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TAX FLASH NEWS

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Section 94A of the Income-tax Act notifying Cyprus as a notified jurisdiction is constitutionally valid

Background

Recently, the Madras High Court, in the case of T. Rajkumar, K. Dhanakumar, and T. K. Dhanashekar[1] (the taxpayers), dealt with the constitutional validity of Section 94A of the Income-tax Act, 1961 (the Act) notifying the Cyprus as a notified jurisdictional area. The High Court while dismissing the writ petitions of the taxpayers observed that the challenge to the constitutional validity of Section 94A(1) of the Act is without any merit. It is not correct that once a tax treaty is entered into, the Parliament loses the power conferred by the Constitution, to make a law. If one of the parties to the tax treaty fails to provide necessary information, then such a party is in breach of the obligation under Article 26 of the Vienna Convention. The beneficiary of such a breach of obligation cannot invoke the Vienna Convention to prevent the other contracting party from taking recourse to internal law, to address the issue.

Facts of the case

- On 16 October 2014, a tripartite agreement was entered into between an Indian company (New Kovai Real Estate Private Limited), a Cyprus company (Skyngelor Limited) and the taxpayers. By the said agreement, Cyprus company sold equity shares and compulsorily convertible debentures of an Indian company to the taxpayers. The taxpayers did not deduct tax at source while remitting the amount to the Cyprus company.
- After three months of execution of the aforesaid agreement, the taxpayers received show cause notices inviting their attention to Section 94A(1) of the Act and Notification No.86[2], calling upon them to show cause as to why each one of them should not be treated as an assessee in default, warranting the initiation of proceedings under Section 201(1)/201(1A) of the Act.
- Before the Assessing Officer (AO), the taxpayers contended that they would have an obligation to deduct tax at source, only if there was chargeability of a payment under Section 195 of the Act. The taxpayers claimed that they had purchased securities at a rate below their face value and that the Cyprus company had, in fact, suffered a loss.
- However, the AO passed orders under Section 201(1)/201(1A) of the Act, directing the taxpayers to pay tax and interest, as determined. A notice of demand under Section 156 of the Act was also issued.

[1] T.Rajkumar, K.Dhanakumar and T.K.Dhanashekar v UOI, Central Board of Direct Taxes, ITO (Intl Taxation) [W.P.Nos.17241 to 17243 & 17407 to 17412 of 2015] – Taxsutra.com

[2] Notification No.86/2013, dated 1 November 2013

- The taxpayers filed appeals under Section 246A of the Act before the Commissioner of Income-tax (Appeals) CIT(A). The taxpayers also filed writ petitions with the Madras High Court challenging the validity of Section 94A(1) of the Act, Notification No. 86 and the press release (dated 1 November 2013), in view of the fact that so long as these are in force, their claim on the merits may prove to be very weak.

High Court's judgment

Different types of treaties, theory of international law and Azadi Bachao Andolan

- The Supreme Court in the case of Jolly George Varghese[3], held that the executive power of the Government of India to enter into international treaties does not mean that international law, ipso facto, is enforceable upon ratification. The Supreme Court observed that the Indian Constitution followed the 'dualistic' doctrine with respect to international law. Consequently, the Supreme Court held that international treaties do not automatically form part of international laws unless incorporated into the legal system by a legislation made by the Parliament.
- Since the Supreme Court held in Jolly George Varghese that Indian Constitution follows dualistic doctrine with respect to international law, it must be taken that an international treaty, can be enforced only so long as it is not in conflict with the municipal laws of the State.
- Further referring to and relying on various decisions, the High Court held that an international treaty or convention, to which, India is a party, can be invoked for the purpose of understanding the scope of and interpreting the constitutional guarantees, so long as the provisions of such treaty or convention are not in conflict with the municipal law. Even those conventions or treaties, to which, India is not a party, can be looked into, if the principles upon which, such conventions or treaties are founded, could be traced to the common law.
- The Parliament empowered the Central Government under Section 90(1) of the Act to enter into an agreement, and simultaneously it conferred a benefit upon the taxpayer under Section 90(2) of the Act. Section 90 of the Act does not say either expressly or by necessary implication that the law made by Parliament would stand eclipsed or excluded, to the extent it is inconsistent with the terms of the agreement.
- The Supreme Court's observation in the case of Azadi Bachao Andolan[4] that the provisions of the tax treaty, with respect to cases to which they apply, would operate even if inconsistent with the provisions of the Act, cannot be viewed in isolation. If viewed in isolation, it would result in mutually inconsistent results.
- Section 90(2) of the Act does not use a non obstante clause to say that the provisions of an agreement entered into by the central government under Section 90(1) would prevail over the other provisions of the Act. Section 90(2), instead of ousting the application of the other provisions of the Act, simply directs attention to what is more beneficial to the taxpayer. If the provisions of the Act are more beneficial to the taxpayer, to whom an agreement of the nature specified in Section 90(1) applies, those provisions would apply to him. If an option is given to choose between two alternatives, it cannot be said that one alternative is inconsistent with the other. This provision does not speak about any inconsistency between the provisions of the Act, and an agreement entered into by the central government under Section 90(1) of the Act.

[3] Jolly George Varghese v. The Bank of Cochin [AIR 1980 SC 470]

[4] Union of India v. Azadi Bachao Andolan [2004 (10) SCC 1]

- Once it is stated that India has followed the dualistic model and once it is found that the courts have drawn inspiration from treaties, whenever the municipal law was silent, it is impossible to think that the supremacy of the Parliament could be compromised by the executive entering into a treaty. The very fact that Article 253 confers power upon the Parliament to make any law for implementing any treaty, coupled with the fact that Section 90(1) of the Act enables the central government to enter into an agreement, would show that the Parliament is supreme. The collective will and the collective conscience of the people, which the Parliament is supposed to reflect, cannot be subordinated to the power of the executive.
- While dealing with the decisions of Azadi Bachao Andolan and P.V.A.L.Kulandagan Chettiar[5] no question arose directly in both the decisions as to whether or not the Parliament has the power to make a law in respect of a matter covered by a treaty. Therefore, the observations found in these two decisions, to the effect that the provisions of the treaty will have effect even if they are in conflict with the provisions of the statute, cannot be stretched too far to conclude that the Parliament does not have the power to make a law in respect of a matter covered by a treaty.
- Therefore, it is impossible to think that once a treaty is entered into, the Parliament loses the power conferred by the Constitution, to make a law even in respect of a matter included in List I of the 7th Schedule.
- Relying on the decision in the case Magan Bhai Patel[6] it was observed that object behind Section 90(1) of the Act is to enable the Parliament, which is entitled to make a law by itself, to delegate the said power to the executive, so that the executive can enter into an agreement, that would confer certain benefits upon persons to whom such an agreement would apply. Therefore, the contention that the Parliamentary law would give way to a treaty goes contrary to the constitutional scheme.

Vienna Convention

- India has not ratified the Vienna Convention, though a reference to the same has been made a few decisions pronounced by the Courts.
- Articles 26 and 27 of the Vienna Convention containing the doctrine of 'Pacta Sunt Servanda', which lays down that every treaty in force is binding upon the parties to it and must be performed in good faith, and a party may not invoke the provisions of its internal law as a justification for its failure to perform a treaty. If one of the parties to the treaty fails to provide necessary information, then such a party is in breach of the obligation under Article 26 of the Vienna Convention. The beneficiary of such a breach of obligation cannot invoke the Vienna Convention to prevent the other contracting party from taking recourse to internal law, to address the issue.
- The High Court thus observed that the challenge to the Constitutional validity of Section 94A(1) is without any merit. The argument that Section 90(1)(c) of the Act cannot be diluted by Section 94A(1) of the Act overlooks the fundamental fact that if the purpose of the central government entering into an agreement under Section 90(1) of the Act is defeated by the lack of effective exchange of information, then Section 90(1)(c) of the Act is actually diluted by one of the contracting parties and not by Section 94A(1) of the Act.

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[5] CIT v. P.V.A.L.Kulandagan Chettiar [2004 (6) SCC 235]
[6] Magan Bhai Patel v. Union of India [AIR 1969 SC 783]

- Nothing turns on the absence of a non obstante clause in Section 94A(1) in contrast to the inclusion of a non obstante clause in Section 94A(2) to (5) of the Act. Any agreement entered into by the central government by virtue of the power conferred by Section 90(1) is in the exercise of a delegated power. Similarly, any Notification issued under Section 94A(1) is also in the exercise of another delegated power. Therefore, there is no necessity to incorporate a non obstante clause in Section 94A(1) of the Act.

'Global leaders statement' and the affidavit of the Union of India

- The High Court observed that many countries suffered evasion or avoidance of tax, by unscrupulous persons exploiting noble theories of public international law. Therefore, certain resolutions were adopted by the leaders of G20 Nations. The High Court observed that there was sufficient justification for the Parliament to insert Section 94A of the Act. In doing so, the Parliament did not show disrespect to any treaty. The resolution passed by the G20 Nations, to take action against non-co-operative jurisdictions, including tax havens, is what is sought to be given effect to, by the insertion of Section 94A of the Act.
- The High Court placed reliance on Circular No.2[7] and also on a counter affidavit filed on behalf of the Union of India which indicated that India is not the only country[8] which took defensive measures, to prevent the abuse of the benefits conferred by treaties.

Validity of Notification No. 86

- The taxpayer contended that Section 94A(1) of the Act confers power upon the central government to notify any country, other than those with whom an agreement is already entered into under Section 90(1), to be a notified jurisdictional area. The High Court observed that the contention of the taxpayer loses sight of the express language of Section 94A(1) of the Act. It uses the phrase 'any country or territory'. One cannot read the said phrase to mean 'any country or territory other than those covered by Section 90(1)'. In a taxing statute, the High Court is not entitled to add or delete any expression and also not entitled to re-phrase the provision.
- The High Court observed that that the lack of exchange of information by Cyprus, which led to the Notification, would not fall under any of the two categories indicated in para 3(b) of Article 28[9] of the tax treaty. The information relating to evasion of tax cannot fall under the category of information, which is not obtainable under the laws or in the normal course of administration.
- While dealing with the contention that when the tax treaty itself provides a procedure for dispute resolution, the Government of India could not have taken recourse to Section 94A(1) of the Act, the High Court observed that Paragraph 3 of Article 27 deals only with difficulties or doubts arising as to the interpretation or application of the tax treaty. It does not deal with the failure of one of the contracting parties to honour its commitment under the tax treaty. The High Court further observed that a clause relating to Mutual Agreement Procedure (MAP), contained in the agreement, cannot oust the jurisdiction of the Parliament to enact a law and the executive to issue a notification in exercise of the power conferred by such a law.

Validity of a press release

- While dealing with the difference in the terms used in Section 94A(5) of the Act as against the term used in the press release and the contention that the press release runs contrary to the statutory prescription and hence liable to be set aside, the High Court observed that the press release is not a legal document, but a note intended for the benefit of the common

[7] Circular No.02/2012 [F.No.142101/2012.SO (TPL), dated 22 May 2012
[8] Countries like Argentina, Australia, Belgium, Brazil, etc. have also taken similar kind of measures.

[9] Article 28 of the India-Cyprus tax treaty provides for the exchange of information

man, therefore, the words and expressions used therein cannot be tested on the strength of law lexicons.

- The High Court also relied on the decision of the Supreme Court in the case of Azadi Bachao Andolan where it was observed that though the circulars issued by CBDT under Section 119 of the Act, have statutory force, the press releases issued by CBDT for the information of the public, do not have the same force. Therefore, the question of assailing the press release does not arise.

Validity of the Constitutional scheme

- It is true that the power conferred upon the Parliament under Article 253 is 'notwithstanding anything contained in the foregoing provisions of this Chapter'. However, the effect of the non-obstante clause in Article 253 is that when Parliament desires to make a law for implementing a bilateral or international treaty or convention, the fetters placed upon the Parliament by Articles 246(3), 249, 250, etc., and the fetters placed in the form of the lists contained in the Seventh Schedule, would stand removed.
- Neither Chapter I of Part XI nor any other provision of the Constitution deals with an inconsistency either between two sets of laws made by the Parliament itself or between a bilateral or international treaty or convention on the one hand and a law made by the Parliament on the other hand. This is due to the fact that a treaty entered into by the country with another country is actually in the realm of executive action in terms of Article 73.

The High Court held that in association with the word ‘tax’, the word ‘haven’ has assumed different connotations in the recent past and Panama appears to have followed Cyprus.

Our comments

In the instant case the Madras High Court has dealt with the constitutional validity of Section 94A of the Act notifying Cyprus as a notified jurisdictional area. The High Court while dismissing writ petitions of the taxpayers observed that the challenge to the constitutional validity of Section 94A(1) of the Act is without any merit.

The High Court observed that if one of the parties to the treaty fails to provide necessary information, then such a party is in breach of the obligation under Article 26 of the Vienna Convention. The beneficiary of such a breach of obligation cannot invoke the Vienna Convention or the doctrine of ‘pacta sunt survada’ to prevent the other contracting party from taking recourse to internal law, to address the issue.

The High Court distinguished the observations of the Supreme Court in the cases of Azadi Bachao Andolan and P.V.A.L. Kulandagan Chettiar and held that observation of the Supreme that the provisions of the treaty will have effect even if they are in conflict with the provisions of the statute, cannot be stretched too far to conclude that the Parliament does not have the power to make a law in respect of a matter covered by a treaty.

This decision will have a far-reaching impact on issues with respect to the applicability of Section 94A of the Act.

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Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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