

# INTERPRETATION OF TAX STATUTES CORE PRINCIPLES

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# Interpretation of Domestic Tax Statutes

# Principles of Interpretation

Foundational principle for a charge under  
Tax Statutes :

“No tax can be imposed on the subject  
without words in the Act clearly showing  
an intention to lay a burden upon him”

- CIT v. Mr. P. Firm, Muar (1965) 56 ITR 67 (SC) – If a particular income is not taxable under the Income-tax Act, it cannot be taxed on the basis of estoppel or any other equitable doctrine.

# Principles of Interpretation

- **Literal construction** – Intention of the legislation must be found in the words used by the legislature itself
- **Strict interpretation** – Words to be construed strictly
- **Contextual interpretation** – Meaning of a term is understood with reference to the context or the purpose for which the provision has been enacted
- **Mischief rule** – Mischief sought to be remedied by the amendment is seen to interpret the provision
- **Harmonious construction** – When the different provisions of the Act are harmonised or reconciled in light of the object and purpose of the enactment in question
- **Principle of Beneficial interpretation** – Construction more favourable to the assessee in case of any doubt
- **The golden rule** – Words should be given their ordinary sense unless that would lead to some absurdity or inconsistency with the rest of the instrument. No hypothetical considerations though

# Principles of Interpretation

- **Liberal construction** – Adopt the rule of liberal construction so as to give meaning to all parts of the statute and to make the whole of it effective and operative if the literal construction make any part of the statute ineffective and meaningless
- ***Ejusdem generis*** - As a rule, where in a statute there are general words following particular and specific words, the general words must be confined to things of the same kind as those specified, although this, as a rule of construction;, must be applied with caution, and subject to the primary rule that statutes are to be construed in accordance with the intention of Parliament. For the ejusdem rule to apply, the specific words must constitute a category , class or genus; if they do constitute such a category, class or genus, then only things which belong to that category , class or genus fall within the general words
- ***Casus Omissus*** – Matter which should have been but has not been provided by the statute, cannot be supplied by the court. Courts depart from this principle in case of any construction leading into an absurd result or to avoid any part of the statute becoming otiose.

- Provisions whether Mandatory or Directory
- Change in law

# Interpretation of Specific provisions

- Charging provisions
- Machinery or Procedural provisions
- Declaratory provisions
- Clarificatory provisions
- Computation provisions – where computation fails
- Limitation provisions
- Penal provisions
- Deeming Provisions and Legal Fictions
- Legal Presumption
- Appeal and Refund provisions
- Provisions creating a Right
- Beneficial provisions – Exemption, Deduction, etc
- Economic Consequences – CIT v. J.H. Gotla 156 ITR 323



# Code by itself

- Apollo Tyres Ltd v. CIT 255 ITR 273 (SC)
- Plastiblends India Ltd. V. ACIT (2017) 86 taxmann.com 137 (SC)

# Burden of proof

- To bring someone under a charge - on Revenue
- To bring Assessee under exemption/deduction - on Assessee
- C. Vasantlal and Co. v. CIT, (1962) 45 ITR 206 (SC) – ITO is not bound by any technical law of evidence and it is open to him to collect materials to facilitate assessment even by private enquiry. However, if ITO desires to use material so collected by him, assessee must be informed of material and must be given an adequate opportunity of explaining it.

# Tools in interpretation - External Aids

- Legislative History
- Circulars, Instructions, etc
- Speech of the Finance Minister
- Other parliamentary Material
- Previous Judicial interpretation or Legislation
- Provisions of other statutes and subsequent enactments
- Dictionary meaning or ordinary meaning
- Leading Commentaries!

# Internal Aids

- Provisos
- Explanations
- Non Obstante Clauses
- Marginal Notes and Headings
- Punctuation
- Definition Clause and Undefined Words

# Precedents

- Judgements of the Supreme Court
- Jurisdictional High Court judgements
- Other High Court judgements
- Special bench ruling of the Tribunal
- Coordinate bench rulings of the Tribunal

# Rules for reading the precedents

- Ratio Decidendi
- Obiter Dicta
- Casual Observations
- Speaking / Non speaking orders

# Circumstances that weaken the binding force of a precedent

- Ruling reversed by a higher court
- When affirmed or reversed on a different ground – depending on the circumstances
- When legislature enacts a statute that is inconsistent with the precedent
- Inconsistent with earlier decisions of a higher court or a court of the same rank
- Precedent sub silentio
- When rendered per incuriam

# **Interpretation of International Law / Treaties**



# History of Tax Treaty

- Earliest Treaty was adopted by Prussia around the start of the Twentieth Century
- First Treaty was with Austria signed in 1899
- In 1920 League of Nations began to play a leadership role
- 1928 published the first internationally important Model Tax Conventions
- After World War I, Germany signed a treaty with Czechoslovakia in 1921 and with Austria in 1922
- The League of Nations began publication on tax treaties in 1923
- The OECD became the Organization for Economic Cooperation and Development



# History of Tax Treaty (cont.)

- OECD first draft model treaty in 1963
- United Nations published a manual for the negotiations of bilateral tax treaties between Developed and Developing Countries in 1979
- In 1980 United Nations published a manual for the negotiations of Bilateral Tax Treaties between Developed and Developing Countries
- OECD made some amendments published in loose leaf form in 1990's
- UN Model Tax Convention 2001
- OECD started amending the publication every 2 to 3 years
- New UN Model on Tax Convention 2011



# Object of Tax Treaties

- Treaties cannot levy tax but can give relief- Azadi Bacho Andolan 263 ITR 706 (SC)
- The Andhra Pradesh High Court in Sanofi's 354 ITR 316 (AP) made some key observations about the importance of DTAA's and their relevance in the global scenario
- In recognition of the pejorative effect of double taxation on exchange of goods and services and movement of capital, technology and persons, agreements/treaties/conventions/protocols were entered into for removing obstacles that double-taxation presents to development of economic relations between nations
- Treaties or Conventions are thus instruments signaling sovereign political choices negotiated between States to avoid double taxation through restriction of tax claims in areas where overlapping tax claims are expected, or at least theoretically possible



# Leading International Tax models and commentary

- OECD Model Tax Convention on Income and on Capital
- United Nations Model Double Taxation Convention between Developed and Developing Countries
- United States Model conventions
- Klaus Vogel on Double Taxation Convention
  - A Commentary to the OECD, UN and US Model Conventions
- Philip Baker on Double Taxation Convention



# Adjudicating Forums in India

- High Court/Supreme Court
- Tribunal
- Mutual Agreement Procedure
- Advance Pricing Agreement
- Authority for Advance Ruling
- Settlement Commission
- Union Cabinet



# Adjudicating Forums not available in India

- Arbitration (Article 25 of the OECD and UN Convention)

# Basic Treaty Principles

- Treaty commitments must be honored by the parties in good faith
- A party may not invoke the provisions of its internal law as justification for its failure to honor its treaty commitments
- A treaty should be interpreted in good faith in accordance with the ordinary meaning of its terms, in their context and in light of its object and purpose



# Interpretation of Treaties vs. Domestic Law

“ *Principles adopted in interpretation of Treaties are not the same as those in interpretation of Statutory Legislation .... Treaties are negotiated and entered into at a political level and have several considerations as their bases ....*

”

- Section 90 of the Income Tax Act
- Treaty interpretation should be holistic
- Indian Supreme Court Decision – Union of India vs. Azadi Bachao Andolan (2003)



# General rule of interpretation [Article 31]

- 1) “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”
- 2) “The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; ...”



**Ram Jethmalani v.s Union of India 339 ITR 107(SC)**

# General rule of interpretation [Article 31] (cont.)

- 3) “There shall be taken into account, together with the context:
- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; ...”
- 4) “A special meaning shall be given to a term if it is established that the parties so intended.”



# Vienna Convention

## Article 32

- Supplementary means of interpretation
  - Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
    - a. leaves the meaning ambiguous or obscure; or
    - b. leads to a result which is manifestly absurd or unreasonable

# Supplementary means of Interpretation

- Travaux préparatoires
- Model OECD/UN Tax Conventions with Commentary
- Conduct shown through Mutual Agreement procedures
- Unilateral country views – example, US Treasury Technical Explanation
- Expert Witnesses
- Court decisions (including foreign Court decisions) prevailing at the time





# Australia

- Four steps governing interpretation
  1. Article 31 of Vienna Convention to be applied in a holistic manner
  2. Starting point of investigation is the text which receives priority in the interpretation process
  3. Courts must look to the context, object and purpose of treaty provision in a more liberal manner
  4. Treaties often fail to exhibit precision of domestic legislation
- Conclusion: Original meaning + Context, Object and Purpose = Answer

# China



- Pan Am Sat International System Inc 7 ITLR 419
  - “Opinion of competent authorities” preferred over expert international law witness produced by Assessee

# Indonesia



- PT Transportasi Gas Indonesia 11 ITLR 407
  - “Beneficial owner” has an international fiscal meaning which was determined by the Indonesian Court after examining – the OECD Commentary, academic writing and reaction of the UK Revenue Authorities after the Indo Food Case.
  - Determination to be made by State of Residence

# Czechoslovakia / India



- In re **AAA vs Financial Directorate 8 ITLR 178** where the interest, is defined in Treaty, must relate to corporate rights, which does not include loans
- Domestic law definition also would not apply where term defined in Treaty
- Metchem Canada Inc 284 ITR (AT) 196 (Mum)
  - When an expression or a clause is picked up from the OECD Model Convention, the normal presumption is that the persons using the said clause or expression are also aware about the meanings assigned to the said clause or expression by the OECD and have used it in the same sense and for the same purpose
- DDIT vs CIA de Navegacao Norsul Brazil (ITAT Mum)
  - Resorting to OECD Commentary is illogical and avoidable if certain expressions have been defined within the DTAA



# Italy

- **UGE SA v Arazzo VAT Office 9 ITLR 345**
- “Commentaries” have a non-binding effect and no force of law ...
- Cannot weigh more than a recommendation towards OECD Member States





# Germany

- Decision of Bundesfinanzhof : In re Partnership  
10 ITLR 628
  - A right to tax the interest in Germany could not be derived either from the terms of the protocol concluded at the time of conclusion of the double taxation convention, or by reference to the technical explanation to the convention issued by the US Treasury, or from the practice of the two revenue authorities in handling similar issues. The practice of the contracting states could not be employed as an aid to treaty interpretation in these circumstances under art 31(3) of the Vienna Convention on the Law of Treaties

# Ireland / Norway



- Kinsella vs. Revenue Commissioners 10 ITLR 63
  - In interpreting international treaties Court would apply article 31 and article 32 of VCT
  - Supplementary means of interpretation includes OECD Model Convention
  - Professor Vogel’s commentary used
  - “Day” means as per Irish Domestic Law, namely, the mid night test
  - Whether “marriage” was a tax avoidance scheme left open

# United States of America



- National Westminster Bank plc vs USA 10 ITLR 423
  - “Held Treasury Regulation was inconsistent with the shared intention of the two State parties and also the 1963 OECD Model Tax Convention...”
  - While the meaning “attributed to treaty provisions by Government Agencies” was entitled to weight, the Court had to give effect to the intention of both signatories and where they differed Government Agency’s decision merited less deference ....



# United States of America

- Jamieson vs. Commissioner of Internal Revenue;  
11 ITLR 40
  - “Last in time” rule applies in US and where there is a later conflicting domestic law it would override the Tax Treaty
- United States v. United Continental Tuna; (1976) 425  
U.S. 164
  - It is, of course, a cardinal principle of statutory construction that repeals by implication are not favoured



# Canada

- Paramount goal is to find meaning of the word in question looking to the language used and intention of parties – **Crown Forest Industries Ltd – Supreme Court (1995) 2SCR 802**
- There cannot be an implied override of a tax treaty – **Her Majesty the Queen v. Melford Developments Inc., 1982 2 SCR 504**

# India



- The **Courts** in India freely use International Court decisions especially from the Commonwealth countries and the United States and is fairly receptive to the OECD Commentary and views of International academicians
- Azadi Bachao Aandolan 263 ITR 706(SC)
- Drafted by Diplomats and not by lawyers
- Application of Principle of good faith
- Vienna Convention - Article 31
- Ram Jethmalani v. UOI 339 ITR 107(SC)

# Mauritius conundrum



- How was the problem created
- Who is responsible for treaty shopping
- CBDT Circular No 682 dated 30 March 1994
- CBDT Circular No 789 dated 13 April 2000
- Press Release dated 1 March 2013

# KEY DISRUPTERS OF PRINCIPLES

- Domestic Law - GAAR – General Anti Avoidance Rule
- International Law
- - BEPS – Base Erosion & Profit Shifting
- - Information Exchange



# Reservation on OECD Commentary

## **Right Florists (P.) Ltd. 143 ITD 445 (Kol)**

- The Government of India 's reservations on the OECD Commentary are relevant only to the extent that OECD Commentary, to that extent, cannot be treated as a fair index of intention of the Government of India and as contemporanea expositio in respect of tax treaties entered into by India after so expressing its reservations. Beyond that, these reservations have no role in judicial analysis

# Equalisation Levy

- India introduced Chapter VIII – Equalisation Levy in Finance Act, 2016 aiming to bring income generated by the digital economy within the ambit of taxation in India.
- The provisions of this chapter are applicable to an Indian resident who carries out business or profession, or a non-resident having PE in India making payment of more than one lakh rupees to a non-resident not having PE in India, to avail of ‘specified services’

# We love the 1960's – Part 1

- Section 90 has been amended by the following Finance Act(s)
  - Finance (No 2) Act 2009
  - Finance Act 1972
  - Finance (No 2) Act 1991 (w.r.e.f. 1-4-1972)
  - Finance Act 2001 (w.r.e.f. 1-4-1962)
  - Finance Act 2003
  - Finance (No.2) Act 2004 (w.r.e.f. 1-4-1962)
  - Finance Act 2013
  - Finance Act 2012 (Explanation-3 w.r.e.f. 1-10-2009)

# We love the 1960's – Part 2

- *Section 9(1) of the Act, retrospective amendment*

*Explanation 4.*—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

*Explanation 5.*—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

# We love the 1960's – Part 3

- Section 9(1)(vi) amended retrospectively by Finance Act, 2012

*Explanation 4.*—For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

*Explanation 5.*—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

- a) the possession or control of such right, property or information is with the payer;
- b) such right, property or information is used directly by the payer;
- c) the location of such right, property or information is in India

# We love the 1960's – Part 4

- *Explanation 6.*—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

- Notification No 91 of 2008 dated 28/08/2008 defines the expression 'may be taxed'
- Wherever the term 'may be taxed' occurs in any DTAA has to be understood as chargeable under the domestic law, subject only to any relief in accordance with the provisions of the agreement.

# Ishikawajma-Harima Heavy Industries Ltd v/s DIT 288

## ITR 408

- Sufficient territorial nexus with India necessary for taxation of income
- Two Conditions working simultaneously
  - A) Must be utilized in India
  - B) Must be rendered in India



Thank You