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Interpretation of Article 3(2) – Significance of phrase 'Term'

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The recent judgment of ITAT[1] Mumbai in the matter of Reliance Jio Infocomm Limited[2] (for brevity 'Jio India') is one of a classic judgment in dealing with the interpretation of phrases/expression that are used in DTAA[3] but which are not defined therein. In this article, we try to summarise the key findings of the said judgement.

Before we proceed to analyse and note the key findings, a peek into the facts of the matter involved is warranted. Jio India has a bandwidth services agreement with Reliance Jio Infocomm Pte Limited (for brevity 'Jio Singapore') and against such agreement Jio India has remitted a payment of US $ 15,91,520. While making such payment Jio has withheld tax under Section 195 of IT Act[4]. Jio India post payment of tax has filed an application before CIT(A)[5] under Section 248 praying for a declaration to the effect that such tax need not be withheld on the payments made to Jio Singapore.

Jio India has stated that since Jio Singapore is fiscally domiciled in India, Jio Singapore can access the India-Singapore DTAA and further the bandwidth services constitute business income and Jio Singapore having no PE[6] in India, the said amounts are not subjected to tax in India and accordingly no deduction is required from the payments made to Jio Singapore.

The CIT(A) after hearing the submissions made by Jio India has stated that from the facts and agreements submitted by Jio India, it was evident that the Jio India was only receiving services and does not have any access to the equipment of Jio Singapore, further, the process involved for provision of services by Jio Singapore to Jio India is not in the nature of 'secret' but a standard commercial process followed by the industry, the said payment does not fit in the definition of 'royalty'. Further, the CIT(A) has held that the definition of 'royalty' under the Article 12 of India-Singapore DTAA is much narrower than the definition as provided in Section 9(1)(vi) of IT Act, Jio Singapore can access the treaty benefit and accordingly amounts made by Jio India would not require withholding of tax. Further, the CIT(A) has held that payments made to Jio Singapore will be in the nature of business profits and cannot be classified as fee for technical services or royalty either under the IT Act or DTAA and in absence of PE for Jio Singapore in India, there is no requirement to withhold the tax.

Aggrieved by the order of CIT(A), the AO[7] has approached the ITAT seeking its intervention and praying that the deduction which was already made by Jio India is in line with the provisions of Section 195 and does not require any consideration as ordered by CIT(A). The AO's main contention was that the amendment made to Explanation 6 to Section 9(1)(vi) in 2012 with retrospective effect from 01.06.1976, wherein the expression 'process' is defined to include transmission by satellite, cable, optic fibre or by any other similar technology, whether or not such process is secret would be equally apply to the expression 'process' which is used in Article 12 of India -Singapore DTAA and accordingly

[1] Income Tax Appellate Tribunal
[2] ACIT vs Reliance Jio Infocomm Limited [2019] 111 taxmann.com 371 (Mumbai – Trib.)
[3] Double Tax Avoidance Arrangement
[4] Income Tax Act, 1961
[5] Commissioner of Income Tax (Appeals)
[6] permanent establishment
[7] Assessing Officer

the payments made by Jio India to Jio Singapore would be subjected to tax under Article 12 *ibid.* The AO's contention is that the same definition as existing in local act would equally apply for DTAA in light of Article 3(2) of India – Singapore DTAA. In simple words, the AO states that since the term 'process' has not been defined in India – Singapore DTAA, by virtue of Article 3(2), the said term would assume the meaning as laid down vide explanation 6 to Section 9(1)(vi) and accordingly the payment made by Jio India to Jio Singapore would be 'royalty' even in terms of Article 12 of India-Singapore DTAA.

ITAT's Analysis:

The ITAT has referred the decision of co-ordinate bench of ITAT in the Jio India's own matter for different assessment year in the judgment referred DCIT v Reliance Jo Infocomm Limited[8][9], wherein the co-ordinate bench has held that the payments made by Jio India to Jio Singapore are not in the nature of 'royalty' in terms of Article 12 of India – Singapore DTAA and accordingly the same has to be treated as business profits and in absence of PE for Jio Singapore, there will be no income chargeable to tax for Jio Singapore in India and no tax is required to be deducted. The revenue has submitted that in light of amendment to the definition of Explanation 6 to Section 9(1)(vi), the payments made by Jio Singapore would fall under the definition of 'royalty' as per IT Act. The co-ordinate bench by placing reliance on the judgment of Honourable High Court in the matter of New Skies Satellite BV[10] and Siemens Aktiongesellschaft[11] has held that unilateral amendments made to IT Act would not override the provisions of DTAA and accordingly brushed away the submissions made by revenue.

ITAT then proceeded to examine the core issue as to whether the expression 'process' as defined in the IT Act would equally apply to the expression 'process' as used in Article 12(3)(a) of India – Singapore DTAA, in light of Article 3(2) vide which, it was stated that the term not defined in DTAA have the same meaning which it has under the law of state concerning the taxes to which DTAA applies. In other words, since the term 'process' which is used in Article 12(3)(a) has not been defined in DTAA, in light of Article 3(2), would assume the same meaning as laid down vide explanation 6 to Section 9(1)(vi) of IT Act.

ITAT has opined that there is a fundamental fallacy in the proposition of AO in considering the expression 'process' as a treaty term and thereby invoking Article 3(2) and leading to the definition as per the local act. The ITAT has held that the provisions of Article 3(2) would come into play for domestic law meaning of ***any term*** not defined in the tax treaty. Hence, in order to invoke the provisions of Article 3(2), it has to be with reference to a 'term' used in DTAA and not defined therein. Hence, it is important to understand the meaning of 'term' so as to decide, whether 'process' can be called as 'term' to invoke Article 3(2).

The ITAT then proceeded to lay down the meaning of 'term' and stated that 'term' is thus a word that that has meaning and refers to objects, ideas, events or state of affair. *A term is thus, in addition to being a word, some kind of a point of reference, whereas a word is only a constituent of language.* Applying the same to the current context, whether expression 'process' in its own right, has any relevance for the tax treaties or can 'process' be said to be term employed in tax treaties? Answering the same as negative, the judgment held that, if at all 'process' has any relevance, it is in defining the term 'royalty' and looking for statutory definition of each word employed in a definition of treaty term

[8] [2019] 73 ITR (T) 194 (Mum)
[9] The facts of the said matter and the current matter are akin
[10] [2016] 382 ITR 114
[11] [2009] 310 ITR 320 (Bom)

and then construct the definition of treaty term as an assembly of the statutory definitions of all these words would be too hyper technical an approach and beyond the mandate of Article 3(2).

Accordingly, the ITAT has held that binding force of Article 3(2) would not come into the play in explaining the word 'process' used in definition of treaty term 'royalty'. The expression 'process' is not a treaty term per se or a reference point, used in the treaty, rather it is an expression or word used in defining the term 'royalty'. The expression 'process' is used in the treaty in that limited context and it does not have an independent existence. The decision of Honourable Delhi High Court in the matter of New Skies Satellite BV (supra) has held that domestic law meaning under Article 3(2) is relevant only when the treaty term itself is undefined and when the expression 'royalty' is defined in tax treaty, there cannot be any occasion to dissect the said definition and applying the meaning of 'process' as per IT Act to DTAA.

The ITAT further proceeded to examine by assuming that if the definition of 'process' is equally applicable for the purposes of Article 12 of India- Singapore DTAA, then, whether on facts and in the circumstances of the case, assignment of domestic law meaning under Article 3(2) to an undefined term, is to be done by way of static interpretation or by way of dynamic or ambulatory interpretation. In simple words, whether the definition of 'process' should be given effect as it stood at the time when the treaty was agreed or when the relevant taxes are levied. This is important because, the expression 'process' is not available in IT Act at the time, when the DTAA between India and Singapore was made. If static interpretation has to be given, then the case of AO does not rest because of non-existence of the definition of 'process' at the time of signing the DTAA. The ITAT has proceed to examine the said question by making a reference to the Honourable High Court judgment in the matter of Siemens Aktiongesellschaft (supra), which laid down that the interpretation should be in ambulatory/dynamic instead of static.

The Honourable High Court in the matter of Siemens Aktiongesellschaft (supra) was caught up with definition of term 'royalty'. The said term was not been defined in the Old India – Germany Tax Treaty[12] and for definition of such terms which were not defined in the old treaty, the Article II(2) stated that the terms not defined in the old agreement will have the meaning which it has under the ***laws in force*** in that territory. In light of the specific reference to '***laws in force'*** which was used in the old tax treaty, the Honourable High Court has held that the definition not laid down in the old agreement can be understood by reference to the legislation which are in force as on the date of such invocation of Article II(2), accordingly it held that the interpretation to be ambulatory/dynamic but not static. In other words, if the judgment of Honourable High Court is applied to the current instance, the definition of 'process' would apply, since the said definition was under IT Act as on the date of making payment by Jio India to Jio Singapore.

However, the ITAT made a distinction from the above judgment of Honourable High Court in light of the absence of the phrase 'laws in force' in Article 3(2) of India – Singapore DTAA. The ITAT after examining the language used in Article 3(2) has held that, since the said article does not anywhere uses the phrase 'laws in force', the said article cannot be deemed ambulatory/dynamic rather to be treated as static. The ITAT further held that retrospective amendments to the domestic law and thereby proposing that such amendments would override treaty provision leads to non-observance of Article 26 of Vienna Convention on Law of Treaties which provides that, 'Pacta sunt servanda: every treaty in force is binding on the parties to it and must be performed by them in good faith' and accordingly held that no matter how desirable or expedient it may be from the perspective of the tax administration, when a tax jurisdiction is allowed to amend the settled position with respect to a treaty

[12] (1960) 40 ITR (St) 21

provision, by an amendment in the domestic law and admittedly to nullify the judicial rulings, it cannot be treated as performance of treaties in good faith.

The ITAT has held that therefore it requires an additional test that is required to be put, while adopting an ambulatory interpretation in such a situation, is whether the amendment is domestic laws end up unsettling a conclusion arrived at under the pre domestic law amendment position that is, reversing the rulings in favour of residence jurisdiction, and if the answer is positive, the ambulatory approach has to be discarded, since adoption of the same would lead to violation of Article 26 of Vienna Convention on Law of Treaties.