RETROSPECTIVE AMENDMENTS PER SE DOUBLE TAXATION AVOIDANCE AGREEMENTS

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1. <u>Introduction</u>

Finance Act 2012 brought a whopping number of retrospective amendments to the Income Tax Act – to be precise there were approximately fifteen sections wherein retrospective amendments were introduced. Most of these retrospective amendments were clarificatory in nature and centered around the international transactions. Like amendment to section 9 (1)(i) for situs of capital asset, section 9 (1) (vi) definition of Royalty, section 195(1) to clarify payments by one nonresident to another nonresident are covered within the ambit of deduction of Tax at Source, section 90 & 90A for meaning assigned to a term under Double Taxation Avoidance Agreements (DTAA's), 92CA for power to a Transfer Pricing Officer, 92C(2) tolerance band, 92B Meaning of International Transaction to cover situations of Business Restructuring or reorganization, 144C Power of Dispute Resolution Panel etc etc....

The most famous and the most discussed amendment, world over, is the taxmann's right to tax indirect transfers of shares to overcome the landmark ruling of Supreme Court in the case of Vodafone. These large numbers of amendments have been made with a view to nullify several judicial rulings including the one above, pronounced in favour of the taxpayer.

2. <u>Issue:</u>

At the time when these retrospective amendments were announced and subsequently made part of the Act, it was ***debated*** as to whether the chargeability of international transactions would still have to be tested in light of the existing DTAA's that India has entered into with other countries or *mere retrospective amendment in the Act would suo motto do away with the tax benefits/tax exemptions that are available to a tax payer who has already planned/ would plan his/her affairs within the boundary of law* (i.e. Income Tax Act read with DTAA). In other words, whether a unilateral act by the Indian Government by modifying its existing tax provisions without there being analogous modification in the DTAA's that India has already entered into many years ago would deny the tax benefits/ tax exemptions?

3. <u>Relief</u>

The apex court in the case of CIT vs. P.V.A.L Kulandagan Chettiar (267 ITR 654) & Bombay High Court in the case of CIT vs. Siemens Aktiongesellschaft (310 ITR 320) have held that the provisions of a DTAA shall prevail over the Act and work as an exception to or modification of the charging sections of the Act. To the tax payer's relief, the detailed guidelines in respect of the application of provisions of DTAA's per se Income Tax Act have been enumerated in a recent tribunal ruling:

WNS North America Inc Vs. ADIT (ITA No. 8621/Mum/2010, dated 14th December, 2012):

Deciding on the taxability of reimbursement of lease line charges paid to international telecom operators, as "royalty" under the Income Tax Act, 1961 in light of Explanation 5 to Section 9 (1)(vii) inserted retrospectively by Finance Act, 2012 the tribunal held that:

i) Any amendment carried out to the provisions of the Act with retrospective effect shall no doubt have the effect of altering the provisions of the Act but will not *per se* have the effect of automatically altering the analogous provision of the Treaty.

ii) There are certain provisions in some Treaties which directly recognize the provisions of the domestic law. For example, Article 7 in certain Conventions provides that the deductibility of expenses of the permanent establishment shall be subject to the provisions of the domestic law. In such a case, if any retrospective amendment is made to the provisions of the Act governing the deductibility of the expenses, the same shall apply under the Treaty as well.

iii) Article 23 in certain Treaties including that of India with Mauritius is 'Elimination of Double taxation'. Para 1 of Article 23 in Mauritius Treaty provides that: "The laws in force in either of the Contracting States shall continue to govern the taxation of income in the respective Contracting States except where provisions to the contrary are made in this Convention".

iv) First part of para 1 of Article 23 makes out a general rule that if income of the permanent establishment is to be computed in India, then the provisions of the Act shall govern the taxation of income in India. However, the second part of para 1 of Article 23 contains a qualification, which makes the operation of the first part of para 1 of Article 23 subject to the fulfillment of such stipulation.

v) The word "except" is the dividing contour between the main provision and the qualification part. The portion starting thereafter enumerates the qualification, which is: 'where provisions to the contrary are made in this Convention.'

vi) When we read full text of para 1 of Article 23, it becomes manifest that if there is some provision in the Treaty contrary to the domestic law, then it is the provision of the Treaty which shall prevail.

vii) Thus the general rule contained in the first part of para 1 of Article 23, being the applicability of the domestic law, has cast a shadow on any provision to the contrary in the Treaty. In case there is no contrary provision in the Treaty, then it is the domestic law which shall apply.

viii) If however, there is some provision in the Treaty contrary to the domestic law then it is such contrary provision of the Treaty which shall override the provision in the domestic law in the computation of income as per the Treaty.

ix) If the retrospective amendment is in the realm of a provision of which no contrary provision is there in the Treaty, then such amendment will have effect even under the DTAA and *vice versa.*

x) Article 3(2) in most of the Treaties including the India-USA DTAA provides that any term not defined in the Convention shall unless the context otherwise requires, have the meaning which it has under the laws of that State concerning tax to which the Convention applies.

xi) The nitty-gritty of Article 3(2) in the present context is that if a particular term has not been defined in the Treaty but the same has been defined in the Act and further there is a retrospective amendment to that term under the Act, it is this amended definition of the term as per the Act, which shall apply in the Treaty as well.

xii) If however a particular term has been specifically defined in the Treaty, the amendment to the definition of such term under the Act would have no bearing on the interpretation of such term in the context of the Convention.

xiii) A country who is party to a Treaty cannot unilaterally alter its provisions. Any amendment to Treaty can be made bilaterally by means of deliberations between the two countries who signed it.

xiv) If there is no amendment to the provision of the Treaty but there is some amendment adverse to the assessee in the Act, which provision has been specifically defined in the Treaty or there is no reference in the Treaty to the adoption of such provision from the Act, again the mandate of section 90(2) shall apply as per which the provisions of the Act or the Treaty, whichever is more beneficial to the assessee shall apply. Going by such rule, the amendment to the Act shall have no unfavorable effect on the computation of total income of the assessee.

xv) The term "royalty" has been defined in the DTAA as per Article 12(3) of Indo- US DTAA. Such definition of the term "royalty" as per this Article is exhaustive.

xvi) Pursuant to the insertion of Explanation (5) by the Finance Act, 2012, no amendment has been made in the DTAA to bring the definition of royalty at par with that provided under the Act.

xvii) Subject matter of the Explanation is otherwise not a part of the definition of Royalty as per Article 12.

xviii) As such, it is clear that the contention of the learned Departmental Representative that the retrospective insertion of Explanation 5 to section 9(1) (vi) should be read in the DTAA cannot be countenanced.

So the tribunal has made it ample clear and rightly so that merely by amending the Act unilaterally the Government cannot impose upon any unjust liabilities on the tax payer and it has to respect the DTAA's entered many years ago. It is also important to note here that wherever the Government wanted to Act unilaterally there have been powers given in the DTAA's as well to do so and the same has been carefully examined by the Honorable Tribunal.