Treaty Making Power & Multilateral Instruments (MLI) – Indian Context

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Introduction

Tax treaties form an important aspect of international laws in framing the taxing rules between the states. Treaty is an agreement between two or more sovereign states. Under the Vienna Convention[1] Article 2 recognises the scope of the tern 'treaty' and is as follows:

> *"treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation;*

In today's context the concept of international laws has seized great attention with the evolving business models, rampant technological advancements, the sovereign tussle by every state in maintaining harmony with the fellow states. Globalization and the economic crisis that the world has seen over the years, have led to international treaties acquiring greater significance since the 20th Century. In this context, the Modern International Law was framed, and International Institutions were formed towards maintaining harmonious relationship between state(s). Evolving with time technological advancements, the disruption it has created and the expansive economic boundaries of global businesses by use of technology in the 21st Century, the need for the international agreements and conventions between countries and protection of sovereign powers are dealt with paramount importance.

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Technology has annihilated the geographic barriers thereby, integrating the world economies into a "global village". Though economies have been integrated through technology and by means of digitalization, the sovereign states' claim over 'their share' of tax revenues testifies the need for a more comprehensive and inclusive tax framework on taxation of cross-border economic transaction has become the need of the hour.

International law includes tax treaties which have been entered into between countries on the fundamental premise to protect the interest of the taxpayers in the respective country. International law recognises that every Sovereign state has the right to enter into International treaties. In India, the Supreme Court states that "*The State is a creature of the Constitution*" in the case of S.R. Bommai v.

[1] Vienna Convention on the Law of Treaties, 1969, Vienna, 23 May 1969

Union of India[2]. Therefore, it becomes extremely relevant in understanding the role, scope and the power under which a treaty agreement (or) a convention (or) an instrument is being entered into by a sovereign state.

Agreements in general confers rights and obligations that are to be fulfilled by each of the parties in good faith[3] and so is the position in case in respect of Tax Treaties. In order to enter into such treaties or agreements, in general a sovereign state derives its authority to enter in to international agreements with another sovereign state subject to the powers conferred under its Domestic Law. In an exception, a few states enter into self-executing treaties and which once entered becomes applicable to the residents of that state[4].

To put it in perspective, Bilateral tax treaties, Tax Information Exchange Agreements ('TIEA'), the recent Multilateral Instruments ('MLI'), etc., come within the purview of a sovereign right under a federal setup that each state may exercise subject to their domestic law sanctions. Further understanding the basic framework or object of these instruments are important.

Most Federal State being a parliamentary democracy derives its power from Constitutional sanctions and not otherwise. Treaty making power of a country under a parliamentary democracy is also vested through its Constitution. Each country has an approach, where the powers are delegated to executive functionaries of the country. [5]In parliamentary democracies, with Great Britain and the remaining members of the Commonwealth constituting notable exceptions, the executive ordinarily must obtain the consent of parliament to conclude important agreements. The absence of parliamentary consent would constitute a clear and fundamental infraction of domestic law and consequently invalidate the treaty (Reference to Article 46(2) of the Vienna Convention is imperative). Further based on a mandatory norm recognized by international law as would be evident from what Oppenheim states in his *International Law*:

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> *"Constitutional restrictions: It is well established as a rule of customary international law that the validity of a treaty may be open to question if it has been concluded in*

[2] AIR 1994 SC 1918

[3] Under Article 26 of the Vienna Convention, treaties are binding on the contracting States and obligations under the treaty must be performed by them in good faith. This is the pacta sunt servanda principle.

[4] Example: USA; At a general level, a self-executing treaty may be defined as a treaty that may be enforced in the courts without prior legislation by Congress, and a non-self-executing treaty, conversely, as a treaty that may not be enforced in the courts without prior legislative "implementation." - THE AMERICAN JOURNAL OF INTERNATIONAL LAW, Vol. 89, p695

[5] Double Tax Treties and Their Interpretation by Klaus Vogel, Vol. 4 [1986] Pg. 17

violation of the constitutional laws of one of the states party to it, since the state's organs and representatives must have exceeded their powers in concluding such a treaty. Such constitutional restrictions take various forms."

Therefore, with the introduction of the new Multilateral Instruments to implement tax treaty related measures, it is important to understand in the Indian Law context - whether the agreement into the MLI framework would at all need a fresh delegation by the constitution? After all the Executive carries the torch under the auspices of the sovereign state's Constitution and the duty of negotiating and entering into an international convention is casted up on though this vested power (delegated through a legislation in Indian context). Second, the framework of the Bilateral Tax Treaty, historically is recognised for the purpose of avoidance of Double Taxation and provide relief to residents of the other state. Further, question arises whether a treaty framework can be modified beyond the powers conferred in the domestic law enabling such treaty making power. Lastly, given the existing Indian framework of the domestic law whether treaty scope can be expanded beyond the foundational enabling under the domestic law.

Treaty Making Power in India

Article 73 of the Indian Constitution delegates the authority of treaty making power to the Union Government. The Executive derives its power from this Article of the constitution to enter into a treaty. Further, in respect of taxation matters the Union derives its powers from Article 246 read with List I of the Seventh Schedule. Article 73 providing the boundaries of the Union on treaty making power reads as follows:

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"73. Extent of executive power of the Union

(1) Subject to the provisions of this Constitution, the executive power of the Union shall extend

(a) to the matters with respect to which Parliament has power to make laws; and

(b) to the exercise of such rights, authority and jurisdiction as are <u>exercisable by the government of India by virtue of any treaty on agreement: Provided that the executive power referred to in sub clause (a) shall not, save as expressly provided in this constitution or in any law made by Parliament</u>, extend in any State to matters with respect in which the Legislature of the State has also power to make laws

(2) Until otherwise provided by Parliament, a State and any officer or authority of a State may, notwithstanding anything in this article, continue to exercise in matters with respect to which Parliament has power to make laws for that State such executive power or functions as the State

or officer or authority thereof could exercise immediately before the commencement of this Constitution Council of Ministers"

By virtue of Cl.(1)(a), the executive power of the union shall be co-extensive with the legislative power of the Union Parliament[6]. The Supreme Court[7] had held that the principle of holding the executive power of the Central Government extends to the same subjects and to the same extent as that of Parliament as long as it does not infringe any provision of law made by the Parliament or the Constitution. Further, in so far as the treaty making power vested under clause (b) reading of Article 253 along with Entry 14, List I of Seventh Schedule is important. Article 253 delegates the power to the Parliament to make laws for implementing a treaty, agreement or convention with other countries or for any decision made at any international conference, association or other body. The extracts of Article 253 with relevant entry are reproduced below:

Under the Constitution of India

"253. Legislation for giving effect to international agreements Notwithstanding anything in the foregoing provisions of this Chapter, Parliament has power to make any law for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body"

Seventh Schedule – List I

"14. Entering into treaties and agreements with foreign countries and implementing of treaties, agreements and conventions with foreign countries."

This therefore would imply that the Parliament shall have the right to make laws for implementation of any treaty or agreement or convention (or) to give effect to decisions made at international conference, association or other body. Applying this in the context of tax treaties that India has entered into with other countries, looking up the power derived under Article 253 the Union has provided the legislative delegation through the Income tax Act, 1961 under section 90.

The theory generally floated is that treaty agreements with another state is an inherent part of Sovereign Power. In the context of Indian Democracy, the State becomes a creature of the Constitution[8]. In such a case, the theory of inherent power to enter into a treaty is to be understood as

[6] Durga Das Basu's Commentary on Constitution of India, Vol. 4, pg. 4470, Edn. 2008
[7] (2006) 9 SCC 69, Sathya Narain Shukla V. UOI
[8] Supreme Court in S.R.Bommai's Case (*supra)*

envisaged by our constitution and its jurispridence. More so in the case of tax treaties, the power to enter into treaty is provided for under section 90 to the Union Government. While describing the constitutional limitations H. M. Seervai states:

> *"The power to make treaties or enter into binding agreements with other nations, has an international as well as an internal aspect. In International Law, nations are assumed to know where the treaty making power resides, as well as the internal limitations on that power. As regards the internal aspect of a treaty or agreement, the Constitutional limitations, if any, on the treaty making power would come into play...... Again, where a treaty imposes an obligation which affects the rights of the inhabitants of a Sovereign State, say, India, the treaty would have to be implemented by a law, and the same would be the position if the treaty involved expenditure of public funds because these can only be appropriated in the manner provided for in the Constitution. Although the power to enter into treaties and implement them is in terms absolute, having regard to the fact that we have a written federal Constitution, a Court would imply limitations on that power as they have been implied in the United States although no treaty entered into by the United States has been held constitutionally void. A treaty, for instance, cannot make provisions which would, in effect, amend the Constitution, or give up the form of Govt. set up by the Constitution, for it could not have been intended that a power conferred by the Constitution should, without an amendment of the Constitution, alter the Constitution".*

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Therefore, to travel beyond the scope provided by the legislature i.e. Section 90 of the Income tax Act, 1961 (hereinafter referred to as ITA) shall not be a proper exercise of the delegated power. The treaty making power under the ITA is provided for under section 90(1), which enables the Central Government to enter into treaty with Government of another country for the purposes specified thereunder. Section 90(1) of ITA is reproduced as follows:

> *"90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—*
>
> *(a) for the granting of relief in respect of—*
>
> *(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or*
>
> *(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the*

case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement."

…………………………………….

Courts have held that the power of entering into a treaty is an inherent part of the Sovereign, however the treaty making power is to be traced through Articles 53, 73, 246 and 253 of the Indian Constitution which enables this possible. Section 90(1) of the ITA is the legislative sanction provided by the Constitution, in terms of entry 14 of Seventh Schedule read with Article 253, without which this enabling power shall not available. What really becomes worthy to note, on first principles, is that executive power of the Union is co-extensive with the legislative power of the Parliament. Therefore, in adoption of tax treaties through the objects and the framework work of the Model Conventions[9] shall need to be heedfully exercised. In this backdrop, it is essential to understand international law in the context of treaty making power by a sovereign state.

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International practise on treaty making:

It is believed beyond doubt that that every sovereign state can conclude international agreements with other states or even enter into agreement with other international organisations. Treaty making power in general is a power exercised by the Heads of the States or by the concerned governments. India also follows such a system, where treaty making is a function of the President of India and by a statutory delegation the conclusion and implementation is made in the Name of the President (Art. 53 of the Indian Constitution) by the Union Government. Similarly, in UK the Foreign and Commonwealth Secretary, who is empowered with full powers of the Crown to enter into a treaty. Further, this similarity extends to the space where in respect of taxation matters, the powers of the state in UK is granted in

[9] United Nations Model Convention ('UN MC'), OECD Model Convention ('OECD MC')

section 788 of the United Kingdom's Income and Corporation Taxes Act, 1988. Further the House of Common (Parliament) exercises full legislative control in respect of the Taxation matters under the Parliament Act, 1911. In USA also, the Constitution gives the treaty-making power in the hands of the President "with advice and consent" of the Senate. However, in USA, the treaty merges with the domestic law on account of the Supremacy Clause of US Constitution.

In case of a federal state or other composite state, it is necessary to distinguish the federal states' constitutional power to conclude a treaty and to incur international obligations towards other parties and its power under the constitution to enforce compliance with the treaty on the part of the constituent states[10]. This becomes extremely relevant in the context of its scope (or) the purpose for which the treaty making power is under section 90(1) of the ITA. It is a well settled administrative law principle that the delegated authority shall have to be strictly construed within the four corners of the statute.

Though failure of the federal state in not giving effect into its municipal laws for implementation of the treaty is no defence to for failure to perform the treaty obligations. Conflicting views keep arising on this due to the complexity involved in the municipal laws and the notion of supremacy given to international agreements. Article 45 of the Vienna Convention expressly states that, the state shall not claim invalidity of its consent by mere means of procedural laws, for instance, the constitutional requirement that a concluded treaty be signed by the Head of the state need not mean the protocol signed by a minister is not a valid agreement. However, if the internal law that relates to the competence to conclude treaty is violated, it is a rule of fundamental importance that such action shall necessarily not be consonance with the customary international law practise[11].

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Therefore, to conclude, in India the treaty making power in the context of tax treaties is manifested by Article 253 of the Constitution, through a delegated legislative power given by virtue of section 90(1) of ITA. This is an administrative delegation given by a statute to the Central Government to enter into a tax treaty.

Domestic Law Exposition - Section 90[12] of ITA

The scope of section 90(1) provides that central government may enter into treaty with government of another country or a specified territory for the purposes of:-

[10] 636, p. 1285 of Oppenheim's International Law – Vol. 1
[11] Article 46 of the Vienna Convention & 636, ibid p. 1288
[12] Those aspects discussion under this article shall apply in respect of section 90A also, as section 90A is akin to section 90 of the ITA but for its applicability to specified associations.

a. Granting relief in respect of income tax paid in India and the other country/ territory;
b. Granting relief in respect of income chargeable under the ITA to promote mutual economic relationships, trade and investment;
c. Avoidance of double taxation of income;
d. for exchange of information for the prevention of evasion or avoidance of income-tax;
e. for recovery of income-tax.

In so far as the treaty making power is concerned, the law is to be understood in conjunction with the legislative implementation granted by the Constitution of India. In interpreting the statutory provision, one may have to factor the Chapter under which a provision has been enacted, the heading provided to the section and then the substantive portion of the statutory provision.

It is a general rule of interpretation that the Heading normally does not form part of the statutory provision but lends assistance in interpreting the statutory intent since heading always serves to convey the intent of the provision[13]. Section 90, 90A and 91 finds its place in Chapter IX of the ITA containing the heading **"Double Taxation Relief"**. This would mean that the main intent of the legislature is provide double tax relief through the provisions enshrined under section 90 and 90A of the ITA. It may also be noted that, a statute may also provide for other incidental aspects that may be relevant in the context of that Chapter in the statute.

Further, one could understand that in the context of section 90(1) of the ITA, the provisions contained thereunder is a delegation of the parliamentary power to enter into a treaty with another country for the limited purposes or scope contained in the statute. Further, this being a constitutional delegation, the same must exercised judiciously within the framework of such provision.

In light of the above, the basic rule of interpretation embodied by the Latin maxim *'ex visceribus actus'* becomes relevant. The rule provides that the interpretation shall be read as a whole and within the four corners of the statue. Further, intention of the Legislature must be found by a reading of the statute as a whole[14] and in its context which is derived from the contextual scheme[15].

This makes the position of even more concrete in terms of the treaty making powers under section 90(1) that it shall only be confined to those aspects contained there under and the administrative implementation cannot exceed the corners provided thereunder. The Hon'ble Supreme Court in the

[13] Khoday Industries (P.) Ltd. v. CIT [1987] 163 ITR 646
[14] Doypack Systems Pvt. Ltd. v.Union of India AIR 1988 SC 782.
[15] Hindustan Aluminium Corpn. Ltd. v. State of UP AIR 1981 SC 1649

case of Azadi Bachao Andolan[16] held that "*It is a well-settled principle of interpretation that Courts in construing a statute will give much weight to the interpretation put upon it, at the time of its enactment and since, by those whose duty it has been to construe, execute and apply it*".

Any Double-tax Avoidance Treaty ('DTAC') entered into with any other country/ specified association by India is exercised under section 90(1) or 90A(1). All DTACs contain in them, the specific power derived by it from section 90(1) or with reference to 90A(1) and is contained in the preamble of treaties. Extracts of the relevant portions of the DTACs are provided below. Some of which still contain the treaty feature as it existed pre-amended position (Eg: UAR) of the ITA viz., the provision as it stands now under section 90(1). Extracts of a few tax treaties are provided for examination:

Country	Relevant extracts from Treaty
Estonia	Agreement for Avoidance of Double Taxation and Prevention of fiscal evasion with foreign countries - Estonia .... NOW, THEREFORE, in exercise of the powers conferred by section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that all the provisions of the said Agreement, as set out in the Annexure hereto, shall be given effect to in the Union of India with effect from 1st day of April, 2013. Notification : No. 27/2012 [F.No. 503/02/1997- FTD-1]/SO 1677(E), dated 25-7-2012
UAR (Egypt)	Agreement for avoidance of double taxation with United Arab Republic (Egypt) ...... Now, therefore, in exercise of the powers conferred by section 90 of the Income-tax Act, 1961 (43 of 1961), and section 24A of the Companies (Profits) Surtax Act, 1964 (7 of 1964), the Central Government hereby directs that all the provisions of the said Convention shall be given effect to in the Union of India. Notification: No. GSR 2363, dated 30-9-1969

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[16] Union of India & ANR v. Azadi Bachao Andolan (2003) 263 ITR 0706 (SC); quoted from the decision in Deshbandhu Gupta & Co. vs. Delhi Stock Exchange Association Ltd. (1979) 4 SCC 565.

Colombia	SECTION 90 OF THE INCOME-TAX ACT, 1961 - DOUBLE TAXATION AGREEMENT - AGREEMENT FOR AVOIDANCE OF DOUBLE TAXATION AND PREVENTION OF FISCAL EVASION WITH FOREIGN COUNTRIES – COLOMBIA NOTIFICATION NO.44/2014 [F.NO.501/3/99-FTD-II], DATED 23-9-2014 ..... Now, therefore, in exercise of the powers conferred by sub-section (1) of section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies that all the provisions of the said Agreement, as annexed hereto, shall be given effect to in the Union of India
MACAO SAR (Specified Territories)	SECTION 90 OF THE INCOME-TAX ACT, 1961 - DOUBLE TAXATION AGREEMENT - AGREEMENT FOR EXCHANGE OF INFORMATION WITH RESPECT TO TAXES WITH MACAO SPECIAL ADMINISTRATIVE REGION OF PEOPLE'S REPUBLIC OF CHINA NOTIFICATION NO.43/2012[F.NO.503/04/2009-FT&TR-II]/SO 2427(E), DATED 10-10-2012 ..... Now, therefore, in exercise of powers conferred by section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies that all the provisions of the said Agreement annexed hereto shall be given effect to in the Union of India with effect from the 16th day of April, 2012.
Taipei (Specified Association Agreement)	SECTION 90A OF THE INCOME-TAX ACT, 1961 - DOUBLE TAXATION AGREEMENT - ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENT BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF - SPECIFIED TERRITORY AND SPECIFIED ASSOCIATION - TAIPEI NOTIFICATION NO. 48/2011 [F.NO. 500/02/2001-FTD-II]/S. O. 2040(E), DATED 2-9-2011 .... Now, therefore, in exercise of the powers conferred by sub-section (1) of section 90A of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby adopts the agreement between India-Taipei Association in Taipei and Taipei Economic and Cultural Center in New Delhi for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and notifies that all the provisions of the said

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	agreement annexed hereto shall be given effect to in the Union of India with effect from the 1st day of April, 2012.
Table #1	

With reference to each of the above, the executive's role to conclude agreements with each of the countries have undergone a change and evidently so, the changes correlate to the amendments made to the ITA to suit and satisfy the economic needs of the country at various instances. As regards scope of section 90(1) or 90A(1), the law kept evolving since the first amendment that took place through the Finance Act, 1972. Consequently, the treaty making power has also been consistently undergone several changes. The list of substantive amendments in this context carried out since 1962 are tabulated below with reference to sub-section (1):

Finance Act, Year	Amendment to ITA
Original Text of the 1961 Act (pre-amendment)	**Agreement with foreign countries** 90. The Central Government may enter into an agreement— (a) with the Government of any country outside India for the granting of relief in respect of income on which have been paid both income-tax (including super-tax) under this Act and income-tax in that country, or (b) with the Government of any country outside India for the avoidance of double taxation of income under this Act and under the corres-ponding law in force in that country; and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
Finance Act, 1972	Insertion of clause relating to exchange of information for the prevention of evasion or avoidance of income-tax by substituting a new section. Some of the taxpayers having transactions with outside countries resort to dubious methods for evading their liability under the tax laws. Tax evasion is thus closely linked with transactions involving over-invoicing and under-invoicing in import and export business operations through secret foreign bank accounts and smuggling of

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	valuable articles into and out of India. With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications, the Finance Act, 1972 has substituted a new section for the existing section 90 in order to empower the Central Government to enter into agreements with foreign countries not only for purposes of avoidance of double taxation of income but also for enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on a reciprocal basis.
Finance Act, 2003	Clause (a) of sub-section (1) to section 90 was amended to expand the scope of relief under ITA through the treaties. Amended clause reads as: *"(1) The Central Government may enter into an agreement with the Government of any country outside India—* *(a) for the granting of relief in respect of—* *(i) income on which have been paid both income-tax under this Act and income-tax in that country; or* *(ii) income-tax chargeable under this Act and under the corresponding law in force in that country* ***to promote mutual economic relations, trade and investment****, or"* The explanatory memorandum provides that the scope was expended in order to **encourage international trade and commerce**, and so as to facilitate that the Central Government may also enter into an agreement with the Government of any country outside India for granting relief in respect of income-tax chargeable under this Act and under the corresponding law in that country to promote mutual economic relations, trade and investment.
Finance Act, 2009	Insertion of specified territories under the scope of treaty making power under section 90(1):

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	"(1) The Central Government may enter into an agreement with the Government of any country outside India or <u>specified territory outside India,</u>—" Explanatory Memorandum states that, the restrictive scope of the treaty making power with only **<u>'any other country outside India'</u>** was expanded to provide for treaty making power to enter into agreements with non-sovereign countries also, in respect of both DTAC and Tax Information Exchange Agreements ('TIEA').

Table #2

In so far as all the above amendments[17], the executive has exercised the treaty making power subject to the sanctions made by the parliament and rightly so in the context of the aspects discussed above. Therefore, it becomes evident that unless the delegated power is being backed by the statutory blessing (as contemplated under Article 253 of the Constitution) the power to expand the scope of treaty does not get the sanction. Arbitrary power and the rule of the Constitution cannot co-exist. The right question under our constitutional framework would be - whether the Union government possessed the legal power to do what it ought to do.?

Our Supreme Court has in the case of *Azadi Bacho Andolan*[18], has set out the law on tax treaties with reference to the Indo-Mauritius DTAC[19]. In decision, of the hon'ble court though on a prima facie impression on the reading of the statue book on the treaty making power under the ITA, agrees to the view of section 90 being a delegated power which enables the Central Government to conclude and implement DTACs. However, it later comes to the conclusion that, the validity of section 90 under the ITA does not come within the purview of the court in the case before it. This seemingly appears to be contradictory and therefore leaves it ambiguous. These views have led to several confusions in interpretation of treaties and scope of treaty making power, as rightly observed by the Hon'ble Madras High Court[20], in the context of testing the constitutional validity of section 94(1).

[17] Since the scope of this article is discuss the foundational aspects of treaty making power, whether the amendments is prospective or retrospective with reference to a treaty entered earlier to the amendment would lead to a separate discussion by itself. the next question that might arise is whether the treaty should be interpreted with a 'Static Approach' or 'Ambulatory Approach' with respect to the amended provisions of the ITA or vice versa. Hence, the discussion on that is therefore restricted to the treaty making power.

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

[19] Post amendment of the section 90(1) by Finance Act, 2003; Refer: Table #2

[20] T. Rajkumar v. UOI [2016] 383 ITR 385 (Madras)

India follows a monistic approach as far as the tax treaties are concerned, unlike the British which follows a dualistic approach where the rights and obligations created by the treaty shall have no effect in the domestic law unless a legislative force is given to them. Whereas a monistic approach shall imply that the provisions of the treaty shall not override the domestic law and rather the domestic law shall serve the purpose of the international treaty. The principles of is contained in the state as part of sub-section (2) of section 90 of the ITA and is reproduced below:

> *Section 90 –*
>
> *(1)….*
>
> *(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies,* ***the provisions of this Act shall apply to the extent they are more beneficial to that assessee****.*

Most decisions of the courts approach the interpretation of tax treaties with reference to 'dualistic' principles[21] generally followed by India with reference to International Treaties other than tax. However, application of dualist approach finds no place in an Indian tax treaty context by virtue of 90(2). The dualistic approach on interpretation of tax treaties would, otherwise applicable in the Indian context on International Agreements in respect of rights of citizens, would lead to misdirected effect on interpretation of tax treaties.

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The other important aspect would be to understand that broad objects of section 90, i.e. (a) Granting relief in respect of income tax paid in India and the other country/ territory, (b) Granting relief in respect of income chargeable under the ITA to promote mutual economic relationships, trade and investment; (c) Avoidance of double taxation of income, etc., being the scope provides the treaty making power, contemplated in 90(1), and meaning that could assigned to such terms. In order to understand this attention is drawn to the decision in *CIT v. Carew and Co. Ltd*.[22] is one involving consideration by the Supreme Court of an agreement entered into for avoidance of double taxation entered into between India and Pakistan and particularly Article 4 of the said agreement. In deciding the issue raised therein, the apex court noticed the distinction between the phrases **avoidance of double taxation and relief from double taxation** in the following terms:

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[21] Attention is drawn with reference to the decision of Apex Court on Maganbhai Ishwarbhai Patel &Ors v. UOI, AIR 1969 SC 783/ (1970) 3 SCC 400. Quoted as per of Azadi Bachao Andolan (supra)

[22] [1979] 120 1TR 540 (SC)

"*Before parting with this case, it is appropriate to point out that a distinction exists between the avoidance of double taxation and relief against double taxation. That distinction is evidenced by the two clauses of section 49A of the Indian Income-tax Act. One important feature distinguishing the two concepts lies in this that in the case of avoidance of double taxation the assessee does not have to pay the tax first and then apply for relief in the form of refund, as he would be obliged to do under a provision for relief against double taxation. The respective schemes embodying the two concepts differ in some degree from each other, and that needs to be borne in mind when statutory provisions are referred to and cases are cited before the court on a point involving double taxation.*"[23]

Therefore, one could infer that the terminology and phrases used in the treaty making power under the statute is important and each object specified therein shall have relevance to the treaty making. All along the treaties have been modified (or) amended through the protocols after deliberations and negotiations between the Competent Authorities. Further, a cogent reading of the amendments[24] made to section 90(1) and the modifications made to the DTACs have much relevance. the premise on which treaties were being concluded (or) modified.

In this background, it is essential to apply the above principle in the context and its relevance with reference to the MLI, which arises from the Action Plan No. 15 of the OECD's BEPS measures, of which India is also a signatory.

Treaty making power - MLI Context

The OECD's Base Erosion Profit Shifting (BEPS), coined by Pascals Saint-Amans after one of the meeting of the bureau members of the Centre for Tax Policy and Administration of the OECD, was a mission that aimed to overhaul the international tax rules around the foundational pillars of Coherence, Substance and Transparency. The actions of the international organisations is a result of exploitation of the differential tax regime in different countries[25] and misuse of such rules, thereby eroding the profits in high tax jurisdictions and shifting of profits to low tax jurisdictions or to jurisdictions with virtually no taxes.

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[23] Referred to in the decision of CIT v. Vr. SRM Firm [1994] 208 ITR 400 (MAD. Later affirmed by SC - [2004] 137 Taxman 460 (SC)

[24] Referred to in Table #2

[25] Referred to as 'tax jurisdictions' as the context may require.

In order to bridge the gap between various tax policies of sovereign states, the OECD and G20 Countries formulated 15 Action Plans, of which Action Plan ('AP') 15 deals with Multilateral Instrument.

International Law principles must be kept in mind where the intention of the parties to the treaty shall have to be given utmost importance in so far as treaty interpretations are concerned. It is important in this background to understand the concept and the mechanics that been developed for implementation of MLI and how MLI would go to modify the existing DTACs. MLI is a single instrument which is developed that would modify the existing DTACs[26] between countries. Unlike earlier practise of amending a DTAC through a Protocol, the MLI shall stand to replace the relevant portion(s) of an existing DTAC. This aspect even extends to amend the Preamble in a DTAC between the two treaties.

MLI framework provides, every sovereign country a choice to either exercise or not exercise the option to become a signatory to MLI. For instance, USA is not a signatory to the MLI by choice. Without getting into the aspects of the choice that a country may exercise of a MLI provision, reservations that can be made to certain provisions, notifications it may issue, etc., the focus shall be as how this MLI, to which India is a signatory, would be valid in the context of powers under section 90(1) or 90A(1) of the ITA.

Mechanics of MLI

As described earlier, MLI shall not replace the current DTACs but, where ever two countries have agreed independently on adoption of an MLI position available under the instrument, then such 'matched option' between the states shall replace the relevant Article/ portions of the DTAC between the countries[27]. In case of a position adopted between both countries under the MLI ('matched MLI position') and such position is absent in a DTAC, then the DTAC shall be added with such provisions. These rules even apply to the adoption of Preamble[28] under the MLI.

Once the MLI Preamble position is accepted by a country, such accepted preamble goes to replace the existing preamble contained in the DTAC or in its absence it will be added to the DTAC. India is a signatory to the MIL and in order to introduce MLI in the Indian Context, the Central Government has obtained a separate cabinet approval[29].

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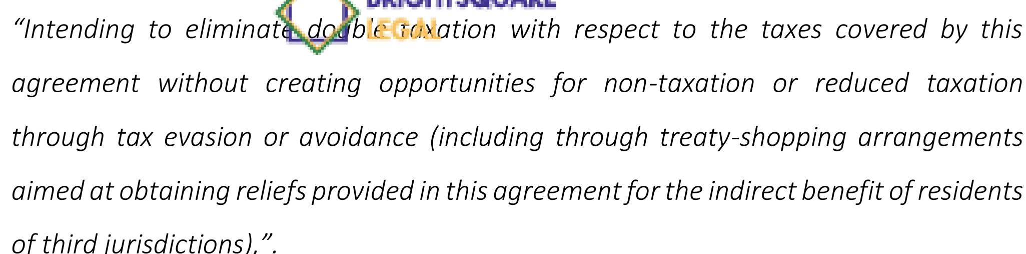
[26] Referred to as Covered Tax Agreements in the context of MLI under the BEEPS
[27] For Example, Article 13 of the MLI which deals with "Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions" provides for the countries to opt for either Option A or Option B to modify their DTACs.
[28] Article 6 of MLI
[29] http://pib.nic.in/newsite/PrintRelease.aspx?relid=161885

Now, the question arises on the power of the Central Government to implement such an instrument supplementing or superimposing the existing DTACs would require a legislative backing in the context of treaty making power under section 90(1) or 90A(1) of the ITA or an approval from Union Cabinet would suffice to give the enabling contemplated by the constitution.

Differently put, in the context of multilateral instrument and the objects envisaged thereunder, can a treaty making power be regarded to be within the scope covered under section 90(1) or 90A(1), becomes critical. The objects of MLI read with the preamble of MLI (which is expressed as minimum standards as per the AP-6 of the BEPS framework on Treaty Abuse), are extremely essential to trace the treaty implementation power in the domestic law context. Ratification of MLI in accordance with the respective country's internal laws essential for becoming part of the MLI convention[30].

Under MLI convention, the basic feature of a DTAC is proposed to be modified (as per the minimum standard requirements of the BEPS plan) through insertion of a preamble to the DTAC or modification of preamble to an existing DTAC. Article 6(1) and 6(3) provides as follows:

> *Article 6 – Purpose of a Covered Tax Agreement*
>
> *1. A Covered Tax Agreement **shall be modified to include** the following preamble text:*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> *"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),".*
>
> *2. The text described in paragraph 1 shall be included in a Covered Tax Agreement in place of or in the absence of preamble language of the Covered Tax Agreement referring to an intent to eliminate double taxation, **whether or not that language also refers to the intent not to create opportunities for non-taxation or reduced taxation**.*
>
> *3. A Party **may also choose to include the following preamble text with respect to its Covered Tax Agreements** that do not contain preamble language referring to a desire to develop an economic relationship or to enhance co-operation in tax matters:*
>
> ***"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,".***

[30] Article 27 of MLI

Therefore, by insertion of such preamble through the MLI into the DTAC which India has already entered into, would lead to modification of the DTACs beyond the scope of treaty making power under the ITA. The intention of the ITA and the powers conferred to the Central Government in the relation to tax treaties should be read as:

(a) for the granting of relief in respect of—

(i) taxes paid on the same income in both countries

(ii) income-tax chargeable, with a view to promote mutual economic relations, trade and investment (by way of concessional rate of tax or nil rate of tax in the treaties)

(b) for the avoidance of double taxation of income

(c) for exchange of information for the purpose prevention of evasion or avoidance of income-tax or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax

Nowhere in this context does the preamble of MLI with reference to prevention of double non-taxation, opportunities for tax evasion or avoidance, treaty-shopping arrangements find place in the texts of the existing provisions of the ITA. This is also contained as part of the preface to the MLI agreement signed by India[31]. In this background, unless the exercise of delegated power is appropriately carried out through parliamentary legislation the treaty implementation in may not receive its sanction. It may be imperative to note that India has been silent on Article 6 and therefore the MLI preamble gets added to the existing preamble of DTACs.

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Conclusion

In India, treaty making power through the parliamentary legislation under the ITA is a specific delegation of power under the Indian Constitution. Therefore, such powers are to be exercised within scope of the four corners of the statute and cannot transgress the constitutional limits. This is a well-accepted and settled principle under the administrative law and more so in respect of the constitutional delegation of powers the scope shall be restrictive in nature.

It is therefore extremely essential to read each of the teams under a delegated power to find out, whether such powers are contained therein. It is widely perceived that the aspects of prevention of double non-taxation, opportunities for tax evasion or avoidance, treaty-shopping arrangements could widely fall under the terms of "for the avoidance of double taxation of income", however if such be the

[31] Provided as part of Annexure to this article.

intention of the statute a separate scope for "granting relief in respect of taxes paid in both countries or relief in respect of rates of taxes" would not have been necessary. Such division of scope with reference to treaty making would not have been necessary.

Even in case of amendment carried out for providing relief on income-tax chargeable in order to promote mutual economic relations, trade and investment, was with object to attract more foreign investments into India given the economic situation of the India at the time when amendment was carried out[32]. Therefore, in my humble view, avoidance of double taxation of income will not encompass[33] to include in it, prevention of double non-taxation, opportunities for tax evasion or avoidance and treaty-shopping arrangements. These aspects would necessarily require legislative sanction by the parliament under the ITA for implementation of International tax treaty with reference to our constitution. True spirit of a treaty is served even under the principle of '*pacta sunt servanda*' only if the sovereign country implements the treaty in accordance with its domestic laws. One can hope that the Budget 2019 provides such an amendment to domestic law to pave way to the MLI.

Note:

Later, the Finance Bill, 2020 proposed for amendment of section 90 in order to ratify and give effect to the application of MLI into the DTAs w.e.f 01 April 2020.

Disclaimer:

The views expressed in this article are personal and does not intend to deter or derogate any view that has been expressed by any court in India, international bodies (or) courts outside India.

[32] Rightly inferred in Azadi Bachao Andolan (supra)
[33] Relying on Azadi Bachao Andolan (supra)

Annexure

"The Parties to this Convention,

Recognising that governments lose substantial corporate tax revenue because of aggressive international tax planning that has the effect of artificially shifting profits to locations where they are subject to non-taxation or reduced taxation;

Mindful that base erosion and profit shifting (hereinafter referred to as "BEPS") is a pressing issue not only for industrialised countries but also for emerging economies and developing countries;

Recognising the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created;

Welcoming the package of measures developed under the OECD/G20 BEPS project (hereinafter referred to as the "OECD/G20 BEPS package");

Noting that the OECD/G20 BEPS package included tax treaty-related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status, and improve dispute resolution;

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Conscious of the need to ensure swift, co-ordinated and consistent implementation of the treaty-related BEPS measures in a multilateral context;

Noting the need to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in those agreements for the indirect benefit of residents of third jurisdictions);

Recognising the need for an effective mechanism to implement agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement;

Have agreed as follows:

………"