MODEL TAX CONVENTION OF OECD AND ITS APPLICABILITY

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Abstract

Among the other achievements of the United Nations, is the development of an entity of international law. Also known as the 'Law of Nations' it is a set of rules that govern the relationship between nations and is generally accepted as binding, based on the principle of Pacta Sunt Servanda. In order to promote the progressive enhancement of the same, the International Law Commission was established by the General Assembly in 1947. The sources of international law are reflected in Article 38(1) of the statue of the International Court of Justice. One such source is the Model Convention propounded by the Organization for Economic Cooperation and Development. An interesting debate pertaining to the convention has ensued since its applicability in the Indian judicial system, which is the highlight of this article.

Keywords: OECD, Jurisdiction, DTAA, Convention, Fiscal

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INTRODUCTION

Tax treaties may be understood as 'agreements entered into between countries, with respect to income and on capital', wherein countries benefit mutually and agree to:

- Certain restrictions from taxing
- Provide relief for the taxes paid in the other country.[1]

As per the United Nations Handbook on 'Selected Issues in Administration of Double Tax Treaties for Developing Countries', "Tax treaties play a key role in the context of international cooperation in tax matters. On the one hand, they encourage international investment and, consequently, global economic growth, by reducing or eliminating international double taxation over cross-border income. On the other hand, they enhance cooperation among tax administrations, especially in tackling international tax evasion."[2]

Such treaties govern important aspects of international taxation rules of several countries. There are over 3000 treaties which are functioning at present[3], and the number would obviously increase in the future. One such initiative is the double tax convention, a draft model, which was first published by the Organization for Economic Cooperation and Development (OECD), in 1963 and recently updated in 2015.[4] It further, serves as a guideline for establishing tax agreements.

Although India is not a member of the OECD, courts in India, have, in several instances referred to the convention, in the process of adjudication, notwithstanding the fact that India has certain reservations about a few articles.

As per the book, 'Managing Tax Disputes in India', which remarkably clarifies complex concepts of taxation, pursuant to the above, a debate has ensued as to whether the observations made by non-member states like India, on the convention of the OECD are binding on Indian courts, for interpretation of tax treaties.[5] Chiefly, there are two schools of thought, expressing contrary opinions on this issue. The first one states that there is a need to take these reservations into consideration, during the

[1] WIRC, "Tax Conventions – History, Overview & Basics of DTAA" https://www.wirc-icai.org/material/DTAA_Training_History_Overview_Basics_of_DTAA.pdf (Accessed on December15, 2017).

[2] UN. Org, "Selected Issues in Administration of Double Tax Treaties for Developing Countries" http://www.un.org/esa/ffd/documents/UN_Handbook_DTT_Admin.pdf (Accessed on December15, 2017).

[3] UN. Org, "An introduction to tax treaties" http://www.un.org/esa/ffd/wp-content/uploads/2015/10/TT_Introduction_Eng.pdf (Accessed on December15, 2017).

[4] Thomson Reuters, "OECD Model Tax Convention on Income and Capital" https://uk.practicallaw.thomsonreuters.com/1-620-7796?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 (Accessed on December15, 2017).

[5] BMR Advisors, MANAGING TAX DISPUTES IN INDIA, pp. 97, 2013.

interpretation of tax treaties. As per the second school of thought, merely recording a reservation on an article in the convention may not be indicative of the negotiations between the contracting countries, at the time tax treaties were introduced. Some of the landmark case laws, which have thrown light on the same, have been discussed below.

CASE LAWS

Commissioner of Income-Tax v. Visakhapatnam Port Trust[6] was one of the significant cases, wherein the court relied upon the MC. Primarily in response to the question, as to in a given conflict between the terms of the agreement and the taxation statutes of the respective nations, the decision of *Ostime (Inspector of Taxes) v. Australian Mutual Provident Society*[7], was cited, which clearly stated that the agreement would prevail in the above situation.[8] In a similar verdict of *CIT vs Vijay Ship Breaking Corporation & ...*[9], Justice R.K. Abichandani, inferred from the wordings of sub-section (2) of section 90 of the Income Tax Act, 1961, that, "Impact of this provision is to make treaty prevail over the Act with an additional advantage of applying more beneficial provisions of the Act."[10] Pramod Kumar, A.M., placed heavy reliance on the MC in the case of *Metchem Canada Inc. v. Deputy Commissioner Of Income Tax*[11], by stating that, "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. Unless a contrary intention is specifically expressed, say by a protocol attached to the DTAA, it is only axiomatic that the clause or the expression will have the same meaning as normally assigned in the tax literature by the OECD."[12] In contravention to the aforementioned cases, the Supreme Court in the case of *Commissioner of Income Tax v. P.V.A.L. Kulandagan Chettiar…*[13], refused to rely on the MC. According to Chief Justice Rajendra Babu, "Taxation policy is within the power of the Government and Section 90 of the Income Tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income Tax Act, it would be unnecessary to

[6] 1983 144 ITR 146 AP
[7] [1960] AC 459, 480-81
[8] Indian kanoon, "Commissioner of Income-Tax, ... vs Visakhapatnam Port Trust" https://indiankanoon.org/doc/865397/ (Accessed on December15, 2017).
[9] (2003) 181 CTR Guj 134
[10] Indian kanoon, "CIT vs Vijay Ship Breaking Corporation & ..." https://indiankanoon.org/doc/1965452/ (Accessed on December15, 2017).
[11] 2006 100 ITD 251 Mum
[12] Indian Kanoon, "Metchem Canada Inc. vs Deputy Commissioner of Income Tax" https://indiankanoon.org/doc/1784610/ (Accessed on December15, 2017).
[13] 2004 Supp(2) SCR 697

refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements."[14] A similar view was taken by the court in *Re: P. No. 28 Of 1999 vs Unknown*[15], wherein the bench found a fallacy in the argument of the council, and was sceptical in relying upon the MC.

ANALYSIS AND CONCLUSION

There was confusion in the judiciary, until recently, a judgement of the appellate tribunal, provided a new direction to this debate. Pramod Kumar, in the case of *Right Florist Pvt. Ltd., Kolkata vs Department of Income Tax*[16], quoted the observation of Lord Radcliffe in *Ostime vs Australian Mutual Provident Society*[17], that the language employed in those documents as the 'international tax language'. In addition to this, as per the tribunal, such documents are to be considered in the nature of *contemporanea expositio* inasmuch as the meaning indicated in these documents to the clauses and expressions in the tax treaties can be inferred as the meaning normally understood in the 'international ta language', developed by the organizations like OECD. On this point of contention, it was concluded that '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.'[18]

Beyond that, it was considered that these documents had no role to play in the process of interpretation of treaties. Hence, the author would like to draw the attention of the reader towards the debate introduced by the book, in the earlier part of this article. Noam Chomsky once said, "I do think that Magna Carta and international law are worth paying some attention to."[19] International law, comprises of treaties, customs, judgements of international bodies, etc. However, it is considered as a weak law, by various thinkers for various reasons. The underlying philosophy as construed by the author in Mr. Chomsky's assertion is that though documents portraying and containing international law and its tenets are often referred to, they only command a persuasive value, and are not to be imposed on the Indian judiciary in the process of interpretation. As the facts of no single case

[14] Indian Kanoon, "Commissioner of Income Tax vs P.V.A.L. Kulandagan Chettiar ..." https://indiankanoon.org/doc/1725672/ (Accessed on December15, 2017).
[15] 2000 242 ITR 208 AAR
[16] [(2013) 154 TT 142].
[17] (1960) 39 ITR 210, 219 (HL)
[18] Indian Kanoon, "Right Florist Pvt. Ltd., Kolkata vs Department of Income Tax" https://indiankanoon.org/doc/98785989/ (Accessed on December15, 2017).
[19] Brainy Quotes, "International Law Quotes" https://www.brainyquote.com/topics/international_law (Accessed on December15, 2017).

are congruent to another, under certain given circumstances, imposition of such reservations during exposition would mean that one is questioning the credibility of the judiciary in a limited sense. Hence, in the opinion of the author, the topic, which was chosen by the writers of the book, is a weak one, and is unsuitable for being debated upon. This is because, however, relevant a provision of any article, which is a part of international law may be, due to its limitations, even in the present-day context, cannot be imposed on the judicial system of any nation-state.