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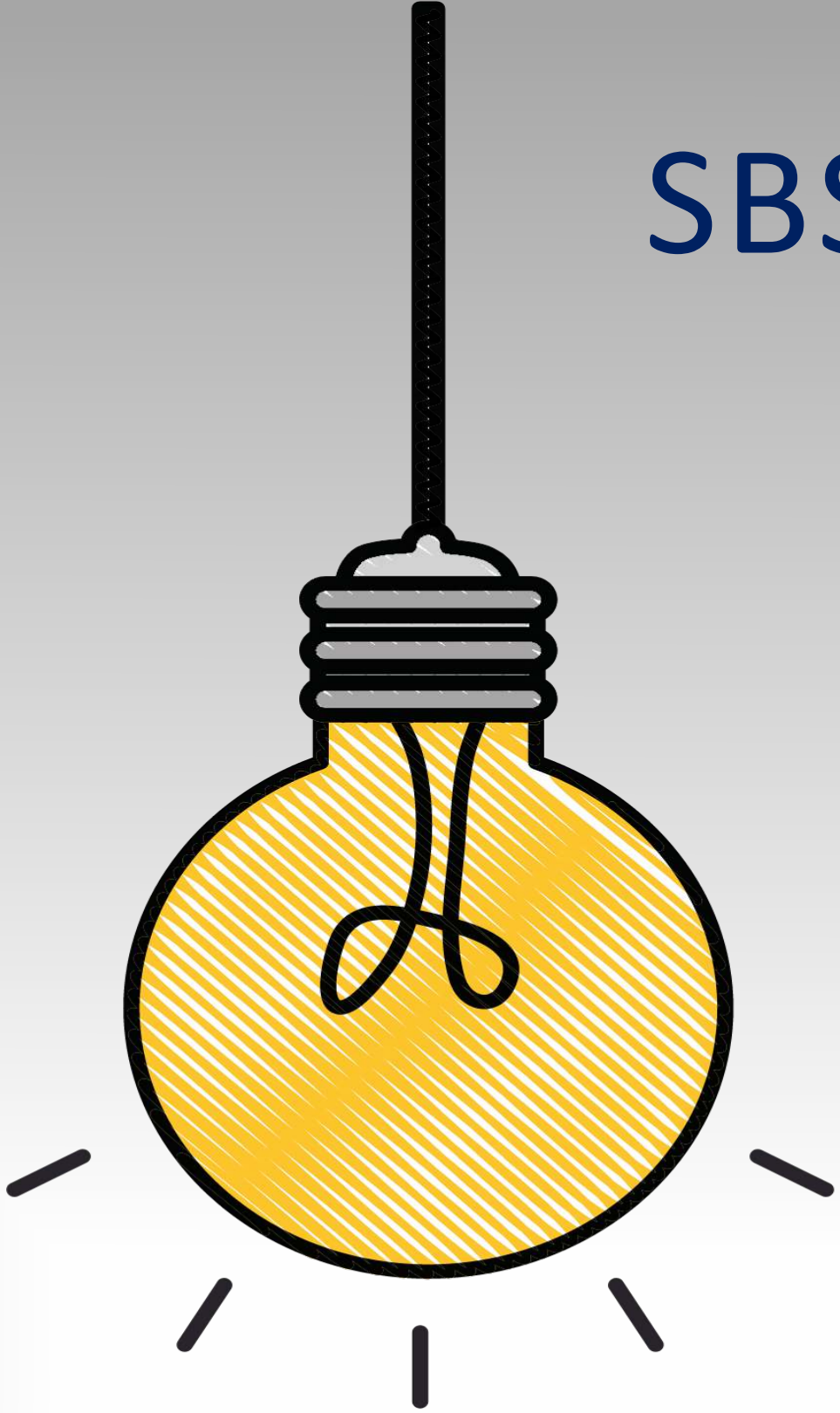

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SBS AND COMPANY LLP

CHARTERED ACCOUNTANTS

Contents

Dear Readers,

In this edition, we have come up with an article on transactions with 'Related party transactions' under section 185 of the Companies Act,2013.

The next article is on scope of adjudicating authority under the Insolvency and Bankruptcy Code, 2016. The moot question that has been discussed is whether the Adjudicating Authority need to look into the disputes surrounding claims and counter claims made in a matter, and whether the same is within the scope of Adjudicating Authority.

The next article ison interpretation of tax treaties by taking recourse to Article 31, 32 and 33 of Vienna Convention on the Law of Treaties. Interpretation of international law differs from domestic law. In this Article, procedure for interpretation of tax treaties has been discussed in detail.

We have also collated certain important judgments under direct tax laws.

I hope that you will have good time reading this edition and please do share your feedback.

Thanking You,

Suresh Babu S

Founder & Chairman

Companies Act

Implications of Section 185 in a related party transaction

Transactions with Related Parties, are part of every business house, whether Big or small. In addition to the compliance of the provisions of Section 188 in relation to the Related party transactions, checking the permissibility of a limb associated with the proposed Related Party transaction, also needs to be kept in mind. This article dwells upon this aspect.

Contributed by CS D.V.K.Phanindra
phanindra@sbsandco.com

1. Section 185 and Section 186 of the Companies Act, 2013, are interlinked sections as far as providing loans, guarantee or providing security by an entity to another entity. The former (Section 185) prescribes the eligible persons to whom loans, guarantee or security can be provided by the Company, and the latter (Section 186), provides for the limits and other conditions associated.

2. Pursuant to Section 185 (1), no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by:
   (a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or
   (b) any firm in which any such director or relative is a partner.

3. Sub-Section (2) provides that a Company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person **in whom any of the director of the company is interested,** subject to the condition that:
   (a) a special resolution is passed by the company in general meeting; and
   (b) the loans are utilised by the borrowing company for its principal business activities.

4. The section further provides for an explanation for "any person in whom any of the director of the company is interested". Accordingly, it means:
   (a) any private company of which any such director is a director or member;

(b) any body corporate at a general meeting of which not less than 25 % of the total voting power may be exercised or controlled by any such director, or by two or more such Directors, together; or

(c) any body corporate, the Board of Directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or Directors, of the lending company.

5. Having seen the provision of Section 185 in brief above, with the help of a related party transaction, let us understand the permissibility of a company giving a loan, including any loan represented by a book debt to, or give any guarantee, or provide any security in connection with any loan taken by:

(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(b) any firm in which any such director or relative is a partner

6. **Related Party Transaction proposed:**

"A Limited", is having a huge order book of Road Contracting works, spread across India, **"P", "Q", "R"** and **"S"** are the Directors and also shareholders. Further, **"X",** and **"Y"** are also shareholders, and they happen to be the sons of **"P"** and **"Q"** respectively. One "**ABC Private Limited",** is also a shareholder in **A Limited.**

7. It is proposed that some of the Road works in the name of **A Limited,** be sub-contracted to **"X"** and **"Y". "X"** and **"Y"** have started 2 entities, **"XZ Private Limited"** and **"YK LLP"**, respectively, for this purpose. **"A Limited"**, has checked the possibility of sub-contracting of the contract, and there is express provision in their original contract for sub-contracting of the work. The gist of the above is given below in the table.

Sl. No	Name of the Project	Sub-Contractors	Related Party	Interested Director
1	Road widening project	XZ Private Limited	Mr. X	Mr. P
2.	Road laying Project	YK LLP		Mr. Y Mr. Q

8. A proposal for granting the sub-contract work to **"XZ Private Limited"** and **"YK LLP",** was placed before the Board of Directors of **A Limited,** on the following terms and conditions:
   (a) Work to be sub-contracted with a margin of 20% to **A Limited;**
   (b) **A Limited** shall provide Mobilisation Advance to the sub-contractors;
   (c) **A Limited** shall provide loan to Sub-contractors;
   (d) **A Limited** shall provide its machinery of Lease to Sub-contractors;
   (e) **A Limited** shall provide for *guarantee/collateral for the loans availed by Sub-Contractors.*

9. With the above, the question now to be answered, is whether the approval of the Board of Directors or the Shareholders, as the case may be is required **ONLY** under Section 188 of the Companies Act, 2013 **OR** whether the approval of the Members is **ALSO** required to be obtained under Section 185 of the Companies Act, 2013, in view of the sub-contracting conditions of giving Loan/Security to the related party.

10. As discussed above, Sub-section (2) of Section 185 provides for categories of persons, **"any person in whom any of the director of the company is interested",** and we need to see whether the parties to whom sub-contract is proposed fall under the said category, with the prime requirement that in the sub-contracting entities:
   (a) Being a Private Limited Company, any Director of A Limited, is a director or member; and
   (b) Being a LLP, at a general meeting of which not less than 25 % of the total voting power may be exercised or controlled by any director, or by two or more such Directors of A Limited together.

11. In the above illustration, **none of the parties in-charge of the sub-contracting entities are Directors of "A Limited",** but are only Shareholders and are **relatives of directors**. Accordingly, **"A Limited",** though is not restricted to enter in a Related Party Transaction, after due approvals from the Board of Directors or Shareholders, as the case may be, **but is restrained under Section 185 of the Companies Act, from giving Loan, or providing Guarantee or Security to the sub-contracting entities.**

12. Further, there is no restriction in relation to the investments that can be made by "A Limited", either in XZ Private Limited and/or YK LLP, as investment is not restricted under Section 185 of the Companies Act, 2013.

13. Another contention that can be raised and is normally raised in this context, which is highly debatable, is why we need to check the permissibility under Section 185 and why not directly seek approval under Section 186, and proceed ahead with the provision of Loan, Guarantee or Security etc.,. To this, as already discussed, both Section 185and Section 186 of the Companies Act, 2013, are interlinked sections, and the law makers are clearly aware that there need not be 2 sections to provide for the same provisions. Section 185 prescribes the eligible persons to whom loans, guarantee or security can be provided by the Company, and Section 186, provides for the limits and other conditions associated.

Insolvency and Bankruptcy Code

Adjudication of disputes surrounding Claims

Once an operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. The scope and purview of the Adjudicating Authority is clear as per the IB Code. Now the question is whether the Adjudicating Authority need to look in to the disputes surrounding claims and counter claims made in a matter, and whether the same is within the scope of Adjudicating Authority. In this Article an attempt is made to discuss on the above with a recent NCLT matter, affirmed by the NCLAT.

Contributed by CS D.V.K.Phanindra
phanindra@sbsandco.com

1 An Appeal[1] was preferred before the Hon'ble National Company Law Appellate Tribunal **(NCLAT)**, New Delhi Bench, arising out of the Order[2] Dt:12.09.2022, of the Hon'ble National Company Law Tribunal, New Delhi Bench-II, by the suspended Director of the Corporate Debtor M/s. Suchi Paper Mills Private Limited, wherein CIRP (Corporate Insolvency Resolution Process) was initiated against the Corporate Debtor for the default of Rs.20,91,690/-. (including interest component of Rs.7,49,460/-).

[1]Comp. App. (AT) (Ins.) No. 1161 of 2022, New Delhi Bench (Flourish Paper & Chemicals Ltd vs. Suchi Paper Mills Limited)
[2]CP (IB) No.603(ND)/2020, NCLT, New Delhi Bench-II.

Facts of the case:

Before the NCLT:

2 The Operational Creditor has supplied PAC (powder) and Sizing Agent (Flopap SS-5840) to Corporate Debtor herein, to the Corporate Debtor, and raised invoices from 08.10.2016 to 17.12.2016. The due date for payment of the last invoice was 01.12.2016.

3 The Corporate debtor had made part payment of the invoices on 07.07.2017, and further payments were not received. Left with no other remedy, the Operational Creditor, sent a Demand Notice, for the unpaid Operational Debt to the tune of Rs.13,42,230/- as on 31.12.2019, plus interest @ 18 % on the unpaid Operational Debt, totalling to Rs.20,91,690/-.

4 In response to the Demand Notice of the Operational Creditor, the Corporate Debtor replied to the notice demanding payment of Rs 25 Lakhs as compensation for loss and damages suffered due to poor quality of goods supplied, and in the reply filed before the Adjudicating Authority submitted that the Application filed on 25.02.2020, is time barred, as the due date of last invoice for payment was 01.12.2016.

5 The Operational Creditor contended that it had received the last payment from the Respondent on 07.07.2017, and further materials purchased from the Corporate Debtor on 08.08.2017 under cross trading to each other, and accordingly claimed that its Application is well within Limitation. The Operational Creditor further submitted that there is no pre-existing dispute as per Section 8(2) (a) of IB Code, 2016, prior to issuance of the Demand Notice, an replies given by the Corporate Debtor are pseudo/sham notice-cum reply, which are only moonshine defence and a false assertion of facts by the Corporate Debtor, without support of evidence.

6 The Operational Creditor also placed on record the Credit notes to the tune of Rs.35,91,500/- given by it to the account of Corporate Debtor, in financial years 2015 – 216 and 2016 – 2017, with regard to supply of materials, which were claimed by the Corporate Debtor to be poor quality and not usable, and further submitted that inspite of given credit notes, the Corporate Debtor was wrongly claiming compensation of Rs.25,00,000/-

7 The Adjudicating Authority perused the documents and pleadings on record, and noted that since the last invoice was due and payable on 01.12.2016 and the part payment by the Corporate Debtor was made on 07.07.2017 i.e., within three years rom the date of default, and accordingly, the Adjudicating Authority was of the view that the application being filed by the Operational Creditor on 2.02.2022, is ell within the limitation period of Three (03) years from 07.07.2017, and is within the Limitation Period.

8 Having found the application to be within the limitation period, the Adjudicating Authority proceeded to examine the issue of Pre-existing dispute. The Operational Creditor submitted that prior to the issue of Demand Notice, the Operational Creditor had issued a Legal Notice on 15.12.2019, and the Corporate Debtor had replied to the same on 16.12.2019.

9 While going through the replies of the Corporate Debtor, the Adjudicating Authority observed that Corporate Debtor has raised the issue of poor quality of goods and

claimed compensation of Rs.25,00,000/-, on account loss claimed to have suffered by it. The Adjudicating Authority further observed that the Corporate Debtor had stated that it had raised various complaints with the Operational Creditor, but the Operational Creditor, failed to address the same. The Adjudicating Authority observed that at no occasion, the Corporate Debtor had placed or produced any proof on record like e-mail or letter or an other communication in support of their contention or which could depict that it had raised complain in regard to poor quality of goods in the past with the Operational Creditor.

The Adjudicating Authority referred to the judgement of Hon'ble Supreme court in Mobilox Innovations [3], as below:

> *40. It is clear, therefore, that once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. It is clear that such notice must bring to the notice of the operational creditor the "existence" of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties. Therefore, all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the* ***"dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. It is important to separate the grain from the chaff and to reject a spurious defence which is mere bluster.*** *However, in doing so, the Court does not need to be satisfied that the defence is likely to succeed.* ***The Court does not at this stage examine the merits of the dispute except to the extent indicated above. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.***

11 The Adjudicating Authority held that in the absence of any real/actual communication between the parties with respect to or in support of poor-quality of goods, the dispute raised by the Corporate Debtor is a patently feeble argument and is moonshine, and did not find the dispute to be genuine.

[3][2017] 85 taxmann.com 292 (SC) (Mobilox Innovations Pvt. Ltd. V. Kirusa Software Pvt. Ltd.)

[4]Company Appeal (AT) (Insolvency) No. 1262 of 2019; New Delhi Bench (Deepak Gupta Vs. Ved Contracts Pvt. Ltd. & Ors.)

12 The Corporate Debtor contended that it had to recover an amount of Rs.16,08,316/- from the Operational Creditor, but the Corporate Debtor could not produce any invoices in support of the claim for recovery. The Adjudicating Authority further stated that even if there was a counter-claim of the Corporate Debtor on the Operational Creditor, the same cannot be adjudicating under a Section 9 Application filed under the IB Code, and referred to the Judgment of the Hon'ble NCLAT passed in the matter of **Deepak Gupta [4] Vs. Ved Contracts Pvt. Ltd. & Ors.**

> *3. Learned Counsel for the Appellant submits that in the accounts of three consecutive years, it is shown that the amount is payable to the 'Corporate Debtor' and there are claims and counter claims, which has not been adjudicated by the Adjudicating Authority. However, such ground cannot be accepted as the disputed question relating to claims and counter claims cannot bedetermined by Adjudicating Authority in an application under Section 9 of the I&B Code...."*

Accordingly, the application filed by the Operational Creditor was approved and the Corporate Debtor was put into CIRP.

Before the NCLAT:

13 During the hearing of the Appeal, the Corporate Debtor came with a Demand Draft for an amount of Rs.13,42,230/-, favouring the Operational Creditor, but the same was not accepted by the Counsel of the Operational Creditor did not accept the same, as he did not have any instructions. Accordingly, the Appellate authority directed to deposit the amount of Rs.13,42,230/-, in favour of "The Pay and Accounts Officer, Ministry of Corporate Affairs, New Delhi".

14 The Appellate Authority noticed that the Adjudicating Authority has rightly observed after perusing the reply filed by the Corporate Debtor to the legal notice of05.12.2019 as well as their reply to the demand notice dated 02.01.2020 that at no occasion the Corporate Debtor had raised complaints with regard to poor quality of goods with the Operational Creditor after issue of the two credit notes aggregating Rs.35,91,500/-. Neither any invoices have been furnished in support of their contention that the Corporate Debtor had supplied material to the Operational Creditor. The Appellate Authority also did not find any communication which has been placed on record by which the Corporate Debtor had sent any reminder to the Operational Creditor in respect of their

outstanding payments. The Appellate Authority noted that the Adjudicating Authority has also been rightly observed that disputes surrounding claims and counter-claims cannot be adjudicated or determined by the Adjudicating Authority given their summary jurisdiction.

15 The Appellate Authority noted that the Adjudicating Authority, had carefully considered the reply and submissions made by the Corporate Debtor and had correctly come to the conclusion that there is no ground to establish any real and substantial pre-existing dispute which can thwart the admission of section 9 application against the Corporate Debtor. The Appellate Authority stated that it has no hesitation in observing, there is no real pre-existing disputes discernible from given facts and all other requisite conditions necessary to trigger CIRP underSection 9 stands fulfilled.

16 The Appellate Authority observed that AdjudicatingAuthority has rightly admitted the application of the Operational Creditor filedunder Section 9 of IBC, and that the impugned order does notwarrant any interference, and accordingly dismissed the Appeal.

Conclusion:

In the present case, the Appellate Tribunal confirming the landmark decision in Mobilox held that disputes surrounding claims and counter-claims cannot be adjudicated or determined by the Adjudicating Authority given their summary jurisdiction.

International Taxation

Interpretation of tax treaties – A study on Article 31, 32 and 33 of Vienna Convention on the Law of treaties

Interpretation of laws plays a vital role in decoding any law whether it is tax law or any other law. Despite that importance, there is no specific Act which deals with interpretation of laws including the taxation laws. However, there are various aids for interpretation of tax laws viz. Circulars, Notifications, Memorandum to Finance Bill, judicial precedents etc. In addition to the above, there are many rules of interpretation for decoding the tax law. However, interpretation of international law differs from domestic law. In this Article, procedure for interpretation of tax treaties has been discussed in detail.

Contributed by CA Narendra
narendrar@sbsandco.com

Introduction:

1 Unlike domestic tax laws, interpretation of tax treaties has a separate procedure. This is because, while domestic tax laws are made by the sovereign country, tax treaties are made between two or more countries. When two countries agreed to enter into an agreement for taxation, each country may apply its own interpretation to tax a particular income under the tax treaty. Hence, rules of interpretation under the domestic law may not be suitable for the interpretation of tax treaties.

2 When different countries enter into treaties with different countries, the question arises is 'what is procedure and mechanism for interpretation of such treaties?' In this regard, ViennaConvention on the Law of Treaties, 1969 signed at Vienna on 23.05.1969 ('VCLT') is considered as holy book for interpretation of treaties. Section 3 i.e., Article 31-33 of VCLT deals with the interpretation of treaties. Before proceeding to analyse the VCLT, it is worthy to note that not every country in the world is not a signatory to the VCLT. However, the International Country of Justice has held that VCLT in principle applications to interpretation of all treaties whether or not counties are party to the VCLT.

3 The Hon'ble Supreme Court of India in the case of Ram Jethmalani[1] has held that" *While India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of*

[1][2011] 12 taxmann.com 27 (SC)

interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also.'

4 In addition to the VCLT, OECD's Commentary on Model Tax Convention, technical explanations, judicial precedents may also be considered as an aid for the interpretation of treaties. In this note, Article 31-33 of VCLT have been discussed in detail.

Vienna Convention on Law of Treaties:

Article 31 of VCLT:Article 31 of the VCLT contains general rules for interpretation of treaties. Article 31 of VLCT is produced below:

1. *A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*
2. *The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:*
   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. *There shall be taken into account, together with the context:*
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty orthe application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement ofthe parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties.
4. *A special meaning shall be given to a term if it is established that the parties so intended.*

5 Article 31(1) of VCLT states that treaty has to interpreted in ***good faith*** and ordinary meaning shall be given to the terms of the treaty in their context and in the light of its ***object and purpose***. The principle of good faith is also linked to Article 26 of the VCLT which states that *'Every treaty in force is binding upon the parties to it and must be performed by them in good faith'.*

6 Article 31(1) of the VCLT states that the treaty must be interpretated in good faith which means that a bon fide and more generous interpretation shall be given to the treaty and no additional interpretation which in favour

7 The Hon'ble SC in the case of Ram Jethmalani (supra) has held that *Article 31, "General Rule of Interpretation", of the Vienna Convention of the Law of Treaties, 1969 provides that a "treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

8 The Andhra Pradesh High Court in the case of Sanofi Pasteur Holding SA[2] has held that *'Where the operative treaty's provisions are unambiguous and their legal meaning clearly discernible and lend to an uncontestable comprehension on good faith interpretation, no further interpretive exertion is authorized; for that would tantamount to usurpation (by an unauthorized body - the interpreting Agency/Tribunal), intrusion and unlawful encroachment into the domain of treaty-making under Article 253 (in the Indian context), an arena off-limits to the judicial branch; and when the organic Charter accommodates no participatory role, for either the judicial branch or the executors of the Act.'*

9 Further, a treaty shall be interpreted in its context and in the light of its object and purpose. The words 'object and purpose' gains significance for the purpose of interpretation of a treaty.The object and purpose of the treaty can be obtained from the reading of the preamble of a treaty. this view has been upheld by the Hon'ble Supreme Court of India in the case of AzadiBachaoAndolan[3] .

10 Article 31 (2) of VCLT states that in addition to the above, any agreement or instrument made by the parties in conclusion of treaty shall be considered for the purpose of interpreting the treaties. This may include a statement made by the party which has been ratified by the other party.

11 Article 31 (3) states that any subsequent agreement made between the countries, any subsequent practice in interpretation or any international rule applicable to the countries concerned shall also be considered for the purpose of interpretation. While Article 31(2) deals with the agreements or instruments signed at the time of conclusion of treaty, Article 31(3) deals with the any subsequent agreement between the parties. When a subsequent agreement is entered into between the parties, due regard shall be given to the context in which such an agreement is entered into. Formal example for this include, protocol entered into between the parties for amending the treaty, Multilateral Instruments ('MLI') came into effect under OECD BEPS Action plan.

[2][2013] 30 taxmann.com 222 (Andhra Pradesh)

[3][2003] 132 Taxman 373 (SC)

12 The next part of Article 31(3) states that any subsequent practice of interpretation of a treaty which establishes the agreement between the parties shall be considered. The subsequent practice may consist of executive, judicial or legislative but such practice shall be common and consistent. Article 31(3)(c) of VCLT states that any relevant rules of international law applicable in the relations between the parties shall be considered. This part deals with the rules of interpretation which are outside the body of the treaty. Finally, Article 31(4) states that a special meaning shall be given to a term if it is established that the parties so intended.

Article 32 of VCLT: Article 32 of VCLT deals with the supplementary means of interpretation. Article 32 is reproduced below:

13 Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.

13 Article 32 of VCLT deals with supplementary means of interpretation of treaties which may include preparatory work for negotiation and conclusion of a treaty, circumstances under which a treaty is concluded (which may analyse the intention of the parties to enter into a treaty), commentaries and explanatory notes, treaties entered into with other countries (parallel treaties).

14 Preparatory work and circumstances under which a treaty is concluded may be considered for the purpose of interpretation of a treaty. As discussed above, unlike domestic law, international treaties are entered into by two or more countries hence, intention of the countries to enter into a treaty may provide the true meaning any term or phrase in the treaty. Preparatory work may include exchange of proposals (oral or written), negotiation terms etc. Typical examples include the correspondence (letters, notes, memoranda) between two or more negotiating states during the drafting of a treaty, initial drafts or proposals for treaty negotiations, declarations and statements made.

15 However, not all preparatory work may be considered as a supplementary means of interpretation, this is because all negotiations and proposals may not be agreed between the countries at the time of conclusion of a

treaty. Hence, while interpreting the treaty, firstly, it is required to understand the meaning of a term from the language provided in the treaty and these preparatory works may be used as additional aid for interpretation of treaty. The following guidelines may be considered for determining the preparatory work:

1. *'The meaning of "the preparatory work" of a treaty shall be limited to include only such representations that emanate directly from the negotiating states themselves.*
2. *In order for a representation to be considered part of "the preparatory work" of a treaty, each and every party which was not itself a negotiating state must have had at least an opportunity to acquaint itself with the contents of the representation; that opportunity must have existed prior to the moment when the party in question expressed its consent to be bound.*
3. *The meaning of "the preparatory work" of a treaty shall not be limited to include only such representations that are produced during the drafting of a treaty.'*[4]

16 Further, commentaries and explanatory notes may also be considered as a supplementary aid of interpretation of a treaty. Generally, OECD MTC and UN MTC are considered as a base for treaty negotiations and its conclusion, which provide a standard format for entering into a treaty by two countries. While the UN MTC is mostly used by developing countries as it contains favorable taxing rights to source country, OECD MTC is mostly used by developed countries as is considered to have favorable taxing rights to resent countries.

17 In respect of MTC, both OECD and UN provide detailed commentary on interpretation of Articles in the MTC. Though the commentary on MTC is not binding on its member counties, it is widely used for interpretation of tax treaties. As far as non-members are concerned, commentary on MTC has persuasive value for interpretation of a treaty. The OECD Commentary states that:

'As the commentaries have been drafted and agreed upon by the experts appointed to the committee on Fiscal Affairs by the Governments of member countries, they are of special importance in the development of international fiscal law. Although, the Commentaries are no designed in any manner to the conventions signed by member countries, which unlike the model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the

[4]Law and Philosophy Library

conventions and, in particular, in the settlement of any disputes.

18 As far as India is concerned, many judicial fora including the Hon'ble Supreme Court of India in the case of AzadiBachaoAndolan (supra) has considered the OECD Commentary for treaty interpretation. However, the Hon'ble Supreme Court in the case of P.V.A.L. Kulandagan Chettiar[5] has held that

' *16. 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 refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements.'*

19 However, even after the above judgment, in many cases have referred to OECD Commentary for interpretation of treaties. Further, treaties entered with other countries may also be used for the purpose of interpretation of tax treaties. The Hon'ble Mumbai Tribunal in the case of Boston Consulting Group Pte. Ltd[6] has held that:

'It is noteworthy that the Government of India has confirmed that memorandum of understanding between India and USA with regard to interpretation of article 12 (royalties and fees for included services), and extracts from which have been reproduced by us hereinabove, also represents the views of the Indian Government. Therefore, even apart from our categorical findings on merits, these views must prevail. We also have no reasons to believe that Government of India had any other views for materially identical provisions in India-Singapore tax treaty. To the extent provisions are in parimateria, there cannot be different meanings assigned to the provisions, unless there is anything repugnant in the context.'

20 The above view has been upheld by the Mumbai Tribunal in the case of Bharat Petroleum Corpn. Ltd.[7] and Preroy A.G.[8] . In addition to the above, judicial precedents including judicial precedents of other countries may also be considered for interpretation of tax treaties. In this regard, the Hon'ble High Court in the case ofVisakhapatnam Port Trust [9]

'45. In view of the standard O.E.C.D. Models which are being used in various countries, a

[5][2004] 137Taxman460 (SC)
[6][2005] 94 ITD 31 (MUM.)
[7][2007] 14 SOT 307 (MUM.)
[8][2010] 39 SOT 187 (MUM.)
[9][1983] 15 Taxman 72 (AP)

new area of genuine 'International Tax Law' is now in the process of developing. Any person interpreting a tax-treaty must now consider decisions and rulings worldwide relating to similar treaties [British Tax Review, 1978 edn., page 394]. The maintenance of uniformity in the interpretation of a rule after its international adaptation is just as important as the initial removal of divergencies Per Scott, J, in Euymedon [1938] AC 41. Therefore the judgments rendered by Courts in other countries or rulings given by other tax authorities would be relevant.'

21 In addition to the above supplementary means of interpretation, academic writings, articles, books published by renowned persons or research persons may also be used as aid for interpretation of tax treaties.

Article 33 of VCLT: Article 33 of VCLT deals with Interpretation of treaties authenticated in two or more languages. Article 33 is reproduced below:

1. *When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.*
2. *A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.*
3. *The terms of the treaty are presumed to have the same meaning in each authentic text.*
4. *Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.*

Conclusion: As stated above, interpretation of a tax treaty is different from domestic law. However, in certain situations, when a treaty specifically does not define any term or word, recourse may be taken to domestic law for the purpose of interpretation of any meaning subject to other condition. Further, as a last resort, taxpayer may approach competent authorities of the treaty countries under MAP as provided under Article 25 of OECD MTC in order to resolve the dispute in interpretation of a treaty.

Summary of Income Tax decisions

1. Chennai Tribunal in the case of Cognizant Technology Solutions India private Limited [1] - The amount distributed on account of buyback of the shares by Cognizant through a court approved scheme is held to be deemed dividend – attracts DDT under section 115-O.

In an interesting case before the Honourable Chennai Tribunal, the Tribunal held the amount paid by the assessee to its shareholders pursuant to a Scheme of Arrangement and Compromise approved by Hon'ble Madras High Court [2], as deemed dividend under section 2(22) of the Income Tax Act, 1961 (IT Act).

The facts of the case were that CTS India (the assessee) is a wholly owned subsidiary of CTS USA. had amalgamated with Cognizant India P. Ltd and Marketrx India P. Ltd. CIPL is subsidiary of Cognizant (Mauritius) Ltd. and MIPL is subsidiary of Marketrx Inc. CTS India has awarded shares in the ratio of 1:1 to the shareholders of the amalgamating companies. This amalgamation has led to CTS USA holding 21.92 percent shares of the CTS India whereas, CML holding 76.68 percent shares of CTS India. The entire amalgamation has the ultimate impact of the share base being shifted from USA to Mauritius.

Thereafter, the assessee purchased its own shares by reducing around 56 percent of the share capital and paid around Rs. 19,000 crores as consideration to its shareholders. At the time of payment, the assessee had deducted tax on the amount paid to USA shareholders. However, under Article 13 of India-Mauritius DTAA, capital gains on transfer of shares of the company is not taxable in the hands of Mauritius shareholders. By virtue of said Article, no tax has been deducted on the amount paid to Mauritius shareholders.

The Assessing Officer had concluded the above arrangement as a colourable device to portray the dividend distribution of the accumulated profits of the assessee as a share repurchase arrangement. Accordingly, the AO held the assessee liable to pay Dividend Distribution Tax under section 115-O of IT Act.

Let us understand the legal position on different kinds of re-purchase transactions.

1. The scheme of Arrangements and Compromises under sections 391-393 under Companies Act, 1956
2. Buyback of shares under section 77A of Companies Act, 1956[3].
3. Reduction of share capital under sections 100-105/402 of Companies Act, 1956.

[1][TS-531-ITAT-2023(CHNY)]

[2]Company Petition No.102 of 2016 dated 18.04.2016.

[3]Section 68 as per Companies Act, 2013

The assessee had vehemently contended that the above scheme explicitly mentions that the said purchase transaction is not covered under either buyback under section 77A of CA, 1956 or as reduction of share capital under sections 100-105/402 of CA, 1956. There are two major reasons for such argument by the assessee.

Firstly, if the purchase of own shares from the shareholders by the assessee would be considered as Buyback under section 77A of Companies Act, 1956, then section 115-QA under IT Act would comes into place. As per section 115-QA, the company is liable to pay tax at 20 percent on the amount distributed upon buyback of the shares. However, it is pertinent to note that repurchase of the own shares can be occurred in various modes other than buyback. To cover all such transactions, section 115-QA was amended vide Finance Act, 2016 w.e.f. 01.06.2016 to include all the re-purchase transactions. Here, the revenue has contended that the proposal to amend the section 115QA was brought up in February 2016. The assessee company immediately processed all the necessary compliances under Companies Act and obtained approval for the above scheme on 18.05.2016, days before the amendment was made effective. Hence, in order to escape frombeing taxed under a broad scope of re-purchase transactions, the assessee company planned the scheme before such amendment.

Secondly, if the scheme of purchase of own shares is not considered as buyback under section 77A of CA, 1956, then it would lead to reduction of share capital as per the provisions of section 100-105/402 of CA, 1956. If it is treated as reduction of share capital, then it would attract the provisions of section 2(22)(d) of IT Act, which provide that any distribution to the shareholders upon reduction of share capital to the extent of accumulated profits available shall be treated as dividend and accordingly, the company shall be liable to pay DDT at 15 percent under section 115-O of IT Act.

Hence, the assessee had contended that the above scheme appears to be a buyback/reduction of share capital, but it is not as such instead it is sui generis buyback approved under sections 391-393 of CA, 1956. Accordingly, neither section 115-QA nor section 2(22)(d) would become applicable.

The Hon'ble Tribunal after considering the various judicial precedents, held that the transaction entered into by the assessee is a colourable device and purchase of its own shares amounts to distribution of dividend which attract provisions of section 2(22) of the Income Tax Act, 1961.

[4]Distinctive/independent
[5][TS-554-ITAT-2023(Mum)]

2. Mumbai Tribunal in the case of Shobha Harish Thawani [5]- Non-disclosure of foreign assets in the "Schedule-FA" of income tax return attracts penalty under Black Money Act.

Currently, the discussion about the disclosure aspects of the foreign assets in the Schedule-FA in the income tax return is the hot topic. The main question arises from the discussion is, whether the non-disclosure of the foreign assets in the ITR attracts penalty under section 43 of BMA or can it be waived off at the discretion of the AO.

Recently, the Hon'ble Mumbai Tribunal has lighted up the heat by passing a judgement against to the assessee by making the assessee liable to the penalty under section 43 of BMA on account of non-disclosure of Foreign assets. However, surprisingly, the co-ordinate bench of the same hon'ble Tribunal has passed a favourable judgement in the case of Ocean Diving Centre Ltd[6] where the facts are quite similar to the Shobha Harish (supra) case. Let us understand the reasoning of the Hon'ble Tribunal in both the cases.

Shobha Harish (Supra) case:

The facts of the case were the assessee had owned foreign assets during the relevant year and failed to disclose the same in the Schedule-FA in ITR. The AO had charged penalty under section 43 of BMA which was later upheld by CIT(A). The assessee appealed before the Hon'ble Tribunal.

The assessee had disclosed the interest income earned from the foreign asset and duly paid the tax on it. Furthermore, the assessee had duly paid tax on the capital gains earned from the transfer of the foreign asset. The only condition the assessee has missed out is non-disclosure of the foreign asset in schedule-FA.

The contention of the assessee is that, there are two kinds of violations with respect to the disclosure of the foreign assets viz., Un-disclosure and Non-disclosure. Simply to put, Un-disclosure means not disclosing anything pertaining to the asset in the return of income like, its income, its existence. Whereas, non-disclosure would mean not disclosing the details of the asset which might be unintentional or bonafide, however has disclosed any income earned from the asset. And the assessee vehemently contended that section 43 of BMA charges penalty for un-disclosure but not the non-disclosure.

The Hon'ble Tribunal has not agreed to the assessee's contention and interpreted that the section 43 nowhere explicitly or implicitly conveys the applicability only to un-disclosed assets. It covers any kind of failure to furnish the details of the foreign assets in the return of income. Accordingly, the Tribunal had upheld the penalty levied by the AO.

[6]B.M.A. No. 22/Mum/2023

Gowra Fountain Head, Flat No 510, 5th Floor, Behind Hotel Westin, HITEC City, Hyderabad, Telangana - 500 081

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