention. This stand is also accepted as an International legal position & Indian Courts have accepted the position even in absence of S. 90(2).

**European Union** has developed its own code for direct taxation. It specifies that where the EU code & OECD model are at variance, the EU code will prevail over the OECD model.

In Chettiar's case, Honourable Supreme court has stated that since the Income tax Act (ITA) and DTA are at variance, the DTA will prevail over the ITA. Basic provisions like charging section (4) and the scope of total income section (5) are held to be not applicable in the present case.

In my humble submission, there is no Treaty Override in this case. Both, the Treaty & the Income tax Act (ITA) are complimentary. It is an error in understanding of the system of Double Tax Avoidance that some thing that is "Complimentary" is canvassed to be "Contradictory" & then valid provisions of ITA have been nullified.

## 11. **Probable Errors:**

This error has probably arisen from the following errors.

**11.1** The Indo Malaysia DTA does not make a specific clear provision in Article (VI) that India, as the COR has a global right to tax an Indian resident. As seen above, it is neither necessary, nor appropriate to make that mention. Article (VI) is one small part of an entire system of ETD. Unfortunately, Article (VI) has been taken by the Honourable Supreme Court as a code complete by itself.

**11.2** Article (XXII) of the India-Malaysia DTA-executed in 1976 makes a clear provision for elimination of double taxation. (In the current-2004 DTA, the relevant Article is Article 23.) However, this Article is not

discussed by the Honourable Supreme Court. Whole Article is reproduced by the Honourable Court in its decision. However, when it came to the Order, this Article is not even referred to. To repeat, what was THE relevant treaty provision, has not been considered at all by the Honourable Court. This is despite the fact that the Attorney General had discussed this matter at adequate length.

**11.3** Section (90) of the ITA does not clarify that India has accepted the Credit System of elimination of Double Tax. Even if a provision were made, Courts would ignore the same if they found the ITA provision to be inconsistent with the DTA.

**11.4** OECD model, Article (23) provides two specific optional paragraphs for elimination of double tax. For the Exemption system - paragraph A and for the Credit System- paragraph B. OECD Commentary explains both the systems - first in principle; and then by illustrations.

However, all the Appellate Authorities in this case have held that the OECD commentary is not binding on the Court & hence neither commentary, nor model treaty need to be looked at.

**11.5** A special characteristic of the OECD model is that it adopts a unique language. Certain phrases have been developed. Each phrase is like a concept. It means a lot. In fact, where a whole paragraph would be required to state an issue, the particular phrase says the whole lot. Significance of these clauses has been explained in the OECD Commentary. Honourable Appellate Authorities have discounted all these legal terms as 'semantics'.

There are some more issues.

## **12. Permanent establishment (PE):**

We are still proceeding further with important basic concepts of DTA which have been covered in the present case. PE is an important concept in taxation of business income. In my humble submission, this part of the scheme of international taxation is as under:

**12.1 COR** A person resident in a country will be fully taxed on his Global income of all kinds in the COR. Category of income is not important at all. Whether the income is from business or from royalty, he will be fully taxed in the COR. (Giving credit for the tax paid in the COS is a separate subject already discussed above.)

When we are considering the income of a person in his COR, the question of PE just does not arise at all. This, in my submission, is absolutely clear. It forms the bedrock of business taxation.

The resident of a country is fully liable to tax in his country. This liability arises purely because he is resident of the country. No further reason is required for the Government to tax him. There is no question of a resident having a permanent establishment in the country of his residence.

**12.2 COS** A Government cannot tax a non-resident. However if a non-resident businessman has presence in the host country (COS) beyond a critical line (thresh hold), then he can be liable to income-tax. That critical line is permanent establishment. In other words, a PE is accepted as sufficient presence in the host country to make the non-resident liable to tax in the host country. So the question of PE arises only for COS..in this case, Malaysia. There is no question of PE for COR .. India.

**12.3** We need not go into PE definition in this presentation. The main issue is: the Concept of PE is totally irrelevant in considering the assessee's tax liability in COR. It assumes importance only while considering the tax liability in the host country (COS).

**12.4** Again, the concept of PE has no relevance AT ALL in Article (VI) pertaining to the Income from Immovable Property. Once a person has an immovable property in the host country, the income from the property is taxable in the host country. For a very simple example, assume a case - (which is not really the fact of the present case):

Mr. Chettiar simply had a residential flat in Malaysia. He had no other people or presence in Malaysia. He simply received the rent income from the tenant. The income was remitted to India by the tenant. Even in such a case, the rent would be fully taxable in Malaysia. No question of any PE.

The above, in my humble submission, is the correct importance & relevance of the concept of PE.

**12.5** Now consider how the Honourable Supreme Court has dealt with the concept of PE.

The Honourable Court has held that the assessee had a PE in Malaysia, he had no PE in India, hence he should be treated as a Resident of Malaysia and a non-resident of India; and hence he cannot be taxed in India! Such a logic, in my humble submission, involves following errors:

(i) Linking a PE with Article (VI) is incorrect. We have seen this in paragraph (12.4) above.

(ii) Considering a PE for determining the residential status is incorrect. Let us see the reasons for this statement in the next paragraph (13).

**12.6** In the facts of this case, it is stated that the assessee is a firm. High Court has considered the case of a Firm. Tribunal has considered the case of HUFs. We will consider both. Article (IV) provides for residential status. Article (IV) (2) provides for the “Dual Residential Status” & “Breaking of Tie”. It should be noted that Article (IV) (2) applies only to individuals & NOT to any other person. Certainly not to a firm. All the issues of personal & Economic relations apply only to an individual & not to a firm. Hence discussion on the subject of “Tie Breaking” is not relevant to the facts of the case and erroneous.

Article (IV) (3) provides for “Tie Breaking” in case of persons other than an individual. In this case, the only tool available for “Breaking the Tie” is the “**Place of Effective Management**”. This is an elaborate concept on which a lot of discussion has taken place internationally. This concept, which would be relevant for “Breaking the Tie” for a firm, has not been discussed at all.

(Note: The discussion in paragraphs 12.5 & 12.6 above is on Indo-Malaysian treaty. Honourable Supreme Court has ignored even the provisions of the treaty –Article IV.)

**12.7** If an assessee is treated as resident of Malaysia, and Non-Resident of India, then the whole discussion should end there. The person is a non-resident. Income is of foreign source. There is no question of any further application of the DTA. No discussion is necessary on Article (VI) for Immovable Properties or any other Article.

It seems Honourable Supreme Court has taken this stand. Hence the decision is short. Error lies in the fact that the assessee was an Indian resident and hence liable to Indian tax on his Global income. Correct issue was: How much relief may be given to him against the tax paid in Malaysia. This has been discussed above in this article, paragraph (8) on EDT by COR – DTA Article (XXIII).

**Notes:**

Honourable SC has held that:

- (i) The assessee is a non-resident of India; and
  - (ii) The source of the income is in Malaysia.
- Then there is no further discussion.

Based on the principles of Connecting Factors (Paragraph 4.5 above) one has to presume that there will be no Indian tax on the transaction. There is no clear statement by the Honourable Supreme Court.

Several subsequent decisions following this decision have accepted what has not been stated by the Honourable Supreme Court. See DCIT Vs. Torquise Investment & Finance Ltd. 300 ITR 1 (SC) (2008).

### 13. Residential Status:

In the treaty, this concept is provided for in Article (IV). In the old Indo -Malaysian treaty, the term "Fiscal Domicile" is used in the title to the Article (IV) and then in the body of the Article, the term used is: "Resident".

The term Resident is defined under Article (IV) (1).

"Dual Residence" and "Tie Breaking" are provided for in the Article (IV) (2) & (3).

The ITAT order very clearly states that all assesseees are Indian residents. Under the Indian legal system the ITAT is the ultimate fact finding authority. Can the Supreme Court go beyond these facts and consider the assessee as a Malaysian resident!

The SC order has given the arguments of the assessee's representative as well as the Attorney General briefly. The order in the first page states that the assessee is a **firm**. By a firm we understand a partnership firm. However, the case discusses provisions applicable to an **individual**. Tribunal has stated in its order that all the assesseees before the Honourable tribunal were HUFs. Let us consider all the relevant provisions.

#### 13.1 Definition:

The **Article (IV)(1)** does not provide independent criteria for determining the residential status. It **refers us to the domestic law**. If a person is treated as Resident under the domestic law of a country, he is resident of that country. So let us see the provisions of the Indian Income-tax Act section 6.

Section 6(1) provides for the residential status of an individual. One has to consider the number of days' stay in India. This matter has not been discussed at all. Because, as can be seen from the Tribunal order, the assessee was not an individual. However, for a complete view of the legal

provisions here, we consider the assessee as an individual and a resident of India & proceed further in paragraph 12.5 below.

**13.2** Section 6 (2) provides for the residential status of a **partnership firm, HUF & an AOP**. It provides: "A HUF, firm or AOP is said to be Resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India."

Note the words: "control and management of its affairs". The word "affairs" could cover even the management of one shop or factory. What is considered here is not the "Central Control and Management" of the firm.

This raises two possibilities. **First:** We take the law literally. If even a small part of the business affairs are situated in India, the firm (or HUF etc.) becomes an Indian resident. For example, let us consider an American partnership firm. It has one thousand partners. 998 partners are located outside India. Two partners are residents of India and they carry on the Indian part of the firm's business. This whole partnership firm will be treated as an Indian resident. Which means, its global income will be liable to tax in India!

This is a risky definition. Certainly this cannot be the intention of the Parliament. It needs to be amended in new Code being considered by the department. Hence the **second option** will be to read into the definition, "CENTRAL control and management". Ideally, in the New Code of Income tax which is under preparation, this definition should be amended.

Anyway, until the Parliament amends the provision, it is **safer to advise** all clients that when a non-resident wants to have regular dealings with India - whether as a collaborator or in other similar serious arrangements, then the non-resident entity must be a corporate entity. Not a partnership firm.

Having considered the domestic law provisions, let us come back to the case.

**13.3** Neither the assessee's representative nor the Attorney General have raised the issue of **dual residence** & the need to "**Break the Tie**". The **question does not arise**. If Mr. Chettiar, an Indian resident has a plantation in Malaysia, it does not mean that he becomes a Resident of Malaysia. Just because a person has a "source of Income" in another country, he does not become a Resident of that country.

**13.4** However, the Honourable Supreme Court has brought in an issue that Mr. Chettiar was resident of both the countries. Hence the "Tie

Breaking” provisions have to be applied to the case. While applying this rule, Honourable Supreme Court has held as under: (Note: while the extract from the decision is reproduced below, serial numbers have been provided by me. This is for ease in referencing the issue while discussing the same.)

*“(1)..in a case where the person is resident in both the contracting states, fiscal domicile will have to be determined with reference to the fact that if the contracting state with which (2) his personal and economic relations are closer, he shall be deemed to be a resident of the contracting state in which (3) he has an habitual abode. (4)This implies that tax liability arises in respect of a person residing in both the contracting states has to be determined with reference to his close personal and economic relations with one or the other. (Note probably there is a grammatical error in this sentence.) (Note 2: This sentence is difficult to understand. There is no printing error.)*

*“ The immovable property in question is situate in Malaysia and income is derived from that property. Further, it has been held as a matter of fact that (5) there is no permanent establishment in India .....(6) we hold that business income out of rubber plantations cannot be taxed in India because of closer economic relations between the assessee and (7) Malaysia in which the property is located and where the permanent establishment has been set up will determine the fiscal domicile.”*

Now let us see each of the above statements one by one.

**13.5 (1)** Facts given in the decision do not talk of the assessee having dual residence.

**(2)** Assuming dual residence, one cannot go to the concept of “Personal & Economic Relations”. In “Tie Breaking” for an individual, there are four different factors. One has to consider one after the other in serial order. First, one has to see his “Permanent Home”. We can go to the concept of “Personal & Economic Relations” only if he has “Permanent Home” in both the countries, or in neither. Missing the first step & jumping to the second step makes the order erroneous.

**(3) & (4)** “Habitual abode” is the third criteria. If the “Personal & Economic Relations” cannot be determined to belong to any one country, then the concept of habitual abode has to be considered. In these sentences, both are considered as part of the same criteria only.

Even if one were to consider the “Personal & Economic Ties”; it would include the family of the assessee & several other factors. The Permanent Establishment cannot be the sole factor to be considered for “Breaking the Tie”. PE is for determining the location of the source of income, not for determining the residential status of the assessee.

It appears, this issue has been determined erroneously even at the first appeal by the Honourable CIT Appeals.

- (5) "It has been held that there is no PE in India". When the assessee is an Indian resident, there is no question of his having a PE in India.
- (7) Residential Status is the characteristic of the assessee, in this case, individual Mr. Chettiar. "Assessee" & his "income" are two different concepts. One does not determine the other. In other words, the location of the source of income cannot determine the residential status.

The interplay of the two concepts: "Residential Status" & the "Source of Income" determines which state will get how much tax. If the source of income or PE were to determine the residential status, there would be a complete confusion of the system of Double Tax Avoidance as we know it and as has been held by several Court decisions.

- (6) In my humble submission and with respect, since there appear errors in different statements of the Honourable Court, the conclusion that the assessee cannot be taxed in India, it seems, is erroneous.

#### 14. **Article (VI) "Income from Immovable Property".**

Now consider the language of the treaty:

"1. Income from immovable property may be taxed in the Contracting State in which such property is situated." This is from the treaty of the year 1976. Even in the new treaty of the year 2004, the words are more or less same.

Honourable SC has considered that this Article (VI) is a complete tax code by itself. It provides for tax right of the Malaysian Government. Hence by definition, India loses the right to tax. In the facts of the case, Article (XXII) for EDT had no function and it had to be ignored.

Root cause of the difference in understanding the treaty arises because of one factor. Right from the tribunal, the appellate authorities have taken exemption method of EDT as the inherent system of elimination of Double Taxation. We have seen above that the ITA, and DTA as a whole, from Article (I) to Article (XXIII) provide for elimination of Double Tax. Taking just one Article out of context has resulted in an error of interpretation of the DTA. (Consider a settled principle of law that the scheme as whole should be considered. No part of the scheme can be held to be redundant. See paragraph 3 of supplement to this article.)



## 15. OECD Commentary.

Is the OECD Commentary binding!

Honourable High Courts of Karnataka (R. M. Muthaiah's case - 202 ITR 508) and Madras (S.R.M. Firm's case -208 ITR 400) have decided that the **OECD Commentary is not binding. Honourable SC has confirmed these decisions. I entirely agree.** Even OECD clearly states that its commentary cannot bind any Court of law.

However, when we say that the commentary is not binding, do we throw it away totally? That would amount to throwing away a substantial intellectual wisdom collected over decades. If one disagrees with OECD commentary - especially the very system on which Indian Government has agreed with another Government - are we doing justice to the agreement?

Let me place for your consideration, two other commentaries. Is the commentary by late Professor Klaus Vogel or by Late Mr. N. A. Palkhivala binding on any authority! Certainly not. Does it mean that you totally ignore both the commentaries! Certainly not. Both have tremendous value. Every one is free to disagree from all the three commentaries. However, if he does disagree, he has to give well considered reasons for such disagreement. These commentaries cannot be brushed aside in any serious discussion on taxation.

## 16. Consequences:

What are the Consequences of this decision!

**16.1** The ratio of the decision is, if an income has been taxed abroad, it cannot be taxed again in India. In other words, while India had so far adopted the "Credit System" for eliminating double taxation; Honourable Supreme Court has converted the same into the "Exemption System" of EDT.

Is it within the competence of a Court to change substantial character of an international agreement - in fact more than fifty agreements - which have been signed by India with fifty sovereign countries!

Consider the consequences of the fact that while the Indian side of the DTA stands altered, the counter part remains unaltered.

**16.2** This decision is today, the "**Law of the Land**". It is binding on all concerned. If some one wants, he can clearly use the decision & claim all

foreign income as free from Indian tax. Department cannot tax such foreign income if it has suffered any income-tax abroad.

**16.3** This can open the flood gates for frauds on tax department, and even in the capital market. Remember some of the past big scandals for last fifteen years. People have used **tax havens** & their entities for converting black money into white. They would send their black money abroad by Hawala & bring the same back to India in some guise or the other. It has been alleged that so far people were bringing their black money to India in the name of some foreign investors, **Participatory Notes** (PNs) and **Overseas Corporate Bodies** (OCBs). Now they will be able to bring the money as their own incomes & will not pay any taxes in India. Imagine the impact that it can have on the stock markets.

A scheme which has been actually repeated in India several times runs as under: Indian company with insignificant net worth decides to make a public issue. It would create fictitious exports. In the past, there was S. 80 HHC granting 100% income tax exemption for export incomes. So this company would get all export profits as tax free. The promoters would transfer by Hawala, their black money abroad. This money would come back as export proceeds. Black money converted into white. Then the company would claim, it has earned Rs.100 X as profits. Considering a price to earnings ratio of 15, the market capitalisation of the company would be Rs. 1,500X. So, the Rs.10 share would be issued at Rs. 50; and the investors could expect the share price to go up to Rs. 100. Tremendous profit for an investment of a few months!

Several companies have cheated thousands of Indian investors under similar schemes. Now S. 80 HHC is not available. But Chettiar's case is available. A company can open up a branch in Mauritius. The branch will earn fictitious profits of large amounts. It will pay an effective tax of 3% in Mauritius. Balance 97% will be remitted to India. No further tax. A bonanza for such promoters. A great risk for gullible small investors. All possible due to an error in a judicial decision.

**16.4** Any practising consultant - can set up an office in Mauritius and receive some of the foreign fees in the Mauritius branch. He will effectively pay 3% tax in Mauritius. And hence he will pay no further taxes in India. The Indian tax rate is 34%. He will make a net gain of 31%!

**16.5** An Indian business group can set up a permanent establishment (PE) in Mauritius. The PE can earn millions of dollars in trading & commission transactions. It will remit the income to India & pay only 3% tax in Mauritius. No tax in India. It will save 31% tax. Huge gain! All supported by the Supreme Court decision. No one can levy a penalty for non-payment of 31% tax.

## 16.6 ITAT decision in the case of Patni Computers:

The above expressions of fear of scandal may look like imagination. Let us consider this tribunal decision. See the absurdities that can result from the compromise of a legal system.

In the case of Patni Computers (109 TTJ 742), the underlying issue is set off of losses claimed by the assessee's branch in Japan against incomes earned by it in India.

The limited facts available from the decision in the case show that the assessee had set up an office in Japan. However, the company debited only expenses in the branch accounts. No revenues were credited to the account. Therefore, there was a loss of around Rs. 54 lakhs.

Assessee claimed set off of losses against the Indian income. Department disallowed the losses on the following grounds. Since the profits earned abroad are not liable to tax in India (as held in the Chettiar's case), even losses cannot be allowed.

Honourable Tribunal has held that -

- (1) S.C. has converted Credit System of EDT into Exemption System.
- (2) It is accepted by India that "Between the ITA & the DTA, whichever is more beneficial to the assessee" shall prevail.  
And
- (3) Under the ITA, the assessee can choose what is more beneficial to him every year. He can keep changing his choice every year.

Result may be that in one year the assessee will claim the loss in the PE for set off against the Indian income. In another year, he may have profits in the PE. That year he may claim that under Chettiar's logic, he will not pay tax in India on his foreign profits. His losses of the first year will be carried forward to the next year in Japan & set off against the Japanese profits. Thus he may claim "Double Dip". In other words, he may claim set off of same losses twice.

Tribunal makes it abundantly clear that this unintended & undesirable position is the result of Judge made law. Tribunal does not agree with the Supreme Court decision, but then the SC decision is the Law of the Land today. It abides by the SC decision with respect.

**Conclusion:** When an established tax system is compromised, people will make absurd claims and department will lose. This is the least of the damages that are possible.

**16.7** Consider a **tax practice philosophy**. Any human being can make errors. He may be in the Government, profession or judiciary. It is not our business to take **undue advantage of anyone's errors**. Even if the Supreme Court of India or the Government of India makes an error, we are not going to take advantage of such mistakes. This policy can pay rich dividends in the form of avoidance of litigation and a peaceful life.

**16.8** Not many people may accept this conservative policy. A **mutual fund** investing abroad has claimed that it is not liable to Indian tax on its foreign dividend incomes. (300 ITR 1) Similarly, several other assesseees have made such claims. And there are several Court decisions which have accepted Chettiar's case decision as a precedent.

More serious: A lot of people will be lured into **hawala market & conversion of black money into white**. They will try to implement several different strategies similar to the strategy discussed above for making public issues and cheating investors. Scandals will be exposed after a few years. India has a multilateral regulatory system. Those who might escape the tax law, may be caught under FEMA & / or PMLA. These people will then spend more than the tax saved in legal expenses to save their skin.

**17. Submission so far:** My humble submission with full respect to the judiciary is: Honourable Supreme Court has given a decision which has some errors. This decision can have for reaching consequences.

Some professionals defend the decision on the grounds of principles of jurisprudence stated in paragraph 1.4 above.

This leads to an obvious observation that something is wrong with the principles. Or probably something is wrong with the way, the principles are interpreted and applied.

## **18. Binding Authority of Precedents.**

How far is a judicial decision binding!

**18.1** Once the decision has been given by Honourable Supreme Court, it is the law of the land & binding on all concerned in India. Even the Special Leave petition by the department was rejected 'on merits'. Hence there is no doubt about the finality of the decision.

**18.2** Now consider following cases pertaining to Share Valuation under Wealth Tax Act.

For share valuation under wealth-tax, the issue was, should the shares be valued on "Break-up value" basis as prescribed by Rule 1D of the Wealth-tax Act; or on "Yield" basis.

CGT. V. Kusumben D. Mahadevia (Smt.) 122 ITR 38. Supreme Court held in favour of "Yield" basis. When the department raised an issue that the yield basis cannot be applied to shares of an Investment Company, the matter went upto Bombay high Court. It was held that even for Investment companies, Yield basis was the correct method. (124 ITR 799).

In another case of Mahdeo Jalan; S. C. held in favour of "Yield" basis. (86 ITR 621).

In the fourth case of Bharat Hari Shinghania; the S. C. held that all the earlier decisions not with-standing, Rule 1D (break up value) was binding!!! (207 ITR 1).

Where is the finality? In our system of judicial process, it is probable that this decision (Chettiar's case) may be overruled.

#### **19. Principles of Jurisprudence:**

We may now consider in details two principles of Jurisprudence that have been accepted in India.

"No need to Refer to the Context"; &

"Judge needs to Know no Law."

Since the word "jurisprudence" has been defined as "the philosophy of law". Hence I take liberty to make full use of concepts of philosophy in elaborating my submissions on these two principles.

#### **20. Reference to Context:**

It has been judicially accepted in India that "when the words of the law (or treaty) are clear, one need not look at the reference or context, nor the intentions". It is based on this & similar principles that the Honourable Courts have refused to consider the OECD model & its commentary.

This principle (of ignoring reference to context) is at variance with the Vienna Convention which provides exactly to the contrary (Paragraph 4.4 above). When the interpretation of an international treaty is concerned what should be the principle of interpretation!

In the present case, if one would read Article (VI) independently, one could arrive at the view held by the Honourable Supreme Court. However, if one were to consider the intentions of the two governments that executed the agreements, the two models of DTA and whole scheme of DTA as discussed in paragraphs (3) to (8) above; the interpretation may be different.

**20.1** Regular practitioners of International Taxation may have no hesitation in saying that these decisions are not in conformity with:

- (i) Accepted practices around the world;
- (ii) Governments' intentions at the time of executing the agreements.  
And hence,
- (iii) Vienna Convention.

Then how is it that all the appellate authorities (in this particular case) have given decisions the way they have given! Have all of them made errors! Or is the defect some where else!

**20.2** Consider the following:

The India- Malaysia treaty is capable of interpretation in the manner in which the Courts have interpreted the same. Let us say, two interpretations are possible. Courts have accepted one interpretation which is contrary to the normally accepted interpretation.

Can we refer to the **Vienna convention and some legal philosophy!**

Words have limited power of expression.

Written words have more limitations than spoken words.

Two fold problems:

(i) They do not convey full intentions of the originator of the words;  
and

(ii) They are capable of several meanings.

So the receiver of the words will interpret them in a manner which is in his interest. There is bound to be a tremendous difference of opinions when several people want to interpret the same law and all of them have different interests.

**20.3** Let us see an illustration. There is a Sanskrit phrase: "Jeevo Jeevasya Jeevanam" (Soul is the life for Soul). This same sentence can be interpreted in two exactly contrary manners.

- (i) All of us .... human beings, animals & birds including vegetarians and non-vegetarians eat other lives. Grass, fruits, wheat & rice ... all have

life in them. Now if we decide not to eat another life, only trees would survive. One life is the support for another life. So eating another life is okay.

- (ii) Another interpretation. One life is the support of another life. So, all of us should support other lives. Whether those lives are of pigeons, dogs & cats or human beings. Help them. One should not kill another life.

People have raised issues: When you eat curd and consume millions of bacteria, or when you take medicine & kill millions of bacteria; can you call yourself Ahimsak (non-violent)! Such questions only show that:

**“No principle can be taken as an absolute”.** This is an independent long discussion. Briefly I may mention that Bhagwan Mahavir has said:

*“Dharma begins with Vivek (discretion). In the absence of Vivek, you can't practise Dharma.”*

This issue can lead some people to have an endless & futile debate (Vitandavad) on Vegetarianism Vs. Non-vegetarianism. While those who can resort to deep thinking may come to a conclusion that:

*“We are all right. Even when two exactly contrary opinions are expressed, both may be right. In any case, there is no reason to fight or even debate. Let everyone live his own life. Un-ekant-vad.”*

Literature has any number of illustrations to prove that same words can mean different things to different people & even to same people at different times. Certain literature depends upon this characteristic of words. And yet our Courts have ruled that where the words of a section are clear, there is no place for Parliament's intentions, any reference to context, any discussions and negotiations or committee reports which went into drafting the sections or the treaties.

- 20.4 This brings us to the Vienna Convention on Treaties. Please see professor Michael Edwards Ker's book on “Tax Treaty Interpretation”.

*“As Lauterpacht commented (1935, 571) nearly sixty years ago. “The first and principal lesson which can be deduced from their [international tribunals'] practice is that in no circumstances ought preparatory work to be excluded on the ground that the treaty is clear in itself. **Nothing is absolutely clear in itself.**”*

*“O'Connell observed similarly (1980, 253, footnotes omitted): “It is said that where a treaty clause is clear and unambiguous it does not require to be interpreted. However, **it may be doubted if a clear and unambiguous clause has ever been devised.**”*

**20.5** I humbly submit to agree with Lauterpacht. Nothing is absolutely clear in itself. All words, phrases and sentences are capable of several interpretations. "Reference to all relevant materials" is useful in reaching a fair decision in any legal matter. Vienna Convention makes it necessary. In case of International Taxation, reference to OECD & U. N. models can be very useful. The models & their commentaries are certainly not binding. However, they have considerable value.

**21. Second Principle to be considered:**

**"Judge needs to Know No Law.** It is the duty of the advocates representing both sides to educate the judges. If they fail in their duties, one cannot find fault with the judges."

Now consider the facts of this case. The departmental representative had made correct representation. The Attorney General, Mr. Soli Sorabjee's submissions to the Honourable Supreme Court in the Chettiar's case are like a text book - stating all the principles of international taxation.

Assessee's representative made an incorrect representation. It was for the judges to choose from two sets of representations. They chose the assessee's representation. Some knowledge of the relevant law may be necessary for the appreciation of the correct choice when two or more choices are available.

**21.1** The seriousness of the situation calls for one more discussion on the idea of concepts. This may be carried on with an illustration of the concept of "Ahimsa".

Ahimsa (non-violence) is a "word" & also a "concept". As a word, it simply means non-violence. However, consider it as a concept & a whole world of thinking opens up behind it. Jain & Bauddha religions are almost entirely built around the concept of Ahimsa. Consider some illustrations of Ahimsak (non-violent) thinking & we know what is a concept.

Display of one's wealth, power, degree etc. is a himsa (violence).

Talking aggressively is also a himsa.

Driving car in a way that causes inconvenience to others, is a himsa.

Aggressive tax planning which is far removed from truth & substance is also a himsa. Tax evasion is not even to be discussed by a true Ahimsak (follower of non-violence).



If a person keeps fighting with all & sundry over petty matters; you cannot even discuss Ahimsa with him. Consider a Jain who would not even eat green vegetables in monsoon. He is a wealthy person being proud of his wealth & eager to display his wealth. He is unfit for finer discussion on Ahimsa. We will be able to discuss the finer aspects of the concept with a non-vegetarian person who is sensitive to the feelings of others. Eating habits do not determine the level of thinking & sensitiveness of a person.

Now we have discussed the difference between a 'word' & a 'concept'. 'Concept' has a lot of thinking gone into it. And if one does not know a concept, we cannot discuss the subject with him. Intellectual discussion with a person not appreciating a concept would be futile.

## 21.2 Now consider Unekantvad (Un-Ekant-Vad).

(i) When both Jain & Bauddha religions talk of Ahimsa, why do we need two different religions!

Consider Upanishads. One would conclude that under Hindu religion also, himsa is impossible. Any himsak (violent) person is not a follower of true Hindu, Christian, Parsi or Muslim religion.

And yet every Ahimsak person also has a different way of thinking & living. It is said that if there are six billion human beings, there are six billion ways of thinking.

(ii) A tax consultant may not believe that Ahimsa & tax evasion have any relationship. A tax commissioner may agree more readily. Simple issue is, on any matter, different people will have different views. And every one will consider that he is right. That is UnEkantVad.

If this is the nature of human communication, reaching a fair conclusion makes it imperative to refer to all relevant material.

**Summary:** We have considered here two concepts: "Concept"; and "Unekantvad". For considering these two concepts, we have considered the illustration of the concept of "Ahimsa". And it is seen that for a meaningful dialogue at a finer level, all sides to the discussion must understand & appreciate all the concepts involved.

Can one discuss international tax matters if he is not conversant with the concepts involved in International taxation! In other words, does this principle that "It is okay if Judge knows no law" require reconsideration!

**21.3** There is a philosophical statement: “There is no Absolute in this world”. Readers interested in deeper study of jurisprudence may make a search on this concept on the internet. Some thing very interesting is in store. Free.

Serious reader would have seen in the discussion on “Jeevo Jeevasya Jeevanam” that no concept can be taken to its absolute. Trying for absolute can only invite endless debate if not friction & wars.

The concept in the current context means: Both these principles of Jurisprudence are valid in appropriate circumstances. And they are invalid in inappropriate circumstances. A principle cannot be extended to absurd situations. Chettiar’s case is a classic illustration of the valid principles having gone wrong.

**Summary:** As provided in Vienna Convention, one has to consider all relevant material before interpreting an international treaty. OECD & U.N. models & their commentaries have to be considered. They are not binding. However, they have good intellectual value. Every specific phrase used in the DTA has a specific meaning. It cannot be brushed aside. Ignoring OECD & U.N. model is likely to cause serious damage. And such damage has been caused in the cases discussed here.

## **22. Possible Solution:**

**22.1** We have seen in paragraph (16) the probability of serious consequences of exempting foreign income from Indian Income-tax. Why allow scandals to take place & then try to catch the people! Amend the law, clarify the Government position. The least, the Government can do is provide the **Indian Model of Treaties** and provide full **Technical Explanations**. Place the same before the Parliament & give them the validity of circulars issued under the ITA. Remove the ambiguities & reduce litigation.

Parliament may make its intention clear. And then every interpreter has to try and interpret the law as per the intention of the Parliament in enacting a particular law. (This is totally different from the concept of “Committed Judiciary”. In the latter case, the judiciary is committed to the Government in power. We are talking of judiciary committed to justice, and ascertaining justice with the help of intention of the law makers and several relevant materials.)

## **22.2 Need for more elaborate law:**

Look at the international tax chapters in other countries’ legal systems. It would not be just one section (as we have S.90). There are

elaborate provisions. Why not clarify in the law that India has adopted the Credit system of EDT! Also divide the chapter on International Tax in two parts.

**Part A:** Normal provisions which will be subject to the Treaty Override clause: "Between the Treaty & the Act, which ever provision is more beneficial to the assessee, shall prevail".

**Part B:** Special provisions which would override any other provision, treaty as well as all Court decisions. In this part of the chapter, provide that India has adopted the Credit system of EDT. This part can also include anti-avoidance provisions like unacceptability of treaty shopping etc.

## 23. Summary of my submissions.

23.1 Every individual thinks differently. Un Ekant Vad.

23.2 Written words have serious limitations. They can be interpreted differently by different people.

23.3 When the 1<sup>st</sup> & 2<sup>nd</sup> concepts are combined, a multitude of alternatives are opened up.

23.4 We have to remember that "Nothing is Absolute".

23.5 To avoid incorrect decision, it is necessary to consider the following:

23.5.1 While interpreting any legal provisions, courts should consider the **purpose** of the provision; or **intention** of the authority that made the legal provision. In this case, the intention of the two Governments that signed the treaty must be considered.

23.5.2 Consider all **relevant material**. In this case, OECD & U.N. model conventions & their commentaries, Prof. Klaus Vogel's commentary should be considered. These commentaries are not binding. However, they have tremendous intellectual value.

23.5.3 There are phrases and **concepts** specially developed in the field of international taxation. They are discussed at length in OECD commentary. Any person deciding a matter of International Taxation should be conversant with these concepts. Only **conceptual clarity** would enable a person to distinguish the correct views (in this case, department's) from the incorrect view (in this case, appellant's).

**23.6** By ignoring the commentaries, Honourable Supreme Court as well as the Appellate authorities below it, have given incorrect decisions in this matter.

**23.7** There are errors in the decision. It can cause serious damage to the revenue. Even more important (i) it is contrary to Government intentions and global practices; and (ii) it can lead to massive frauds in the capital market.

It is necessary for the Government to amend the law and nullify this decision.

**23.8** The fact that India has accepted the "Credit system" of Elimination of Double Tax" is not stated in the Income-tax Act.

The system of DTA agreement is - Double tax is avoided by both COS & COR placing restrictions on their taxing rights. Articles 6 to 22 are for the COS; and Article 23 is for the COR. Categorisation applies to the COS and not to the COR.

This scheme has not been explained or stated in the ITA. World has suffered a lot because the right words have not been said at the right place and at the right time. Indian Income-tax Act needs to be modified.

**23.9** One may not rely on this (Chettiar's) decision and believe that foreign income would be tax free in the hands of an Indian resident. I appreciate that many experts have different views on this matter. And there have been some Court decisions following Chettiar's case. My submission is different.

**23.10** The principles of jurisprudence mentioned in paragraph I.4 above may be relevant in some circumstances & not relevant in other circumstances. For determining when to apply these principles and when not to apply, discretion is the key. Unfortunately in some cases, Government, profession as well as judiciary are giving less importance to discretion.

**23.11** There is nothing complex or esoteric about International tax. A professional who can practise Indian Income-tax, can certainly practise International Tax. However, before practising international tax, he may study the special concepts involved in this branch of law. And until he has studied the concepts, he may be cautious before practising it.

## 24. Final Submissions:

Do the principles of Jurisprudence require a review! I humbly submit, that what is required is use of discretion, understanding that a principle cannot be taken as an absolute.

We have considered the serious issues on two principles of jurisprudence accepted in India. They are good in normal circumstances. However, they cannot be taken as absolutes. Impact of misapplication of these principles has been seen.

The judge made law has reversed the system of elimination of double tax. This error can cause serious difficulties. In fact, it has started causing difficulties in the form of mis-carriage of justice. This requires that the Government has to make some serious amendments in the law.

Does the decision require a review! Special leave petition has been rejected "on Merits". Hence the only course available is amendment in law.

Should the Government amend the law! I humbly submit, "Yes".

I appreciate the serious implications of this proposal. If found to be of some worth, it may be debated. I sincerely apologise if any one's feelings are hurt. The purpose of this article is to raise some serious issues; with respect to all, and with greatest respect to the Indian judiciary.

Rashmin Chandulal Sanghvi

## Annexure 1 – Supplement to the Article.

### Legal Precedents on Philosophy of Law.

In this article I have raised several issues of philosophy. One may doubt appropriateness of the same. Consider the fact that almost every concept developed in this article based on “character of language, & words”, and philosophy of “Ahimsa” & “Un Ekant Vad” etc. has been considered – though in different words, in the following books & Court decisions:

(i) Justice G. P. Singh’s book: “Principles of Statutory Interpretation” published by M/s. Wadhwa & Co.

(ii) “Salmond on Jurisprudence” – 12<sup>th</sup> edition published by M/s. Tripathi.

(iii) M/s. Kanga, Palkhivala & Vyas – The Law & Practice of Income-tax, 9<sup>th</sup> edition, Chapter 1. Published by M/s. Butterworths.

In the following list, page numbers indicate: either the page No. of **Justice G. P. Singh’s** book; or **Salmond’s** book, or **M/s. Kanga, Palkhivala & Vyas’s** book.

1. Rashmin’s submission: **DTA should be interpreted according to the intention of the two Governments that executed it.**

G. P. Singh –Page 2. - “*Conventional way of interpreting or construing a statute is to seek the “intention” of its maker. A statute is to be construed according to the intent of them that make it.*” Whole chapter is on “intention”.

Kanga, Palkhivala & Vyas – Page 12 – Volume I.

*“The object of all constructions or interpretations is to ascertain the intention of the law makers and to make it effective.”*

Kanga, Palkhivala & Vyas – Page 17

*“... tax laws have to be interpreted reasonably and in consonance with justice adopting a **purposive** approach.”*

Rashmin’s note: Of course the same book gives a long list of citations stating that when the language of the law is clear, reference to any other material & an attempt to find out the intention of the legislature is not necessary.

When to apply which citation is a matter of **discretion**. This is my submission in the article: “Nothing is absolute. One has to use discretion”. And the theme of the discussion is, when interpretation is required, primarily, it has to be in keeping with the intention of the legislature.

2. **Rashmin: Words have limitations.**

G. P. Singh – Page 3 - *The task (of interpretation) is often not an easy one and the difficulties arise because of various reasons. To mention a few of them: **words** in any language are **not scientific symbols** having any precise or definite meaning, and **language is but an imperfect medium** to convey one's thought. It is **impossible** even for the most imaginative legislature to forestall **exhaustively situations** and circumstances that may emerge after enacting a statute where its application may be called for."*

G. P. Singh – Page 3 - *Words are capable of referring to different referents in different contexts and times.*

G. P. Singh – Page 27 - *"The same word may mean one thing in one **context** and another in a different context. For this reason the same word used in different sections of a statute or even when used at different places in the same clause or section of a statute may bear different meanings."*

3. **Rashmin: Ignoring article XXII altogether and making article VI as complete code by itself is an error.**

G. P. Singh – Page 25 - *"It is a rule now firmly established that the **intention of the Legislature** must be found by reading the **statute as a whole.**"*

G. P. Singh – Page 25 - *"Every clause of a statute should be construed with **reference to the context** and other clauses of the Act.*

G. P. Singh – Page 29 - ***There is, indeed, solid** and respectable authority for the rule that you should begin at the beginning and go on till you come to the end; then stop.*

G. P. Singh – Page 33 *"The courts strongly lean against a construction which reduces the statute to a futility."*

Kanga, Palkhivala & Vyas – Page 18 *"The court should adopt a harmonious construction that gives meaning to **all parts of the Act.**" "Entire statute must be read as a whole."*

Kanga, Palkhivala & Vyas – Page 19 *One provision of the Act cannot be so construed as to defeat another provision of the Act, and the several provisions in the Act must be read together and as parts of one large scheme.*

4. **Rashmin –Un Ekant Vad – Every man will think differently. Every man will interpret a sentence in a different manner.**

Salmond page 88 - *"A herd of Wolves", it has been said, is quieter and more at one than so many men, unless they all had one reason in them, or have one power*

*over them.” Unfortunately they have not one reason in them, each being moved by his own interests and passions.*

Kanga, Palkhivala & Vyas – Page 37 *In case of conflict between the decisions of the Supreme Court, the decision of the larger bench should be followed. Between two decisions of benches of equal strength of the Supreme Court, the later decisions should be followed, provided, the earlier decision is considered.*

Rashmin: The fact that every individual thinks differently is established by the fact that even Courts have given contrary decisions.

When reading a sentence or a section, different views are normal and natural. Considering the intention of the legislation is the best way to minimise the mischief caused by differences and contrary rulings.

5. **Rashmin: All relevant material should be considered before arriving at a decision. This includes OECD draft convention & the commentary.**

*In CIT v. Vishakhapatnam Port Trust [1983] 144 ITR 146 (India), it has been held: “In view of the standard OECD Model which is being used in various countries, a new area of general “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 judgements rendered by Courts in other countries or rulings by other tax authorities would be relevant.”*

Kanga, Palkhivala & Vyas – Page 27 Due importance must be given to the legislative history, context and background.

G. P. Singh – Page 28 - VISCOUNT SIMONDS (LORD TUCKER agreeing) in that connection said: *“I conceive it to be my right and duty to examine every word of a statute in its context, and I use context in its widest sense as including not only other enacting provisions of the same statute, but its preamble, the existing state of the law, other statutes in pari material, and the mischief which I can, by those and other legitimate means, discern that the statute was intended to remedy.*

Kanga, Palkhivala & Vyas – Page 27 Due importance must be given to the legislative history, context and background.

6. **Rashmin: There is nothing absolute in this material word.**

Honourable Supreme Court’s decision in Collector of Customs v/s D. Bhoormull (AIR 1974 SC 859), wherein it was held that:

*“... ..The prosecution or the department is not required to prove its case with mathematical precision to a demonstrable degree; for, in all human affairs*



*absolute certainty is a myth, and- as Prof. Brett felicitously puts it - "all exactness is a fake". El Dorado of absolute proof being unattainable, the law, accepts for it probability as a working substitute in this work-a-day world. The law does not require the prosecution to prove the impossible. All that it requires is the establishment of such a degree of probability that a prudent man may, on its basis, believe in the existence of the fact in issue. Thus, legal proof is not necessarily perfect proof; often it is nothing more than a prudent man's estimate as to the probabilities of the case. ... ..Since it is exceedingly difficult, if not absolutely impossible, for the prosecution to prove facts which are especially within the knowledge of the opponent or the accused, it is not obliged to prove them as part of its primary burden"*

Rashmin: The fact that every individual thinks differently is established by the fact that even Courts have given contrary decisions.

When reading a sentence or a section, different views are normal and natural. Considering the intention of the legislation is the best way to minimise the mischief caused by differences and contrary rulings.

Some more support is given in Michael Edward Kerr's book on Vienna Convention. This is included in my article & hence not repeated here.

My article discusses principles of philosophy. In this supplement I am quoting judicial pronouncements which use these principles in their judgements. This is natural as jurisprudence is "Philosophy of Law". And philosophy says: "Be Fair & truthful. Look at the substance rather than form". At the highest level of thinking, all philosophies merge.

2<sup>nd</sup> Supplement on the next page...

## Supplement 2. One More Illustration of consequences:

Chettiar's case is one illustration. Let us see one more illustration of consequences of following these "principles of jurisprudence" as mentioned in paragraph 1.4 above. Second illustration is now considered briefly. It is on the issue of applicability of India-UAE DTA.

India has signed a DTA with United Arab Emirates (U.A.E.). The UAE has seven Emirates including the Emirate of Dubai. Government of Dubai has decreed an Income-tax Act, but it is not applied to individuals. Hence except for a few entities like banks and oil companies, no one pays income-tax in Dubai.

Now if an NRI from Dubai invests in India, can he claim benefit of India - UAE DTA? The issues are:

To claim the benefit of the DTA, the NRI must be a "Resident" of Dubai. (Article 1.)

To claim residential status, he should be "liable to tax" in Dubai. (Article 4.1.)

Department took a stand that since the NRI is not liable to pay income-tax in Dubai, he cannot claim DTA relief. Different judicial authorities have given different decisions as summarised below.

1. Emirates Fertilizer Trading - Advance Ruling - October 2004 (272 ITR 84): (Authority - Justice Quadri) Ratio: UAE DTA applies.

*"It follows that in view of the provisions of para. 3 of article 13 of the treaty, the capital gains arising to the applicant can be taxed only in the UAE and not in India and that their taxability under the Act in India does not depend upon whether they are as a fact taxable in the UAE."*

2. Abdul Razak A. Memon - Advance Ruling - May 2005 (276 ITR 306): Authority - Justice Quadri). Ratio: UAE DTA cannot apply to individuals. Therefore Capital gains article cannot apply.

*"The applicant, an individual, residing in UAE is not entitled to claim the benefit of the provisions of the treaty entered into between India and UAE."*

However interest and dividend articles will apply due to CBDT circular!

3. **Observation:** Same authority - AAR, same individual as the Chairman of AAR; has given two contradictory decisions in less than one year. Which principles of jurisprudence can justify this situation!

Rashmin