



SATURDAY INTERNATIONAL TAX GYAN !!!

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Back to Basic Principles

SITG No. 244



**Treaty to be read
as a whole and not
in isolation**

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Introduction

- ❖ A tax treaty operates as a comprehensive legal framework aimed at eliminating double taxation and preventing tax evasion.
- ❖ It's provisions must be interpreted as a unified whole, since a fragmented reading can distort it's intended function.
- ❖ A selective or isolated interpretation can lead to asymmetrical tax treatment, potential treaty abuse, and jurisdictional disputes.
- ❖ Courts have consistently reaffirmed that treaties must be construed in a manner that upholds the principle of pacta sunt servanda (agreements must be honored in good faith) while ensuring alignment with their underlying economic and fiscal objectives.

Illustration 1

Case: Hindalco Industries Ltd. vs. ACIT [2005] 94 ITD 242 (Mumbai)[01-03-2005]

Issue: Whether training fees paid by Hindalco to a US company (Reynolds) for employee training, linked to the purchase of know-how, were taxable in India under the India-US DTAA.

Two Views Considered:

- **Hindalco (Assessee's View):**

Training fees were part of the know-how purchase deal, which qualifies as sale of property under Article 12(5)(a) and accordingly such training should be excluded from article 12 and not liable for taxation. The assessee selectively applied Article 12(5)(a) to claim exemption from taxation.

Illustration 1

- **Revenue (Tax Authorities' View):**

The Revenue contended that the training fees were covered under fees for included services under Article 12(4) and were taxable in India. Their argument was based on the fact that technical knowledge was imparted through training, which fell under the definition of included services. Moreover, they claimed that since the sale of know-how is liable for taxable in the source country (India) as per source rule, the training fees should also be taxable.

Analysis of the Case Law

- ❑ The intention behind exclusion in article 12(5)(a) is to exclude taxation of ancillary services or subsidiary services wherein the principal service is not taxable.
- ❑ Accordingly, article 12(5)(a) cannot be read in isolation without reading its full meaning and checking whether the principal service is liable to tax or not.
- ❑ Hon'ble Tribunal stated that one needs to first check if primary service is taxable and if it is not taxable then only move to the exclusion and accordingly one should read entire treaty.
- ❑ Treaty must be read in their entirety, considering their context and purpose. It should not be like that only beneficial fact should be considered to select the article of the treaty and one could get escape taxation by misinterpreting the exclusion..

Various case laws supporting the Illustration

- ❖ This principle which essentially implies that provision of the treaty are required to be construed in harmony with each other was extended to various cases like –
 - Dy.CIT V. Boston Consulting Group Pte Ltd. [2005] 94 ITD 31 (Mumbai- Tribunal)
 - Dy. CIT V. Gupta Overseas [2014] 42 taxmann.com 42/ [2015] 153 ITD 357 (Agra – Tribunal)
 - FRS Hotel Group (Lux) S.a.r.l., In re [2018] 404 ITR 676/94 taxmann.com 23/ 256 Taxman 361 (AAR – New Delhi)

Principle of Holistic Interpretation

- ❖ A treaty must be interpreted in good faith in accordance with the ordinary meaning of its terms in their context and in light of its object and purpose.
- ❖ In **Hindalco Industries Ltd. v. Asstt. CIT [2005] 94 ITD 242 (Mumbai Tribunal)**, the tribunal observed that every provision of a treaty **derives its meaning from the larger framework of the agreement**.
- ❖ Literal interpretation without considering the broader tax implications can result in an unintended tax advantage or undue treaty benefits.
- ❖ Therefore, the contextual application of treaty provisions is paramount, requiring a reading that aligns with the economic realities and fiscal policies of the contracting states.

Conclusion

- ❖ A tax treaty is not merely a set of independent clauses but a legally binding framework that requires a structured and context-driven interpretation.
- ❖ Courts have repeatedly underscored that tax treaties must be read as a whole, with due regard to their economic, legal, and fiscal implications.
- ❖ A fragmented reading risks creating tax asymmetries, distorting cross-border tax liabilities, and undermining the principle of reciprocity between contracting states.
- ❖ The doctrine of effective interpretation (*effet utile*) mandates that each provision should be applied in a manner that reinforces the treaty's overarching objectives.
- ❖ A holistic and coherent approach to treaty interpretation is essential to ensure international tax certainty, consistency, and alignment with global anti-abuse measures.

Reference of Previous SITG of Back to Basic Principles Series

S.No	Particulars	Link
1.	Right to Choose Between DTAA and IT Act	<u>Click here</u>
2.	If two views possible, view which is favourable to taxpayer should be adopted	<u>Click Here</u>
3.	Guidance on the Principal Purpose Test (PPT) under India's Double Taxation Avoidance Agreements (DTAAs)	<u>Click Here</u>

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