T. RAJKUMAR V. UNION OF INDIA: A CASE ANALYSIS

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I. INTRODUCTION

The constitutional validity of Section 94A under the Income Tax Act, 1961 was upheld by the Madras High Court in *T. Rajkumar v. Union of India*. The court stated that in the wake of scams, curbing tax avoidance has become a priority.[1] In the judgment, the High Court upheld the Income Tax provision under Section 94A[2] permitting the Government of India to notify a country as a "notified jurisdictional area" in the absence of a provision of information exchange with any country or territory.[3] It was also held that these provisions were not contradictory to Articles 246 and 248 of the Constitution and there was no question of legislative incompetence of Parliament. The High Court also affirmed the validity of Central Board of Direct Taxes notification, No. 86/2013, along with a press release notifying Cyprus as "notified jurisdictional area".[4] The High Court's decision has been received with considerable skepticism within the legal community as it raises contentious questions on the equation between India's duty towards Cyprus under the realm of international law as well as its own rights within the domestic sphere to further the goal of effective information exchange.

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[1]T Rajkumar v. Union of India, (2016) 68 taxmann.com 182 (Mad.) [hereinafter Rajkumar].

[2]The Income Tax Act, 1961, § 94A [hereinafter IT Act].

[3]*Id.*

[4]*Id.*

In the course of this case comment, the authors aim to analyze this judgment and note its ramifications for India- both domestically and internationally. For the sake of clarity, analysis of the judgment has been divided into three parts. In Part I, the authors outline the arguments made by the opposing parties and the response of the court to these arguments with respect to the constitutional validity of Section 94A of the Act. In this part, a comprehensive summary of the multi-faceted judgment is provided under three broad heads- the constitutional aspect, the international law aspect and finally, the jurisprudential aspect. In Part II, a critique of the judgment is advanced wherein the authors stress on the importance of remaining consistent with our international obligations both under public international law and more theoretically, through the lens of jurisprudence of international law. In Part III, the authors further discuss the various precedents and the tax implications of such a decision. It is argued that the High Court erred in upholding the validity of Section 94A in light of India's duties to Cyprus in pursuance of the agreement between both the countries. The authors' objective through this case comment is to point out the problems in the reasoning employed by the High Court and argue against the final position that the Court takes.

II. FACTS, ISSUES AND ANALYSIS OF THE CASE

The facts of the case originate from a tripartite agreement signed in pursuance of the 'Double Taxation Avoidance Agreement' between India and Cyprus ('Agreement') signed between an Indian company, New Kovai Real Estate Private Limited, a company from Cyprus called Skyngelor Limited and the three petitioners in the case.[5] By the said Agreement, the Cyprus company, which held about 15,200 equity shares of face value of INR 10 each and about 21,39,200

[5]Rajkumar, *supra* note 1, ¶ 8.

compulsorily convertible debentures of face value of INR 100 in Kovai Real Estate Private Limited, undertook to sell the shares and debentures to the petitioners.[6] The Indian Government required information on this exchange and requested Cyprus to reveal the tax-related information of the transaction to the concerned authorities.[7] On their failure to do so, the Indian government decided to notify Cyprus as a 'notified jurisdictional area' and thereby compel it to reveal the needed information.[8] In pursuance of this, the petitioners immediately filed statutory appeals under the mandate of Section 246A of the Income Tax Act before the Commissioner of Income Tax.[9] Simultaneously the petitioners also challenged the validity of Section 94A of the Act, the Notification and the Press Release issued by the Indian government, claiming that India had violated duties towards Cyprus that it had agreed to undertake by signing the Agreement.

Keeping these facts in mind, several issues can be delineated on the basis of which the court was to decide the case. Firstly, is it valid to notify any country as a 'notified jurisdictional area' without reference to the existence of a Treaty with that country, with respect to Articles 14, 19(1)(g), 51, 245, 253 and 269 of the Constitution of India ('Constitution')? And secondly, does India have an obligation under the Vienna Convention on the Law of Treaties ('VCLT') and the principles of codified international law to remain consistent with regard to its obligations under the Agreement? Finally, and more

[6]*Id.*
[7]*Id.*
[8]IT Act, *supra* note 2. Section 94-A of the Income Tax Act reads thus: (94-A. Special measures in respect of transactions with persons located in notified jurisdictional area.—(1) The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee…).
[9]Rajkumar, *supra* note 1.

broadly, the court was to demarcate a balance between India's treaty obligations and the government's right to regulate by way of statutes.

With respect to the first issue, the Petitioners based their case on the Supreme Court's decision in *Union of* India *v. Azadi Bachao Andolan* ('Azadi').[10] The Petitioners contended that Section 90 of the IT Act was specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement (DTAA).[11]Therefore, the provisions of such a notified Agreement, in this case the DTAA, would operate, even if inconsistent with the provisions of the Income Tax Act.[12]The Petitioners further argued that it was unmerited to treat countries with which India had entered into agreements with, and countries which no such agreement existed, as 'alike' under Article 14.[13] It was further contended that the provisions of Section 9A violated the enshrined freedom of trade and business under Article 19 (1)(g) of the Constitution.[14] Furthermore, it was argued that the power under Article 245(1), is made subject to the provisions of the Constitution and hence, the said power is subordinate to Article 253, which confers power upon the Parliament to make laws for implementing any Treaty, Agreement or Convention with any other country.[15] That the power under Article 245(1) is subordinate to the power under Article 253 is also made clear by a non-obstante clause contained in Article 253.[16] This is due to the obligation on the government to observe treaty obligations in good faith, codified under the directive principles of state policy under Article 51(c) of the

[10]*Id.*
[11]*Id.*
[12]*Id.*
[13]*Id.*
[14]*Id.*
[15]*Id.*
[16]*Id.*

Constitution.[17] Therefore, the petitioners in essence contended that Section 94A was unconstitutional and exceeded the powers given to the government.

In response to these claims, the High Court contentiously upheld the validity of Section 94A and elaborated upon the Respondent's arguments to dismiss the grounds elaborated upon by the petitioners. With respect to Article 253, the court held that this provision is an enabling provision that empowers the Parliament to make any law for the whole or any part of the territory of the country for implementing any Treaty, Agreement or Convention with any other country.[18] They held that 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.[19] Furthermore, the Court held Treaty entered into by the country with another country is actually in the realm of executive action in terms of Article 73.

III. ON MONISM, DUALISM AND THE DOCTRINE OF GOOD FAITH - MISSING LINKS IN THE JUDGEMENT

International law has a complex relationship with the domestic laws of any country and jurisprudential schools have attempted to understand this relationship in varied manners. International treaties are the result of the negotiations between the States and therefore, it is

[17]INDIA CONST. art. 51, cl. c. This Article directs Indian authorities to foster respect for international law and treaty obligations in the dealings of organised peoples with one another; and encourage settlement of international disputes by arbitration.
[18]*Id.*
[19]Rajkumar, *supra* note 1.

implicit in these treaties that there is consent of the states that are parties to it.[20]In this regard, there are two jurisprudential schools that detail the relationship between international law and domestic law- called monism and dualism respectively.[21]

Monists,[22] as the court noted, regard international law and municipal law as parts of a single legal system.[23]Monists argue that municipal law is subservient to international law within this paradigm.[24] Dualists[25] inhabit a more complex position. The first premise of dualist thought is that municipal law can apply international law only when it has been incorporated into municipal law.[26] This incorporation can result from an act of Parliament or executive action given effect to by the courts.[27] Second, and more ambiguously, dualists hold that if international law conflicts with the domestic law, then domestic law will prevail.[28] However, this does not necessarily mean that most states would disregard international law. In fact,

[20]Sunil Kumar Agarwal, *Implementation of International Law in India: Role of Judiciary*, Dean Maxwell & Isle Cohen Doctoral Seminar in International Law, Faculty of Law, McGill University [hereinafter Agarwal].
[21]*Id.*
[22]J. G. Starke, *Monism and Dualism in the Theory of International Law*, 17 BRIT. Y.B. INT'L L. 66, 81 (1936) [hereinafter Starke]. Monism has obtained the widest theoretical acceptance as with regards the position today. Monists like Hans Kelsen are seen as providing one of the most theoretically viable accounts of the relationship of international law with domestic law.
[23]Agarwal, *supra* note 20.
[24]*Id.*
[25]Starke, *supra* note 22. Triepel and Anzilotti are the leading exponents of the dualistic construction. Monism ad dualism differ on two counts- they differ in the social relations they govern and the very judicial roots they originate from. According to Starke, monism originates from the basis of common will that foregrounds international law whereas dualism is rooted in the will of the state.
[26]Agarwal, *supra* note 20.
[27]*Id.*
[28]*Id.* This has been contested and cannot be seen as an overarching rule for all contexts- thereby defeating the very force of international law and treaty obligations undertaken.

Indian statutes have on several occasions upheld international treaties and obligations over domestic law if the circumstances are such.[29]

Therefore, certain aspects of the present case need to be noted. Crucially, the agreement between India and Cyprus had been incorporated by the government by way of Section 90 of the Act- thereby leading to an affirmation of the treaty within domestic law.[30] In this scenario then, India has incorporated the treaty within its domestic framework and the question of whether it should override domestic law will be a specific case-based determination. In this light, Article 51 of the Constitution is of immense relevance. The Directive Principles of State Policy as enshrined in Article 51 of the Indian Constitution enjoin the State to endeavor, inter alia, to foster respect for international law and treaty obligations in the dealings of organized people with one another.[31] It is a fundamental principle of statutory interpretation in Indian domestic law that, wherever possible, a statutory provision must be interpreted consistently with India's international obligations, whether under customary international law or an international treaty or convention.[32] If the terms of the legislation are not clear and are reasonably capable of more than one meaning, the treaty itself becomes relevant, for there is a prima facie presumption that Parliament does not intend to act in breach of international law, including therein a specific treaty obligation.[33] Hence, in a situation wherein international law and

[29]Vishaka v. State of Rajasthan, A.I.R. 1997 S.C. 3011 (India). The Supreme Court looked into the Convention for Elimination of Discrimination against Women (CEDAW) to deal with issues relating to sexual harassment of women in work places.

[30]Rajkumar, *supra* note 1.

[31]INDIA CONST. art. 51, cl. c. This Article directs Indian authorities to foster respect for international law and treaty obligations in the dealings of organised peoples with one another; and encourage settlement of international disputes by arbitration.

[32]Agarwal, *supra* note 20.

[33]S.M. Sikri, C.J. in Kesavananda Bharathi v. State of Kerala, A.I.R. 1973 S.C. 1461, at ¶ 21 observed as under: It seems to me that, in view of Article 51 of the

domestic law contradict each other, courts must strive to ensure that specific treaty obligations are not defeated and India acts in accordance with its treaty obligations. The reliance by the court exclusively on the dualist model as a reason to evade its treaty obligations vitiates the principle codified under Article 51 (c) of the Constitution to ensure that India acts in accordance with its treaty obligations.

The second aspect that the Court has to navigate it the claim made under the Vienna Convention on the Law of Treaties (VCLT) that obliges the Member States to treat every Treaty in force, as binding upon the parties thereto.[34] Articles 26 and 27 of the Vienna Convention contain the doctrine of *'Pacta Sunt Servanda'*.[35] This doctrine lays down the fundamental principle 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.[36] Furthermore, by the court's own reference in the present case it is clear that since several aspects of the VCLT are customary international law, India would be obliged to follow it irrespective of the fact that it has not ratified the convention.[37] However, the court here is still persistent in holding that though Article 26 of the Vienna Convention obliges both the contracting parties to perform their obligations in good faith, India is not bound to follow the principles of good faith as codified here. The Court reasoned that one of the four purposes for which an agreement

directive principles, this Court must interpret language of the Constitution, if not intractable, which is after all an intractable law, in the light of the United Nations Charter and the solemn declaration subscribed to by India.

[34]The Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

[35]*Id.* at a. 26, 27.

[36]*Id.*

[37]Ram Jethmalani v. Union of India, (2011) 8 S.C.C. 1 (India). The Supreme Court referred to Article 31 of the Vienna Convention and pointed out that though India is not a party to the Convention, it contains many principles of customary international law.

could be entered into by the Central Government under Section 90(1) is for the exchange of information.[38] 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. Hence, the Court argued that as Cyprus had breached its treaty obligation, India had no obligation to maintain the treaty in good faith. We argue, in this respect, that the court cannot rely on the alleged breach of the treaty obligation by Cyprus to in turn, allow India to breach its treaty obligations since breach of a treaty by one of the parties thereto does not automatically terminate the treaty.[39]

Therefore, for a cumulative appraisal of these reasons, the authors conclude that India has an obligation under the VLCT to observe the treaty in good faith. Furthermore, a harmonious reading of Article 51(c) of the Constitution and the doctrine of good faith enshrined under the VLCT, make it evident that the court erred in allowing a domestic law to override the existing treaty obligation that India had undertaken.

IV. PREDICTING FUTURE RISKS AND THE IMPORTANCE OF SUBSCRIBING TO PRECEDENT

In this part of the comment, it is argued that the case of *Union of India v Azadi Bachao Andolan* ('Azadi') is pertinent, and the precedent laid down in this case must be followed.[40] The present case discussed the Azadi case in great detail and the contentions in Azadi formed a considerable portion of the present case. In Azadi, the court clearly laid down a precedent establishing that Section 90 of the

[38]IT Act, *supra* note 2, § 90(1).
[39]*Article 27. Violation of Treaty Obligations*, THE AMERICAN J. INT. L., Vol. 29, Supplement: Research in International Law (1935), at 1077-1096.
[40]Union of India v. Azadi Bachao Andolan, (2004) 10 S.C.C. 1 (India).

Income Tax Act, 1961 was specifically created with the intent to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement and that when it happens the provisions of such an Agreement would operate, even if inconsistent with the provisions of the Income Tax Act.[41] The petitioners claim that Section 90 is a legislative provision that is excessive in nature owing to grant of delegated power to the Central Government to classify any State as a 'notified jurisdictional area'.

The High Court was of the opinion that the Supreme Court judgment in the Azadi case that allowed provisions of tax treaty to overrule provisions of IT Act can create inconsistency if seen in isolation.[42] The court underlined that the provision under section 90(2) allows the assessee to opt for provisions of a tax treaty or the IT Act. He can apply for whichever seems beneficial, and this does not conclude the inconsistency of alternatives.[43] The High Court was of the view that Section 90 did not deal with the inconsistency between the tax treaty and Act provisions. If a country fails to exchange necessary information as per the obligation of good faith in a treaty, the other country can resort to action under its domestic law.[44] We argue that in analyzing this particular judgment the High Court erred in its interpretation of Section 90.

It was reiterated in the *CIT v. P.V.A.L Kulandagan Chettiar* ('Chettiar case') that in case of a conflict between the provisions of the Agreement and the Act, the provisions of the Agreement shall prevail.[45] The flaw in the High Court's logic lies in the fact that it holds that even though the Parliament has a right to make new

[41]*Id.*
[42]*Id.*
[43]*Id.*
[44]*Id.*
[45]C.I.T. v. P.V.A.L Kulandagan Chettiar, (2004) 267 I.T.R. 654 (S.C.) [hereinafter C.I.T. v. Kulandagan].

provisions under Section 90, if these provisions are not beneficial to the assessee or not in accordance with Section 90(2) of the Act, they will not take precedence in any matter.[46] Taxing statutes are to be interpreted in an extremely strict manner.[47] However, it is an established principle that in case of ambiguity between two conflicting provisions under a taxing statute, the provision beneficial to the assessee shall be taken into consideration.[48] In this particular scenario, even when the transaction resulted in a capital loss to the Cypriot seller and thus, no taxable income arose in the hands of the Cypriot seller, the seller was nonetheless asked to pay 30% withholding tax by the tax authorities.[49] This percentage is much more than what they would have to pay if the DTAA was followed instead. Furthermore, this move sets a bad precedent for all the other future investors as Section 94A came into existence after the treaty was signed. Taxing statutes cannot be fiddled with for convenience and to circumvent established principles and judicial pronouncements as it creates apprehension in the business community.[50]

These principles were adopted by the Supreme Court in Azadi as well.[51] No question arose directly either in the Azadi case or in the Chettiar case as to whether or not the Parliament has the power to make a law in respect of a matter covered by a Treaty.[52] Therefore, the observations found in these two decisions, to the effect that the

[46]*Id.*
[47]C.I.T. v. Vadilal Lallubhai, (1973) 3 S.C.C. 17 (India).
[48]Section 90(2) in The Income Tax Act, 1995 reads thus: Where the Central Government has entered into an agreement with the Government of any country outside India under sub- section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
[49]C.I.T. v. Kulandagan, *supra* note 45.
[50]Vodafone International Holdings B.V. v. Union of India, (2012) 6 S.C.C. 613 (India).
[51]*Supra* note 52.
[52]*Id.*

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.

In order to interpret this argument better we need to revisit the Chettiar case, the ratio decidendi of which explicitly mentions that the double taxation relief is to be necessarily granted to those states that have entered into the Double Taxation avoidance agreement with India.[53] Further, Taxation policy is within the power of the government and Section 90 enables the government to formulate its policy through treaties entered into by it.[54]

In this particular scenario Section 94A is the other provision of the Income Tax Act which was added after the DTAA with Cyprus came into existence. According to Section 94A(5) the withholding tax is decided at 30% for any payment. This provision in itself is problematic as it does not allow for any scope of tax reduction, rendering the DTAA redundant, as the purpose of double taxation agreements is to reduce tax burden for foreign investors in an attempt to incentivize them. In fact, it can be clearly ascertained from Section 90(2) that where a double taxation agreement has been entered into, the provisions of the Act would apply only to the extent that they are beneficial to the assessee. Thus, as per a combined reading of Section 90(1) and (2), even if Cyprus is a "notified jurisdictional area", Cypriot investors would still benefit from the DTAA signed between Cyprus and India. Thus, Section 94A in itself is rendered useless.

As far as the implications of such a decision are concerned we need to take a look at the recent *Vodafone International Holdings BV v Union of India* case.[55] It is pertinent to note that the *Vodafone case* upholds

[53] *Id.*
[54] *Id.*
[55] *Supra* note 57.

that the tax authorities cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but instead should apply the 'look at' test to ascertain its true legal nature.[56] It was aptly held that the Government Authority responsible can apply the substance over form test only when it is established with the support of certain facts and circumstances that a transaction or a scheme is a sham or might be tax avoidant in nature.[57] It was also said that it is the responsibility of the Revenue to look at a particular foreign direct investment in India in a holistic manner.[58] In order to prioritize future investments from Cyprus and continue trade in a wholesome manner, this regulation is an added burden. Therefore, in conclusion, this decision has set risky precedents for the future in relation to tax based policies for the future.

Post the judgment, on June 29th, 2016, the negotiation on the Double Taxation Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income between Cyprus and India was successfully completed, in New Delhi. Following the entry into force of the amending Agreement, the Indian Authorities will proceed with retrospectively rescinding the classification of Cyprus in the 'Notified Jurisdictional Area.[59] However, the judgment continues to have ramifications for future agreements entered into by India with other nations and for future harmonious relations within the international community.

[56] *Id.*
[57] *Id.*
[58] *Id.*
[59] *See Cyprus-India sign double taxation waiver agreement*, SIGMA LIVE (June 30, 2016), http://www.sigmalive.com/en/ news/economy/146484/cyprusindia-sign-double-taxation-waiver-agreement.dpuf.

V. CONCLUSION

The present case is, therefore, problematic in several ways. First, we have argued that in a dualist set-up, countries must abide by international obligations that they voluntarily undertake. Second, the precedent laid down by the Apex Court in the Azadi case and other judgments must be respected by the Court and this case, therefore, deviates from the prior position of the law. Hence, we argue that such a case ignores the importance of past precedent in its attempt to ensure that the judgment is beneficial to India. Although the court makes certain important observations in this case, there is a tangible risk of this precedent being wrongly used in the future to allow India to escape international obligations that it has undertaken.