

BMR Legal



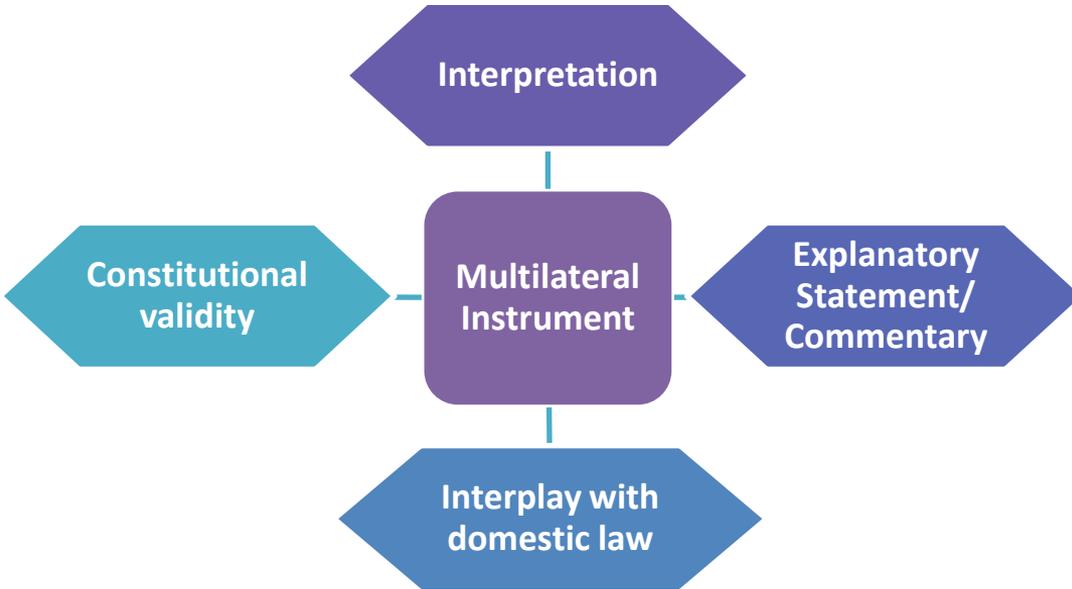
*MLI – an Indian perspective,
challenges & opportunities*

*International Taxation Conference – 2016
December 1, 2016*

Contents

- **MLI – Sustaining Challenges**
 - **Constitutional framework on treaty and judicial outlook**
 - **MLI and explanatory statement - interpretation**
 - **Implementation challenges**
 - **Annexures**
- 

MLI – sustaining challenges



- Jurisprudence on key aspects
- Reservations to OECD MC & Commentary
- Interplay with domestic law viz. 'Equalization Levy', 'CbCR', GAAR
- Interplay with existing *tax treaties*

Recapping

- **Modify** existing bilateral treaties
- **Negotiation** flexible with minimum standards
- **Include APs:**
 - **2** on Hybrid Mismatches
 - **6** on Treaty benefits in inappropriate circumstances
 - **7** on Artificial avoidance of PE
 - **14** on Dispute resolution mechanism

Constitutional framework on treaty

Article 51(1)(c):
Respect for international law and treaty obligations

Article 53:
Executive power of the Union – vested with President; exercised by subordinates

Article 73:
Extent of executive powers - matters on which Parliament has powers to make laws

Article 246(1):
Parliament has exclusive power to make laws for matters in the Union List

Article 253:
Parliament to make law for implementing any treaty

Article 372:
Laws before Constitution, shall continue until altered or repealed or amended

Constitutional framework on treaty

Key empowerment elements on constitutional powers

- Treaty making power vests with the Parliament, has not been exercised
- Treaty making an executive action –coextensive with Parliament’s legislative (Entry 14 of Union list, Article 73 read with Article 53)
- No mandatory ratification by Parliament
- Treaties concluded by Union through delegated powers
- Treaty obligations to be respected in good faith

In other jurisdictions: -

- **US**: President have powers to enter into treaties with advice/ consent of the Senate
- **France**: Power vests only with the President
- **UK**: Government may enter into treaties, Parliament may alter
- **OECD Countries**: Majority provide ratification by Parliament

Powers to enter into treaties – Judicial outlook

- Treaty needs to be implemented, if it is within the powers of the constitution*
- States are bound by the treaty; internal law cannot be cited as justification for not performing treaty obligations**
- Treaties do not become part of national law, incorporated into legal system by appropriate law [s90(2) of the IT Act]***
- Courts interpret national law and maintain harmony with the rules of international law and treaties***
- National law, even if contrary to international law, has to be respected***

No express provision in Constitution for 'entry into force' for tax treaties and ratification by Parliament; power conferred through an entry in Union list

*Maganbhai Ishwarbhai Patel Vs. UOI [1969 AIR 783] (SC)

**AWAS Ireland v. DGCA (March 2015) (Delhi HC)

***Page 110, P.M. Bakshi, The Constitution of India 12th Edition (New Delhi: Universal Law Publishing Company Private Limited, 2013)

MLI interpretation – Liberal or literal?

- Article 31: Treaty to be interpreted in good faith as per the ordinary meaning, in their context, object and purpose



*VCLT may be adapted as a customary law for interpretation**

Indian jurisprudence on treaty interpretation

- Meanings of words in tax treaties, be the ordinary meaning in that context and in light of its object and purpose*
- Treaties are not to be interpreted as statute, rather like an agreement**
- Literal/ legalistic meaning be avoided when the object is defeated; important to harmonize interpretation with the object and purpose***

*Ram Jethmalani v. UOI [2011] 200 Taxman 171 (SC); AWAS Ireland v. DGCA (March 2015)(Delhi HC)

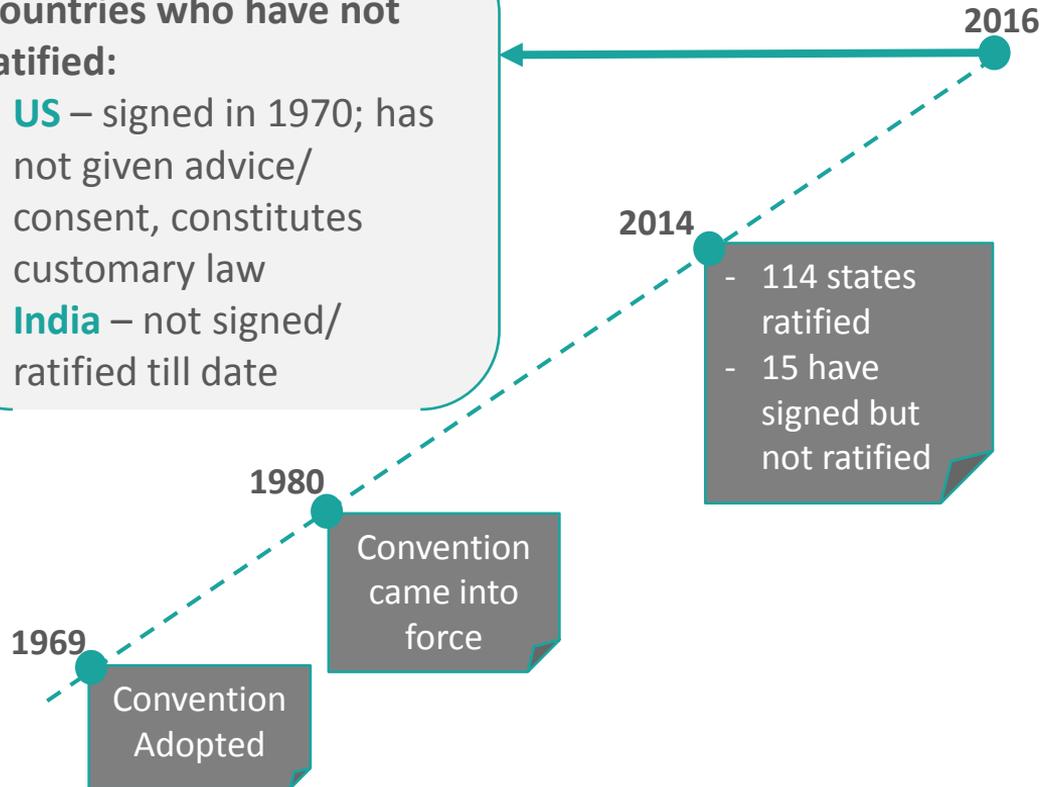
** New Skies Satellites N.V. v. ADIT [2009] 121 ITD 1 (Delhi) (SB)

***Mashreqbank PSC v. DDIT [2007] 14 SOT 1 (Mum.)

Aid of VCLT in MLI interpretation

Countries who have not ratified:

- **US** – signed in 1970; has not given advice/ consent, constitutes customary law
- **India** – not signed/ ratified till date



Applicability of Article 38 to India

Article 38:

“Rules in a treaty becoming binding on third States through international custom”

- Integration with global economy & active engagement with OECD, OECD MC has evolved as ‘customary law’ for Indian tax treaties
- Sanctity of external aids (such as Commentary, Explanatory Statement), still needs to be tested

Jurisprudence on OECD Commentary

In favour

- SC in *Azadi Bachao* made reference to OECD MC and Commentary to interpret meaning of term 'liable to tax' under India-Mauritius tax treaty*
- OECD Commentary can be relied, if terms in the tax treaty and domestic law are similar**
- Same meaning should be assigned to an expression in a tax treaty as assigned in OECD MC and Commentary***

*Union of India v. Azadi Bachao Andolan (SC) [2003] 263 ITR 706

**Asia Satellite Telecommunications Co. Ltd. v. DIT (Delhi HC) [2010] 332 ITR 340

***Metchem Canada Inc. v. DCIT (Mumbai ITAT) [2006] 100 ITD 251

Jurisprudence on OECD Commentary (Cont)

Against

- IT Act enables the Government to formulate treaties; not necessary to refer OECD MC or any other agreement*
- OECD Commentary contains views of the authors and cannot be equated with the decision of the SC or any law**
- For interpreting the IT Act and tax treaty, OECD Commentary cannot be relied**

Considering conflicting views of Courts, sanctity of amended OECD Commentary (due to APs) and Explanatory Statement to MLI would need to be tested

*CIT v. P.V.A.L. Kulandagan Chettiar (SC) [2004] 137 TAXMAN 460

**Gracemac Corpn. v. ADIT (Delhi ITAT) [2010] 42 SOT 550

Guidance on acceptance of OECD Commentary

Reference to OECD Commentary in tax treaties*

Full Reference	<ul style="list-style-type: none"> • Where contracting states have accepted
Restricted full interpretation rule	<ul style="list-style-type: none"> • Accepted till either state has reservations or the protocol has contrary interpretation
Partial Interpretation Rule	<ul style="list-style-type: none"> • Reliance restricted to a specific article of the tax treaty
Clarification Reference	<ul style="list-style-type: none"> • Relied for interpreting a text in the treaty, not binding on the states
Confirmation Reference	<ul style="list-style-type: none"> • Referred for the purpose of confirming the interpretation of a text
Other reference	<ul style="list-style-type: none"> • Generic references, not primarily for interpreting text of the treaty

131 tax treaties refer to OECD Commentary

None of the Indian treaties refers to OECD Commentary

- **Theoretically:** 'full reference' or 'restricted full' of Commentary/ Explanatory Statement should be adapted for successful implementation of MLI

- **Practically:** countries may differ for each Article & preference may vary for each Contracting State

*C. West, References to the OECD Commentaries in Tax Treaties: A Steady March from "Soft" Law to "Hard" Law?, 9 World Tax J. (2017), Journals IBFD

MLI - implementation challenges

- An objective to incorporate treaty changes (in over 3,000 treaties) in force, without renegotiating each treaty
- MLI to apply if two states who have entered into tax treaties decide to ratify the MLI
- As MLI and existing tax treaties would coexist, their norms could accumulate or conflict
- Implementation methodology advocated by scholars:
 - ***Lex Posterior***: Later in time principle to prevail if the two treaties cannot be reconciled or the first treaty is repealed by express words or implications* ➡
 - ***Lex Specialis***: Special rule prevails over general rule** ➡

*CP Tiwari And Ors vs Shakuntala Shukla And Ors (SC)

** Sanwaraml Kejriwal vs Vishwa Cooperative Housing Society Limited 1990 SCR (1) 862 (SC)]

MLI - implementation challenges (Cont)

- A norm of MLI may accumulate with norms of treaties in two cases:
 - It confirms the norms contained in the treaties (eg India-US treaty and MLI provides 'active business test' to prevent treaty abuse)
 - It adds/ complements the norms of existing treaties (eg India's reservation on international arbitration under Article 25 and AP 14)
- MLI norm may conflict with norms of treaties when solutions offered amount to different results. Some specific examples are discussed in subsequent slides:

MLI implementation challenges – Agency PE

Agency PE – Article 5 and AP7

- | | |
|---|--|
| <ul style="list-style-type: none"> ▪ Treaty: Agent exercises authority to conclude contracts* ▪ MLI: Agent plays main role in conclusion of contracts which are concluded without modification by principal | <ul style="list-style-type: none"> ▪ Treaty : Independent agent (legal and economically) acting in ordinary course not to constitute PE** ▪ MLI: Agent acting exclusively on behalf of closely related principal (control/ 50% interest) is not an independent agent |
|---|--|

- Changes in line with India's reservation to OECD Commentary
- Express provision in MLI to replace Agency PE clause in the treaty
- Lex Posterior principle to apply (ie MLI should prevail over treaty)
- Status of other reservations? Shall it continue in absence of express dealing in APs and MLI? 

*India's reservation to Paragraph 5, OECD MC

** India's reservation to Paragraph 6, OECD MC

MLI implementation challenges – Treaty anti-abuse

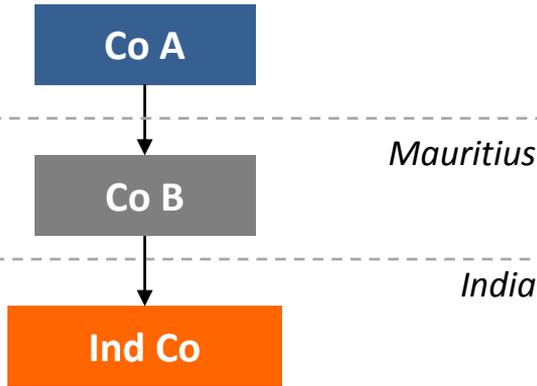
Treaty anti-abuse – AP 6

- | | |
|--|---|
| <ul style="list-style-type: none"> ▪ India-UK treaty: Treaty not available if one of the main purpose of transaction or creation of entity is to avail treaty benefit ▪ MLI: LoB test in the form of qualified person/ active business test; PPT test for transactions | <ul style="list-style-type: none"> ▪ India-US treaty: Qualified person/ active business test to avail treaty benefit ▪ MLI: LoB test in the form of qualified person/ active business test; PPT test for transactions |
|--|---|

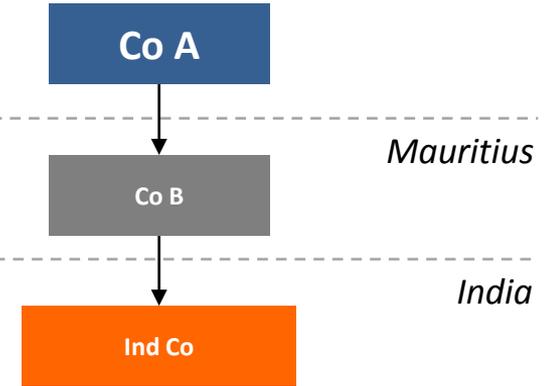
- Changes proposed in AP 6 at variance to treaties entered into by India
- Select treaties has LoB and PPT as anti-abuse provision (eg India-Sri Lanka)
- Status of treaties with Article specific LoB? [India-Mauritius tax treaty provides for expenditure test & *bona fide* business test for capital gains exemption]
- Interplay with domestic GAAR vis-à-vis anti-abuse provision under MLI

MLI implementation challenges - Illustration

Co B meets specific LoB under treaty but fails general LoB & PPT under AP6



Co B meets specific LoB under but fails GAAR under domestic law



- Specific LoB should prevail over general LoB & PPT – *applying Lex Specialias* principal?

- Domestic GAAR could prevail over treaty
- Article 51(1)(c) of VCLT – sustainable?

MLI implementation - challenges & recommendations

- Implementation challenges would ultimately depend on:
 - Extract and Language of MLI
 - In what form contracting states make reference to existing tax treaties
 - In what form reservations are expressed by the countries signing MLI
- Sanctity of explanatory statement to MLI and related APs – Whether MLI would make any reference and If yes, in what form?
- In case of conflict between domestic tax law and MLI, ordinarily MLI should prevail [s90(2) of IT Act]
- In cases where GAAR is applied, an attempt should be made for harmonious reading of GAAR provisions and MLI

Mukesh Butani | Partner

mukesh.butani@bmrlegal.in

Direct: +91 11 66783010

DISCLAIMER: This presentation transmitted to the recipient is confidential, legally privileged and intended solely for the use of the individual or entity to whom they are addressed. If you are not the intended recipient, you are notified that disclosing, copying, distributing or taking any action in reliance on the contents of this information is strictly prohibited under the law and the sender shall not be liable for any losses. Please notify the sender immediately by email if you have received this by mistake, and immediately delete this from your system. Unless related to BMR Legal business, the information contained within this presentation are those of the sender alone and do not necessarily constitute those of the Law Firm.

© Copyright 2016, BMR Legal. All Rights Reserved.



Annexure

BMR Legal

Lex Posterior – Indian Jurisprudence

Lex Posterior: Later law prevails

Broom's legal Maxim

- “It is then, an elementary rule that an earlier Act must give place to a later if the two cannot be reconciled *lex posterior derogat priori - non et nonum ut priores leges ad posteriores trahantur* (Emphasis supplied) - and one Act may repeal another by express words or by implication ; for it is enough if there be words which by necessary implication repeal it. But a repeal by implication is never to be favoured, and must not be imputed to the legislature without necessity, or strong reason, to be shown by the party imputing it. It is only effected where the provisions of the later enactment are so inconsistent with, or repugnant to, those of the earlier that the two cannot stand together; unless the two Acts are so plainly repugnant to each other that effect cannot be given to both at the same time a repeal cannot be implied” –**Chandra Prakash Tiwari And Ors vs Shakuntala Shukla And Ors (2001)(SC)**



Lex Specialis – Indian Jurisprudence

Lex Specialis: Special rule prevails over general rule

Sanwarmal Kejriwal vs Vishwa Cooperative Housing Society Limited 1990 SCR (1) 862 (SC)

- “Ordinarily, therefore, a general provision, a dispute touching the business of the society, would have to give way to the special provision in the Rent Act on the maxim generalia specialibus non derogant. That is why this Court harmonised the said provisions by holding that in matter covered by the Rent Act, its provisions, rather than the provisions of the Societies Act, should apply”

DIT-II vs OHM Ltd [2013] 352 ITR 406 (Delhi HC)

- “...Basically the rule that the specific provision excludes the general provision has been applied...”
- “...It is a well settled rule of interpretation that if a special provision is made respecting a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim ‘Generallia specialibus non derogant’...”

CIT vs Copes Vulcan Inc [1987] 167 ITR 884 (Madras HC)

- “When there is a special provision dealing with a special type of income, such a provision could exclude a general provision dealing with income accruing or arising out of any business connection...”

Basis Indian judicial precedents, a specific provision shall prevail over generic provisions of law. Applying similar interpretation of law over MLI, possible to say LoB to prevail over PPT?



India's reservation against OECD MC & Commentary on Article 5

Reservations	Whether reservation addressed in AP7?
Include service PE clause	No
Entity using facility or maintaining stock to deliver goods could create a PE	No
Person acting on behalf of the enterprise habitually maintains stock of goods or merchandise or secures orders in the other state may lead to constitution of PE	No
Enterprise carries on insurance business through a dependent agent shall constitute a PE	No
Agent acting on behalf of or almost on behalf of one enterprise, shall not be an independent agent	Yes
The twelve month test in relation to construction/ building site or installation project should not be applied individually to each site or project	Partially addressed

India's reservation against OECD MC & Commentary on Article 5 (Cont)

Reservations	Whether reservation addressed in AP7?
Activities carried out in a limited geographical area may constitute a PE irrespective of the independent nature of the activities	No
Tangible or intangible properties by themselves may constitute a PE of the lessor	No
Merely by being a part of the negotiations or controlling some elements, agent can be said to exercise the authority to conclude contracts	Partially addressed
A website or a server may constitute a PE in certain circumstances	No
Source based taxation should be followed; If the services are performed in the state of residence, it could still be taxed in the other state	No
Provision of services for two different projects of a same customer may be construed to be a single project and therefore forming a PE	No
PE to be constituted even if there is no control/ supervision on employees present in another state	No