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“I see it differently”: Interpreting the BEPS MLI

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Earlier this month, the author of this blog was at the IFA UK branch meeting where experts assembled to discuss certain interpretational aspects concerning the BEPS Multilateral Instrument (BEPS MLI) from a UK perspective. Most of these issues would have relevance in other jurisdictions too (including India) as more and more countries ratify the BEPS MLI.

As we know, on June 25, 2019, India deposited its Instrument of Ratification with the OECD along with its “Final Position” in terms of the covered tax agreements, options and notifications under the BEPS MLI. India has chosen to substitute “calendar year” with “financial year” and the BEPS MLI will have an impact on India’s covered tax treaties from April 2020.

Conference discussions and newspaper columns have largely focussed on the substantive changes that the BEPS MLI would introduce to India’s covered tax treaties. Some of the discussions did focus, albeit narrowly so, on the ratification of the BEPS MLI and the potential constitutional challenges that it faces in view of section 90(1) of the Income Tax Act.

Scant attention has been paid, however, to issues relating to the interpretation of the BEPS MLI: an area that seems to have been reserved mainly for tax lawyers and judges.

BEPS MLI is a recent addition to the expanding international tax landscape, and we will have to wait for some more time before Indian courts meticulously look at its interpretational aspects. Presumably, most of the interpretation issues would be tackled in the same way that courts usually tackle a bilateral tax treaty.

In interpreting tax treaties, Indian courts have been careful in noting (as a starting point) that those engaged in diplomacy use somewhat different language than what regular Parliamentary draftsmen use. As a result, judges, when confronted with ambiguous tax treaty language, avoid a violent, legalistic reading of the provisions and stick to a more liberal approach.

Like their counterparts in other jurisdictions, Indian courts often turn to the rules of interpretation contained in the Vienna Convention on the Law of Treaties (VCLT). The Supreme Court of India, for instance, has more than once stated that the rules of interpretation contained in the VCLT, being customary international law, extend to the interpretation of tax treaties.

What are these principles and what do they mean in the context of the BEPS MLI?

As per Article 31(1) of the VCLT, 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 light of its object and purpose."

How do judges interpret the BEPS MLI in *good faith*? The principle of *good faith* has featured in court decisions relating to treaty override and non-compliance with the express provisions of a tax treaty such as the Article on exchange of information. In both instances, it was the contracting state (and not the taxpayer) that allegedly abused tax treaty provisions.

The key task of a tax court is to give ordinary meaning to the terms of the BEPS MLI. The term "ordinary" used in Article 31(1) of the VCLT is not to mean a very general, dictionary meaning of a specific term, but such meaning that is ordinarily ascribed to that term in the area of international tax law.

Article 31(2) states that the context for the purpose of the interpretation of a treaty shall comprise its preamble, among other things.

Article 6 of the BEPS MLI introduces the following Preamble to all covered tax treaties:

"*Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions).*"

Further, the Preamble to the BEPS MLI states:

"*…Recognizing that governments lose substantial corporate tax revenue because of aggressive international tax planning that has the effect of artificially shifting profits to locations where they are subject to non-taxation or reduced taxation…*

…Recognizing the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created…"

The BEPS MLI contains an alphabet soup of objects and purposes that are complex to identify. Absence of judicial precedents would make the task of a judge even more difficult. At times, the objects and purposes of a treaty (explicitly stated or otherwise) can often come into conflict with one another: a situation could be identified as facilitating tax avoidance and eliminating double taxation at the same time. The question then becomes of preference: which result Contracting States could be said to have intended (or preferred) to avoid?

Practically, there is no material difference between "object" and "purpose" and both more or less mean the same thing. The objects and purposes of the BEPS MLI, however, must inform the ordinary meaning of the text of the Instrument. As we know, the BEPS MLI does not rescind or replace existing tax treaties and, therefore, it would have to be read alongside the relevant tax treaty and in a harmonious manner.

Although the ordinary meaning of a term is to be found in the text of the treaty itself and so applied, Indian courts have often gone into supplementary materials to resolve ambiguity in the text of a tax treaty. Article 32 of the VCLT gives them that leeway.

In the context of the BEPS MLI, these supplementary materials would include the OECD guidance

on the BEPS MLI (such as the toolkit and FAQs), BEPS reports, country position on the BEPS MLI, works of academics, among others. Of course, these materials do not bind domestic tax courts but could be helpful (and in some cases, desirable) in discerning the meaning of a particular provision. Where necessary, a judge must be ready and willing to examine the French version of the Instrument as well.

Likewise, tax courts must endeavour to follow the same interpretation that has been followed by foreign courts and tribunals so that there is a common application of tax treaties across jurisdictions (unless the interpretation is manifestly incorrect). This is, to some extent, followed in domestic tax cases, where judges tend to subscribe to the views of their fellow judges in many cases, though there are exceptions.

Finally, it would also be interesting to see if the contents of the BEPS MLI would be given retrospective effect. The new Preamble would perhaps be the most controversial in this area. There have been cases in the past where Indian courts and tribunals have ruled against retrospective application of tax treaty-related amendments. However, it would be interesting to see how a court approaches the BEPS MLI in the event that an argument is made that the context of the relevant tax treaty includes the newly incorporated Preamble (as part of the BEPS MLI).

On October 26, 2009, noted jurist Ronald Dworkin said the following in his inaugural Frederic R. and Molly S. Kellogg Biennial Lecture on Jurisprudence in the Coolidge Auditorium of the Library of Congress:

"Imagine a judge who has just sentenced a villain to jail, or perhaps worse. And then says at the end of his opinion: *…of course, that's the way I see it; that's my opinion; that's the way I read it. But there are other interpretations and they are equally good…We would want that judge to be sent to jail*."

And yet, this is so common in judicial construction of statutes.

The Indian Income Tax is one of the most complex legislations in India (and perhaps in the world). Tax courts and tribunals often deliver differing opinions – even in the absence of any clear ambiguity in the text of the law. There is no doubt then that we will see the same trend in the context of the BEPS MLI, given how vaguely some of its provisions have been drafted.

In writing this blog, the author benefited from presentation given by Professor Jonathan Schwarz at the UK IFA branch meeting held on July 4, 2019.

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