

# Incoherence in applying international tax law: hemorrhaging development

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Published online: 23 August 2016

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**Abstract** This paper critically analyses the much discussed judgements of the Supreme Court of India in the *Azadi Bachao Andolan* and *Vodafone* cases. These decisions have generated much discussion, at least in part, because they were instances where a developing country court has had an opportunity to possibly challenge the pre-eminence given to investments (existing division) in international tax law. However, the court ended up relying heavily on the principle of efficiency (a principle developed to facilitate capital exporting nations) to arrive at its decisions. Although the court did mention development in the former case, and despite the opportunity to develop or even discuss it in the latter case, it was overlooked. Also, in both these cases the court has ruled out its role in creating international tax law or even to attempt a purposive interpretation. This analysis opines that the principle of efficiency does not cohere with development and the decisions of the court reify its belief that investments automatically lead to development. Importantly, it has forgotten that tax revenues are desperately needed by the state, and therefore it is time for a division based on equity (entitlements). It is also argued that such a division based on equity would cohere with the efficiency and therefore be neutral and fair.

**Keywords** Double taxation agreement · Equity · Efficiency · Coherence · Entitlements · Development

## 1 Introduction

With globalisation and the increased flow of capital to developing countries, it can be said that International Tax Law (ITL) has begun to emerge from its youthful state. Thus, awareness about its

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deployment is only growing in developing countries. However the widely read decisions of the Supreme Court (India) in the *Azadi Bachao Andolan*<sup>1</sup> and *Vodafone*<sup>2</sup> cases have provided a rare opportunity, in fairly quick succession, to analyse the deployment of ITL within a developing country.

Historically none of the present day “developing”<sup>3</sup> countries played any significant role in moulding these tax laws, ‘nor were these laws made for a globalised world’<sup>4</sup>; yet the developing countries have had to play by these very laws. Thus it is widely accepted that to make the present tax laws balanced (equitable division/inclusive of developing country perspectives), changes are needed, especially to the principles of tax division. Importantly, the differing<sup>5</sup> underlying “reasons”<sup>6</sup> adduced for such an overhaul highlights the “disparate interests” as well.<sup>7</sup> The nature of these interests are best captured in the title to the United Nations (UN) Double Taxation Model Convention – ‘between Developed and Developing Countries’. This not only helps contextualize the debates for an overhaul of international tax laws, it also warns of the differing interests therein. Hence, it is safe to assume (established later) that the present international tax division could be skewed in favour of the main capital exporting nations (efficiency perspective). But, even the attempts under the auspices of the UN (perceived as a global tax apparatus<sup>8</sup>) to help developing countries find additional resources for

<sup>1</sup> *Union of India and Another v Azadi Bachao Andolan*, 56 ITR 563 (2003).

<sup>2</sup> *Vodafone International Holdings BV v Union of India and Another*, 6 SCC 613 (2012).

<sup>3</sup> Admittedly there exists various methods/formulas to determine or define a developing country, but it is generally accepted that it is a continuum concept. Moreover, the scope of this paper would not permit a discussion about such a criterion. However, developing country, as used here, refers to India or states similarly situated – where there is a huge requirement for revenues to develop human resources and infrastructure.

<sup>4</sup> The Base Erosion and Profit Shifting (BEPS) initiative points to this reality; refer to, Organisation for Economic Cooperation and Development (OECD), *Addressing Base Erosion and Profit Shifting* (OECD Publications, Paris, 2013) [5–7] <[http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-base-erosion-and-profit-shifting\\_9789264192744-en#page3](http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en#page3)>.

<sup>5</sup> The absence of an equitable division is a matter that needs consideration because the present principles work only when the flows of capital between the jurisdictions are relatively balanced, and in reality the flows are unbalanced; refer to, Arthur J Cockfield, Purism and Contextualism within International Tax Law Analysis: How Traditional Analysis Fails Developing Countries, 5 *eJournal of Tax Research* (2007) 200–201.

<sup>6</sup> The BEPS Report wants changes because in the present globalised context, the rules do not favour efficiency; refer to, OECD, *supra* note 4, 35.

<sup>7</sup> Asif H Qureshi, Perspectives in International Economic Law – An Eclectic Approach to International Economic Engagement, in, Asif H Qureshi (ed) *Perspectives in International Economic Law* (Kluwer Law International, London, 2002) 27.

<sup>8</sup> What started off (1967) as an ad hoc working group with persons acting in their personal capacity has subsequently become the UN Group of Experts, and finally in 2005 has been upgraded as an UN Committee; refer to, Michael Lennard, The Purpose and Current Status of the United Nations Tax Work, 14 *Asia-Pacific Tax Bull* (2008) 23–24.

“development” does not directly address the issue of an inequitable division in international taxes.<sup>9</sup>

Thus, it is important that developing countries play a pro-active role in reorienting the present tax laws to collect a higher share of the taxes based on entitlements (here considered as equity). The argument raised here is that, ‘for such an equitable division, entitlements are to be linked to the territory and not the person’ (as discussed in Section 3.2). The present tax laws are not focussed on equity, and although not equating equity to formulary apportionment, and talks on such apportionment have not worked. Similarly, for an equitable division to happen, the law creating process has to become “participatory and fair”.<sup>10</sup> Incidentally, the law making through the UN has been sporadic and the Organisation for Economic Cooperation and Development (OECD) does not have to take care of the interests of non-members. Thus using the existing law making processes to create substantive equity has proved unachievable. It is in this context the need to create international practice (requirement of custom) through “national courts”<sup>11</sup> becomes important. This also implies that a re-negotiation of tax treaties or even a multilateral tax treaty could wait.

As has been noted,<sup>12</sup> the success of juridical formalisation is merely legal organisation giving explicit form to a tendency already immanent in practice, or it is seen that such rules are backed by factual situations consonant with them<sup>13</sup> as well. Thus, to reorient tax laws to favour developing country perspectives, there is need for more developing countries to support such practice (not just through judicial formalisation, through academic literature and political support) which relies on a perspective of entitlements linked to development. Also, such practice would help create a common understanding of such tendencies or values, and thereby help limit the indeterminacies attached to legal formalism.

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<sup>9</sup> It only says, Globalisation should be inclusive and equitable (wording is not categorical), and it calls for a holistic approach to achieving financing for development; refer to, United Nations, Report of the International Conference on Financing for Development, A/CONF.198/11, [2] <<http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N02/392/67/PDF/N0239267.pdf?OpenElement>>.

<sup>10</sup> Fair decisions can be arrived at by making such decisions in an original position and behind a veil of ignorance; refer to, John Rawls, *Political Liberalism*, 2nd edn (Columbia University Press, New York, 2005) 304–307.

<sup>11</sup> It forms part of the legal structure that could provide legitimacy as well as an evolutionary roadmap; refer to, Thomas M Franck, *Fairness in International Institutions* (Clarendon Press, Oxford, 1997) 7.

<sup>12</sup> Pierre Bourdieu, The Force of Law: Toward a Sociology of the Juridical Field, 38 *Hastings L J* (1987) 848.

<sup>13</sup> *Ibid*, 849.

However, if this did not happen, in such situations where the law is “unsettled”,<sup>14</sup> there would be a tendency among the ‘rising or dominant groups to impose as official, the social world which sustains their own world view or which favours their interest’.<sup>15</sup> The analysis of these two cases would show how a paucity of research espousing the cause of “equity” (development) has helped “efficiency” occupy centre stage, and also perpetuate such a perspective. Undoubtedly, this has influenced policy discourses in developing countries as well and the Supreme Court’s reliance on “efficiency”<sup>16</sup> in the *Vodafone* case exemplifies this. Importantly, in doing so, the court has not only relied on an economic principle which is beyond its domain of expertise, but it has also rejected the need for an equitable division.

The following discussion progresses as follows: Section 1 analyses the Supreme Court decisions in the *Azadi Bachao Andolan* and *Vodafone* cases, to highlight how the decisions completely ignore the aspect of higher revenue share and focusses only on supporting investments. Similarly, this section also critically analyses the arguments adduced by the court to support its decision to show how they lack legitimacy due to a lack of reflecting shared values. In Section 2, the disparate elements of IEL, especially ITL and International Development Law (IDL), as components of International Economic Law (IEL) are discussed. This is done to highlight the importance of coherence and thereby borrow into the principles of IEL to support new practice. Therefore, this section also analyses the way forward, by putting forth the requirements and justifications in creating new practice. Here, the present system of principles based laws within ITL is discussed, and the idea of “coherence”<sup>17</sup> implicit to both ITL and IEL is explained. The discussion

<sup>14</sup> Is used to refer to the transitory state of ITL, when compared to some of the other branches of IEL or Public International Law. Also unsettled is used here in some ways to refer to the nature of the norm (non-legal enforcement), and this is true of ITL. But, in such situations since it is the main transactors who develop a norm, their choices are also bound to be reflected in such norms; refer to, David Charny, *Illusions of a Spontaneous Order: Norms in Contractual Relationships*, 144 *Univ Pennsylvania L Rev* (1996) 1844–1845.

<sup>15</sup> Bourdieu, *supra* note 12, 848.

<sup>16</sup> Efficiency has been discussed very briefly in Section 3 (lowering the tax rates, thereby helping investments get a better rate of return) while discussing ITL, but it should be clarified here that by avoiding double taxation, the Double Taxation Agreements are seen as an efficiency enhancing instrument, and the DTA does this as well. However, its ability to attract investments, singly, is suspect or unproven empirically, and it is on this capability that the Supreme Court has relied; for a discussion on the ability of DTAs to attract investments, refer to, Lisa E Sachs & Karl P Sauvnt, *BITs’, DTTs’, and FDI flows: An Overview*, in, Karl P Sauvnt & Lisa E Sachs (eds) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (OUP, Oxford, 2009) lix.

<sup>17</sup> It means the justifications provided to the existing legal materials (statutes, decisions, and rules) by principles, policies and purposes; refer to, Joseph Raz, *The Relevance of Coherence*, 72 *Boston Univ L Rev* (1992), 284, 285. Also, a law is coherent if it could be explained by a consistent set of principles and policies; refer to, Ronald Dworkin, *Taking Rights Seriously* (Duckworth, London, 1996) 90–100, 294–327.

also argues that pursuing efficiency singly to achieve higher investments levels would not lead to higher tax collections or an equitable share. Section 3 analyses the fault lines as seen from the discussion of the two cases and the state of ITL. Apart from summoning a strong argument for promoting practice through national courts based on the principle of “equity”, it is argued that such a vision would also cohere with the principle of “equity” borrowed from IEL, and the idea of “development” mentioned by the Supreme Court in the *Azadi Bachao Andolan* case as well.

## 2 Problematising the decisions

To recall some of the main observations made by the court in relation to the two decisions, namely the *Azadi Bachao Andolan* and *Vodafone* cases. The *Azadi Bachao Andolan* case relates to the misuse of the Double Taxation Agreement (DTA) signed between India and Mauritius. The misuse in question related to the use of the said treaty by the nationals of third nations – treaty shopping. Hence the key contention in this case was that third country nationals were not entitled to the benefits of the Indo-Mauritius DTA. While considering this argument, the Supreme Court held that it could not offer any relief in such instances, unless a Limitation of Benefit (LoB) clause is incorporated into the DTA by the respective states. Importantly, the court also observed, ‘there is nothing like “equity” in a fiscal statute [...], the statute applies *proprio vigore* or it does not’.<sup>18</sup> The court therefore declined to take up the responsibility of rectifying the law to achieve equitable taxation.<sup>19</sup>

Also, the court clarified that several considerations could have played a role in the negotiation of a tax treaty,<sup>20</sup> or simply put – political expediency. Although the court did not say that the Indo-Mauritius treaty was aimed at promoting treaty shopping, but it impliedly accepts this position. The court does this by accepting the position that the promotion of trade and investment mentioned in the preamble to a DTA has to be considered in interpreting the treaty.<sup>21</sup> It is this acceptance that allows the court to justify the impugned administrative Circular (No.789 F.No.500/60/2000-FTD Government of India Ministry

<sup>18</sup> *Azadi Bachao Andolan*, *supra* note 1, 29.

<sup>19</sup> *Ibid*, 31, 32.

<sup>20</sup> *Ibid*, 33.

<sup>21</sup> *Ibid*, 33.

of Finance, Department of Revenue, Central Board of Direct Taxes) which clarified the meaning of “residence” under the Indo-Mauritius DTA, and thereby enabled the treaty shoppers to take advantage of the said DTA. Importantly, the court concludes that “treaty shopping” is justified and could be tolerated because it helps attract foreign investments and thereby “development”.<sup>22</sup>

In the *Vodafone* Case, a Cayman Islands registered company transferred its shares to Vodafone, a Dutch Company; due to this transfer, the Dutch Company comes to hold shares of Mauritius registered companies which in turn held shares of an Indian Company. The court at the outset itself says that this case is not about treaty shopping but anti-avoidance.<sup>23</sup> The Revenue Authorities in India contended that although the sale happened outside India, there was a taxable transfer of capital in India. However, the court said that Section 9 (1) (i) of the Indian Income Tax Act of 1961 allowed for taxation of income deemed to accrue or deemed to arise in India, and includes only income from direct transfer of capital assets situated in India. Therefore, if a non-resident transfers assets within India, the income from that would be classed as accruing within India, or by Section 5(2) – it would be classed as income<sup>24</sup> for tax purposes. However, the court concluded that these provisions did not allow for the taxation of “-indirect transfers”, as in the present case, although a capital transfer is effected in India.<sup>25</sup> Since the sale of shares happened outside the “territorial” confines of India, it did not give rise to a taxable income within India.<sup>26</sup>

Such an interpretation, the court says is essential for the attraction of FDI and for efficiency – “certainty” of tax laws.<sup>27</sup> It also said that a transaction (inflow of FDI) should be looked at in its entirety, hence the “look at” test is the more appropriate one.<sup>28</sup> Therefore, business structures for tax evasion and genuine business purpose can be understood by looking at the duration for which the holding structure exists, the timing of exit, the “taxable revenues” in India, the continuity of business upon exit, etc.<sup>29</sup>

<sup>22</sup> *Ibid*, 34.

<sup>23</sup> *Vodafone*, *supra* note 2, 39.

<sup>24</sup> *Ibid*, 45 (The court concludes that this happens through a fiction as the receipt of such income is outside India and that such a fiction cannot be given purposive interpretation to include indirect transfer of assets).

<sup>25</sup> *Ibid*, 44–46.

<sup>26</sup> *Ibid*, 93.

<sup>27</sup> *Ibid*, 94.

<sup>28</sup> *Ibid*, 40.

<sup>29</sup> *Ibid*, 41.

But by looking at these two decisions, one question becomes obvious. What are the overriding factors to be considered while adjudicating on a dispute related to international taxation? Is it the appropriateness of the test to be applied or the objectives of taxation that takes primacy; should the issue of tax avoidance or treaty shopping be applied in a way it suits the taxing jurisdiction; should such taxation be seen as a facilitator of development; is the goal only to get maximum investments at any cost? Similarly, a certain philosophy within these decisions also becomes visible. First, primacy is being accorded to foreign investors and investments, and yet argues for development. Second, the court is unwilling to go beyond the paradigm of “efficiency” (an economic principle) in the interpretation and implementation of ITL and ignores equity. Third, the court does not see itself as a lynchpin in the creation of ITL and abdicates this role to the legislature.

As far as the *Azadi Bachao Andolan* case is concerned, there was not much opposition to the decision from the businesses and tax practitioners, unlike the decision of the High Court in the *Vodafone* case, where it was found against *Vodafone*. Incidentally, in the *Azadi Bachao Andolan* case the Supreme Court by upholding treaty shopping has inadvertently upheld tax evasion utilising tax havens. However, it should be remembered that tax evasion and the role played by the tax havens in investments are opposed by the OECD and the UN. Yet, there has been limited opposition to this decision which supports treaty shopping via tax havens. But, although, the reasoning given by the court for accepting “treaty shopping” is contentious, it is interesting - developing countries could allow treaty shopping as it facilitates “development”. Hence it is incumbent on us to understand the threads of “development”, “treaty shopping” and “tax avoidance” interwoven into these decisions as well.

## 2.1 Analysing the philosophy of the court

First, while deciding in *Azadi Bachao Andolan*, the Supreme Court does acknowledge that there is an outflow of revenue due to the non-taxation/ taxability of the incomes generated from foreign investments.<sup>30</sup> Yet, in both *Azadi Bachao Andolan* and *Vodafone*, relying on the observation in an English case,<sup>31</sup> the Supreme Court stresses (perhaps

<sup>30</sup> *Azadi Bachao Andolan*, *supra* note 1, 132.

<sup>31</sup> *IRC v Duke of Westminster* 1936 AC [1].

correctly) that it is neither able to call such minimisation of taxes as evasion (colourable)<sup>32</sup> nor effect a change in policy, thereby showing its adherence to the belief in “development” based on the smooth (efficient) inflow of foreign investments.

Second, on the question of using tax havens to make investments; the court in *Azadi Bachao Andolan* make no mention about it, although Mauritius is a well-known tax haven. But, in *Vodafone*, the court clarified that the present case was about tax avoidance, while the *Azadi Bachao Andolan* was about treaty shopping. Here it is appropriate to ask; is there any similarity between the two cases in “effect” and “operation”? Well, in the *Azadi Bachao Andolan*, a third person had used the opportunity provided by the tax haven to create a structure and reduce tax payments. Whereas, in *Vodafone*, a share transfer happens outside India whereby it affects the ownership of an Indian subsidiary, and as a result no taxes have to be paid in India. Thus, for a capital importer, both the cases offer the same effect; yet the Supreme Court dismisses this as the result of government policy. Therefore, in both these cases it is the reduced incidence of taxation using a tax haven that is at the heart of the issue – whether it is called as tax avoidance or treaty shopping.

Additionally, in the *Vodafone* case, the Court went further to explain the logic to explain whether a structure is principally for avoidance and hence an artificial device. To reach such a conclusion, the court set out certain requirements; for example, the duration for which the holding structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on exit are all crucial in deciding the corporate business purpose of a transaction.<sup>33</sup> So, as long as a transaction is “preordained” it signals avoidance, and when the transaction is an ‘investment to ‘participate’ it would not be avoidance’.<sup>34</sup> For this the court relies on the “look at approach” (at the entire transaction), and the court even goes on to suggest that the “taxable revenue” paid in India could be a criterion. Yet, despite the best efforts by the court to explain that a structure was not pre-ordained, a visible disconnect is evident between the logic applied in the two decisions. Hence, it is important to apply its formula to the facts in the *Azadi Bachao Andolan* case to better understand this disconnect.

<sup>32</sup> *Azadi Bachao Andolan*, *supra* note 1, 35.

<sup>33</sup> *Vodafone*, *supra* note 2, 41.

<sup>34</sup> *Ibid*, 51.



Applying the formula – if the “taxable revenue” criterion from the *Vodafone* case is considered, this would contradict the decision in the *Azadi Bachao Andolan* case because there was nil or next to no taxes paid in this latter. Moreover since Foreign Institutional Investments (FII) is untaxed globally, using the DTA with Mauritius does nothing more (as in the *Azadi* case). Does this mean that the transaction in *Azadi Bachao Andolan* was tax avoidance or was it not? In fact the court disregarded this issue completely behind the development argument. It is therefore easy for one to see the incoherence in the arguments laid by the same court on similarly structured transactions in the two cases. Though it is difficult to say how the court could reach such a formula, it is but reasonable for the court to say that every person has a right to use legal methods to pay lower taxes and thus the Mauritius route.

Therefore, it is another thing for the court to conclude that the Mauritius route was not used by the investor as part of a “preordained” transaction, but only as a method for investments to participate in India. Such a conclusion seems plausible, only when the transaction is looked as a whole, or from a country perspective to promote investments. Importantly, the reasoning of the court to favour *Vodafone* shrinks to its observation that the Revenue Department “vacillated”<sup>35</sup> and thus adopted a “dissecting” and not a “look at approach”. Hence the efficacy of this formula for future application is attenuated. Also, a note of caution is in order here; although the court does distinguish between Foreign Direct Investment (FDI) and FII,<sup>36</sup> perhaps it has not given much thought to their vastly different effects<sup>37</sup> on tax revenues and hence for development.

This also makes it evident that the court has relied on an underlying vision of “development”, of virtually equating investments to development. As a corollary of this belief, it also implies that investments would happen only if they are “efficient” (certainty). But in reality, this also means, investments to a state “Y” from state “X” would happen only if the returns are above the rate what the investments could have derived in its home state “X” or in another jurisdiction. This is controlled by the market and it is questionable whether the court does have a role to play in this?

Third, the Supreme Court has been willing to limit its role in the growth of IITL; in the *Azadi Bachao* case the court said that unless there are LOB provisions in the treaty, the court could not read such provisions into the

<sup>35</sup> *Ibid*, 50.

<sup>36</sup> *Vodafone*, *supra* note 2, 181.

<sup>37</sup> Ruud A de Mooij & Sjef Ederveen, Taxation and Foreign Direct Investment: A Synthesis of Empirical Research, 10 *Intl Tax & Pub Finance* (2003) 675.

treaty to prevent its abuse. Similarly, in the *Vodafone* case, the Supreme Court has said that the Income Tax Act does not tax indirect transfers and hence tax was not payable. But, as would be seen in Section 3, the national courts have a role to play in the development of International Tax Law. Therefore, from the *Vodafone* case another conclusion is also possible; the Supreme Court has followed the *Azadi Bachao Andolan* case to apply treaty as it is.

To better understand the “analysis” relied upon by the court in arriving at its decision and also to understand whether the present ITL favours countries such as India, an analysis of the fundamental principles and structure of ITL is necessary. As is known, there is a bit of economics, politics and law involved in the application of ITL, and this happens because it is part of IEL. Thus an understanding of ITL in relation to IEL becomes an imperative.

### 3 International economic (development & tax) laws

International Tax Law is part of International Economic Law<sup>38</sup> and the latter deals with the laws and customary practices that govern the economic interactions between actors in different nations.<sup>39</sup> So generally, IEL is considered to subsume both the private and public international law aspects.<sup>40</sup> But more importantly, since the economic relations cover disparate areas, the normative frameworks in the different areas are interlinked and this calls for a holistic approach to the legal issues in economic relations and should not be weighed down by any one of those disparate areas.<sup>41</sup> Thus from a legal standpoint, it is necessary to cultivate a method to participate in the international economic order in a manner which partakes of all the international economic legal frameworks,<sup>42</sup> and such an approach is still in its infancy. Nonetheless, it would be uncontroversial to shape IEL from a chosen perspective from which it is viewed or in relation to the international economic order. For, a description of IEL also means how economic phenomena are perceived and shaped – development of international economic order.<sup>43</sup>

<sup>38</sup> Stephen Zamora, Is There Customary International Economic Law?, 32 *German Yrbk Intl L* (1989) 15.

<sup>39</sup> Stephen Zamora, International Economic Law, 17 *Univ Pennsylvania J Intl Econ L* (1996) 63.

<sup>40</sup> The concept of IEL can be conceived as a branch of Public International Law (narrow definition) and also as including all branches of law concerned with the economic phenomena of international concern (broad definition); refer to, Asif H Qureshi & Andreas R Ziegler, *International Economic Law*, 3rd edn (Sweet & Maxwell, UK, 2011) 8, 9.

<sup>41</sup> *Ibid* 6–7.

<sup>42</sup> *Ibid*, 7.

<sup>43</sup> *Ibid*, 9.

Although international economic order can be analysed from different perspectives, with globalisation a “welfare” perspective becomes relatively more important. Since taxation and development play a significant part in achieving welfare, it is important to understand them within the whole or as elements of IEL. For example, ITL concerns the national taxation of incoming and outgoing cross-border transactions, it is part of IEL; thus an analysis of ITL generally or from a particular perspective should cohere with the other elements of IEL as well. Importantly, ITL also seeks to eliminate double taxation, as it can burden the investor and the flow of trade. It also looks at the counter point to this; the tax incentives provided to attract investments can distort investments and thereby efficiency or “tax competition”.<sup>44</sup> Similarly, although ITL may be analysed from a development perspective, and such a perspective should also cohere with efficiency. If the different perspectives are all unified in a law, it means the law is coherent and such a law is both neutral<sup>45</sup> and fair.<sup>46</sup>

### 3.1 International development law

International Development Law (IDL), another aspect of IEL, looks into the methods and laws to facilitate development. Although development is mostly concerned with developing countries, the discourse on IDL has involved the question of rights and duties states have in relation to the development process. Yet, in relation to this development process, consensus on two issues has been elusive – the rights and duties of nations and “redistribution”.<sup>47</sup> However, IDL and the development debate suffers from two shortcomings. First, there is a dearth of analysis by writers from developing states focussing on the disparate areas of

<sup>44</sup> The discourse on tax competition can have two strands of arguments – first, competition is generally considered better because it helps lower prices and tax rates, but there is also a counter argument. The lower taxes are offered by the capital importer and hence drives investments to places not on the basis of comparative advantage, but on the basis of taxes – thereby being inefficient. Moreover, the capital importer collecting lower taxes would lead to lower levels of development and force the other developing countries to lower their taxes as well; hence we have “beggar thy neighbour arguments”.

<sup>45</sup> Martin Krygier, *Law as Tradition*, 5 *L & Philosophy* (1986) 253.

<sup>46</sup> Ronald Dworkin, *Laws Empire* (Fontana, London, 1986) 219.

<sup>47</sup> Qureshi & Ziegler, *supra* note 40, 617. Regarding redistribution this can happen only within a community and that is because the society has helped those persons achieve through the contribution of the other as well; refer to Alexander W Cappelen, *he Moral Rationale for International Fiscal Law*, 15 *Ethics & Intl Aff* (2001) 98. Thus in such societies inter-individual equity is the basis of tax division because through such division there is redistribution – Nancy H Kaufman, *Fairness and the Taxation of International Income*, 29 *L & Pol Intl Bus* (1997) 152. But since there is no real redistribution in the present globalised economy and hence evidence that a global community remains unrealised – Francois Bourguignon, Victoria Levin & David Rosenblatt, *International Redistribution of Income*, 37 *World Dev* (2009) 7.

IEL<sup>48</sup>; thus only areas of relevance to certain interests have been highlighted. Consequently, as of yet, there is no constitution or institutions for IDL. Therefore, the growth of a development perspective has been led by interests and biases within other areas of IEL (notably trade).<sup>49</sup>

Second, although there has been some forward movement on the rights and duties debate related to international development law, it still remains inconclusive. This is largely because the present laws favour capital and thus without the cooperation of the nation's controlling it there would be no forward movement in this debate. Even though the fundamental yardstick of the need based rights is "entitlements",<sup>50</sup> it is but important to remember that the entitlements (discussed in the next section) in relation to ITL are not need based, but rights linked to the territory. However, in the present IDL discourse, "preferential treatment" has been adopted to bridge the gap in the levels of development and its linkage to the "welfare state"<sup>51</sup> has meant that meeting of the minimal human needs would be sufficient. Consequently, this has meant that economic assistance / aid<sup>52</sup> is accepted as enabling the achievement of these minimal needs.

Globally, this has led to the growth of interventionist (top down) policies to achieve development and thereby a sidelining of market forces. As a result, the focus has not been on the content of development law, but on a programmatic agenda.<sup>53</sup> This resulted in policies and programmes being hampered by a lack of financial resources,<sup>54</sup> and where implemented proved incapable of using the aid effectively.<sup>55</sup> Simply put, the lack of institutional or procedural justice has hampered the development of substantive IDL as well. As would be

<sup>48</sup> Qureshi & Ziegler, *supra* note 40, 620.

<sup>49</sup> *Ibid*, 7.

<sup>50</sup> Borrowing from the debates within the International Law of Development, where entitlements means rights based on needs; refer to, Oscar Schachter, *The Evolving International Law of Development*, 15 *Columbia J Transnatl L* (1976) 10.

<sup>51</sup> There are different variations of this concept, but the basic understanding is that the state responsibility for those unable to avail themselves of the minimal provisions for a good life through equality of opportunity (social security benefits) and equitable distribution of wealth (progressive taxation).

<sup>52</sup> With aid, the problem is that, it can be seen as a zero sum game because it is seen as a one-way process and much of its benefits are whittled away by trade restrictions; refer to, Bourguignon et al, *supra* note 47, 3, 7.

<sup>53</sup> This refers to the poverty alleviation programmes initiated by the International Financial Institutions; refer to, Qureshi & Ziegler, *supra* note 40, 619.

<sup>54</sup> Mohan Giles, Edward D Brown, Bob Milward & Alfred B Zack-Williams, *Structural Adjustment: Theory, Practice, Impacts* (Routledge, London, 2000) 120.

<sup>55</sup> David Dollar & Jakob Svensson, What Explains the Success or Failure of Structural Adjustment Programmes, 110 *The Economic J* (2000) 897.

seen in the next section, ITL is still developing, and the state of the law calls for a different approach to make it work for development. It is therefore suggested that a better option is to borrow into the principle of “duality of norms”,<sup>56</sup> which would enable the differential application of laws to states on the basis of their levels of development. So this section shows that the blind belief of the court in investment automatically leading to development seems misplaced.

### 3.2 State of international tax laws

The principal source of ITL is the multitude of bilateral DTAs<sup>57</sup> – instruments designed to limit “double taxation”.<sup>58</sup> These DTAs owe much of their provisions either to the UN or the OECD Model Tax Conventions (MTC). Importantly, the MTCs contain mere standards<sup>59</sup> rather than rules, whereby the meaning of these standards are uncertain and require “interpretation”.<sup>60</sup> Consequently the meanings have to be determined ex-post, by case law or a functional equivalent of case law.<sup>61</sup>

The principal role of a DTA is to limit the taxing power, or to divide the taxes between the jurisdictions.<sup>62</sup> These limits are reached through a bargain before the conclusion of such treaties. Moreover, international law does not prohibit double taxation, because jurisdiction to tax unlimited as it is derived from sovereignty and this in turn is territorially linked.<sup>63</sup> But the working of ITL is slightly different in that it allows extra-territorial taxation provided there is an economic/sufficient link between the tax payer and the taxing state. This principle was developed by the League of Nation’s Experts (Experts)<sup>64</sup> to divide the

<sup>56</sup> A key concept to understanding the background to a legal definition of a developing country is the duality of norms; refer to, Guglielmo Verdirame, *The Definition of Developing Countries under GATT and Other International Law*, 39 *German Yrbk Intl L* (1996) 166.

<sup>57</sup> Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 *Intl Tax 7 Business Lawyer* (1986) 7. (none)

<sup>58</sup> There are two types: “juridical”, where the same tax payer is taxed in two jurisdictions on the same subject matter and “economic” when the same economic transaction is taxed in two jurisdictions during the same period but to different persons.

<sup>59</sup> Although only the OECD MTC is considered, the same would apply to the UN MTC as well; refer to, Eduardo Baistrocchi, *The Transfer Pricing Problem: A Global Proposal for Simplification*, 59 *Tax L* (2006) 944.

<sup>60</sup> John A Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 *Washington L Rev* (1993) 16.

<sup>61</sup> Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 *Duke L J* (1992) 560.

<sup>62</sup> Vogel, *supra* note 57, 8.

<sup>63</sup> Asif H Qureshi, *The Freedom of a State to Legislate in Fiscal Matters under General International Law*, 41 *Bulletin for International Fiscal Documentation* (1987) 14.

<sup>64</sup> League of Nations, *Report on Double Taxation Submitted to the Financial Committee – Economic and Financial Commission*, League of Nations, Doc. E.F.S.73.F.19 (1923) 20.

total income between the competing states according to the investor's economic interest under each authority. Four considerations were taken into account to explain this principle,<sup>65</sup> and of these the experts gave "primacy"<sup>66</sup> to the place of origin of the wealth and residence of the owner of the wealth.

Without delving into the historical reasons for the present rules or the conclusion reached by the Experts, it is important to focus on the principles that help divide international taxes. First, the principles of "source" and "residence" - they play a crucial role both in the division of international taxes and for "rulings on double taxation".<sup>67</sup> A "source" state means one where the actual activity from which the income generated happens, or where value is added to the good.<sup>68</sup> In fact there could be various factors that adds value or causes increase in wealth and labelling one of them as "source" is a juridical act.<sup>69</sup> On the other hand, a "residence" state means the state where the tax payer is normally resident or domiciled. But in bilateral treaties, source is allowed to tax (Art 23 A and B of the Model Conventions) because a deduction or exemption is allowed by the resident state. Therefore, it would not be wrong to accede to the view that the 'tax payers residence is given the exclusive or primary right to tax income while the source has little or no right to tax such income'.<sup>70</sup> Apart from the historical fact of the few states involved in international investments, a plausible reason could be the 'desire of the Experts to ensure the application of progressive income taxes to the world-wide income streams of the tax payer'.<sup>71</sup> This seems plausible, because the Experts had admitted that the 'lack of reciprocal flows between the treaty partners due to the differing levels of development could only be rough justice'.<sup>72</sup> But, if there are

<sup>65</sup> Ibid, 22–23; the place of — a) acquisition of wealth (where wealth originates); b) location of wealth (situs of wealth); c) enforceability of rights to wealth (place providing legal apparatus to rights regarding wealth) and d) consumption of wealth (place or residence/domicile of the investor).

<sup>66</sup> Ibid, 25.

<sup>67</sup> Klaus Vogel, State of Residence May As Well Be State of Source – There is no Contradiction, 59 *Bull Intl Fisc Doc* (2005) 420.

<sup>68</sup> Klaus Vogel, World-wide vs Source Taxation of Income – A Review and Re-evaluation of Arguments, (Part - I), 8-9 *Intertax*, (1988) 225. This definition is slightly different from the notion espoused by the Experts; source means origin of wealth and residence means where the wealth is spent; refer to, League of Nations, *supra* note 62, 23.

<sup>69</sup> Vogel, *supra* note 67, 420.

<sup>70</sup> Charles R Irish, International Double Taxation Agreements and Income Taxation at Source, 23 *Intl & Comp L Q* (1974) 293.

<sup>71</sup> Cockfield, *supra* note 5, 203.

<sup>72</sup> Hence the Experts had called for reciprocal exemption of the tax payers from each jurisdiction; refer to, League of Nations, *supra* note 62, 42–51.

reciprocal flows of income between the treaty partners, then the principle used whether it is source or residence is neutral.<sup>73</sup>

Second, a principle related to source and residence – “efficiency” needs understanding. Any tax in cross-border transactions would pose questions of efficiency, but a “theoretical agreement”<sup>74</sup> on an optimal tax for such transactions has been unachievable to date. But, it is important to explain the principle of “efficiency” that is being spoken here. Here “efficiency” refers to the allocation of resources to the place where it derives the maximum returns, and not where it is most productive. Thus, despite incentives or tax holidays distorting production efficiencies,<sup>75</sup> it does help to attract FDI.<sup>76</sup> Moreover, the benefits for the capital exporters to invest abroad outweigh the benefits of investing within national boundaries.<sup>77</sup> Additionally, since outward and inward investments are not in competition with each other,<sup>78</sup> generally the Residence State offers tax credit based on “equity” between its resident tax payers<sup>79</sup> for the income they make either nationally or internationally (horizontal equity).

Thus, we arrive at a cognate concept of efficiency called – neutrality,<sup>80</sup> on which the present tax division heavily relies. Efficient investments also mean that they should be neutral, meaning it should not be tax differentials that decide investment choices. As Vogel says, it is almost like saying that taxes should have no impact on investments – a practical impossibility.<sup>81</sup> But, when “neutrality”<sup>82</sup> of investments is

<sup>73</sup> Irish, *supra* note 70, 295.

<sup>74</sup> Michael Keen & David Wildasin, Pareto-Efficient International Taxation, 94 *Am Econ Rev* (2004) 259.

<sup>75</sup> Alex Easson & Eric M Zolt, Tax Incentives, World Bank Institute (2002) [34] <[http://www.derecho.usmp.edu.pe/postgrado/maestrias/maestria\\_derecho\\_tributario/materiales/ciclo1/analisis\\_economico\\_impuestos/material/15\\_%20EassonZoltPaper.pdf](http://www.derecho.usmp.edu.pe/postgrado/maestrias/maestria_derecho_tributario/materiales/ciclo1/analisis_economico_impuestos/material/15_%20EassonZoltPaper.pdf)>.

<sup>76</sup> Even here the relationship is not clear cut; it works best for Multi-National Corporations from nations which give tax exemptions on foreign income; refer to, Alexander Klemm & Stefan Van Parys, Empirical Evidence on the Effects of Tax Incentives, WP/09/136 IMF Working Paper (2009) [21] <<https://www.imf.org/external/pubs/ft/wp/2009/wp09136.pdf>>.

<sup>77</sup> Michael J Graetz, Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies, 54 *Tax L Rev* (2001) 286.

<sup>78</sup> *Ibid*, 290.

<sup>79</sup> Kaufman, *supra* note 45, 152.

<sup>80</sup> Global neutrality is impossible to achieve and masks the protection of specific domestic interests; refer to, Tsilly Dagan, The Costs of International Tax Cooperation, Working Paper No 1-03, (January 2003) [3] <[http://www.biu.ac.il/law/unger/working\\_papers/1-03.pdf](http://www.biu.ac.il/law/unger/working_papers/1-03.pdf)>.

<sup>81</sup> Klaus Vogel, Worldwide vs Source taxation of income – A review and re-evaluation of arguments – II, *Intertax* (1998) 314. Similarly, the reasons for World-wide taxation have been generally accepted; refer to, Vogel, *supra* note 66, 220.

<sup>82</sup> Related to international taxation there are two neutralities: *Capital Export* and *Capital Import*. The former means taxes on exporters of capital from a country should be neutral so that the choice to invest abroad or at home is not based on taxes on income. The latter means investments in one country should be subjected to the same tax treatment.

analysed, it is again seen as being linked to “equity” amongst the tax payers within the capital exporting countries.<sup>83</sup> In fact, efficiency and economic allegiance as espoused by the Experts is also premised on inter-individual equity (progressive taxation).<sup>84</sup> Yet, in the literature (especially legal) there is seldom any discussion about “equity”.<sup>85</sup> It is important to remind the reader that inter-individual equity and the equity referred here are different. The former is intra-national and promotes world-wide (residence) taxation, and the latter is inter-nation equity promoting source taxation. But, as with all questions of fairness, it has been difficult to arrive at a consensus on the “normative” foundations for an equitable division of international taxes.<sup>86</sup> This is not to say that there has been no discussion for an “equitable” division of international taxes, especially with calls for “inter-nation equity”<sup>87</sup> (varies with income – vertical equity). The Musgraves also say that the use of legal principles like “residence” and “source” has made an equitable division of taxes further difficult, because the economists are inclined to view such division as a national loss or gain.<sup>88</sup> Importantly, “inter-nation equity” does help to highlight the context (sharing of revenues with the source state<sup>89</sup>) of its use, when national interests conflict.<sup>90</sup>

But, it should be reiterated here that international income is a “pie-concept”<sup>91</sup> (the production of Multinational Corporations happens with inputs from different states), where a neat division may be difficult. Therefore, as mentioned earlier, it is inequitable to persist with “residence” and its principal right to tax international income. Moreover, the primacy of residence is based on inter-individual equity which has limited application in a globalised economy.<sup>92</sup> Importantly, the provisions of the MTCs or DTAs do not call for a fair division of taxes. Additionally, the lack of an institutional structure means that the

<sup>83</sup> Kaufman, *supra* note 47, 152.

<sup>84</sup> League of Nations, *supra* note 64, 20.

<sup>85</sup> Cockfield, *supra* note 5, 200.

<sup>86</sup> Klaus Vogel, Worldwide vs Source taxation of income – A review and Re-evaluation of Arguments – III, 11 *Intertax* (1998) 393.

<sup>87</sup> Richard A Musgrave & Peggy B Musgrave, Inter-nation Equity, in, Richard M Bird & John G Head (eds) *Modern Fiscal Issues: Essays in Honor of Carl S Shoup* (University of Toronto Press, Canada, 1972) 63.

<sup>88</sup> *Ibid.*, 72.

<sup>89</sup> *Ibid.*, 69.

<sup>90</sup> Mitsuo Sato & Richard Bird, International Aspects of the Taxation of Corporations and Shareholders, 22 *Staff Papers – International Monetary Fund* (1975) 421– 423.

<sup>91</sup> Richard A Musgrave & Peggy B. Musgrave, *Public Finance in Theory and Practice* (McGraw-Hill Company, Singapore, 1989) 568.

<sup>92</sup> Kaufman, *supra* note 47, 152–153.



“procedural” element of fairness is also missing. But, as mentioned earlier, it is possible for the courts (in developing countries) to intervene and decide where the value was added.

Thus we have reached a point of explaining why an equitable division of international tax revenues should not be bogged down by questions related to the normative (value judgements) foundations, thereby leading to questions of rights and duties. The power to tax is attached to a territory as of right, although that could be disputed by another state; or it is an “entitlement”.<sup>93</sup> These entitlements can be considered as “rights” in a limited sense, because they entitle you to make claims and are protected by law.<sup>94</sup> Every territory which enjoys sovereignty enjoys inalienable entitlements<sup>95</sup>; they can only be lost either voluntarily or due to the force of the moral argument of the other. In fact, the Experts considered<sup>96</sup> economic allegiance (reasonable link) as reflecting entitlements and saw it as being separate from territory. But the fact remains that economic allegiance is merely a method to make taxation more effective and not a limitation on jurisdiction.<sup>97</sup> This is precisely the reason why there is no general rule of international law to avoid double taxation, unless there is a treaty. It is therefore visible that international tax division does not cohere with an equitable division based on entitlements. Therefore, there is a case to make equity a core principle in the division of international tax division. Such a division would not be based on the rights and duties debate, but on a re-examination of the inalienable rights lost in the evolutionary growth of the present tax laws.

#### 4 The way forward: coherence of tax laws

Finally, before we can achieve the objective of making “equity” as a fundamental principle of international tax division through practice, three issues require clarification. First, there is a need to create practice or understand the methods available to do it. Second, there is a need to understand the likely problems while interpreting international tax laws. Third, there ought to be coherence between such practice and the objectives sought by a state entering a DTA.

<sup>93</sup> Ronald Dworkin, *Taking Rights Seriously* (Duckworth, London, 1996) 188.

<sup>94</sup> Anthony D’Amato, The Concept of Human Rights in International Law, 82 *Columbia Law Review* (1982) 1114.

<sup>95</sup> Guido Calabresi & A Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 *Harvard L Rev* (1972) 1092.

<sup>96</sup> League of Nations, *supra* note 62, 47.

<sup>97</sup> Qureshi, *supra* note 63, 19.

First, as discussed earlier, since the treaties rely on the present tax rules and principles, extensive negotiation would be required to infuse equity as a tax principle. Similarly, efforts at the UN has not found much success that too cannot deliver in the short term. Hence adjudication is undoubtedly the best bet to create practice.

Second, as there is no global tax adjudicatory body, the national courts are sought to play this role. However, when national courts adjudicate they have to encounter the criticism of bias; hence the rules for interpreting such treaties also become important. Thus an idea about some of the problems of interpreting an international tax treaty is handy because our aim is to infuse the principle of “equity” anew and this would also help justify such an infusion.

Since many bilateral tax treaties are incorporated into the domestic laws, the same laws are applied globally. These bilateral treaties are based on model tax conventions. Although the commentaries and guidelines related to the model provisions are supplementary to the main texts, they still form part of the interpretative material to these treaties.<sup>98</sup> Importantly, the commentaries or guidelines to these MTCs are specific and more practical, and unlike the text they are not abstract but refer to concrete situations.<sup>99</sup> This overlaid nature of the basic text to these treaties is in addition to the local laws related to taxation; this situation calls for specialist skills<sup>100</sup> to understand these relationships and to find an interpretation that favours the cause of particular nations.

As mentioned earlier, despite the existence of treaties, the principles or standards inhering in them would require interpretation to expound them through case law or otherwise. But, indeterminacy of the laws can afflict any such interpretative exercise. First, language is socially constructed through interactions and the social context.<sup>101</sup> Thus the meaning can vary according to the linguistic contexts and may have to be settled through contests. Second, when laws are in the form of broad principles, it leads to uncertain regulation.<sup>102</sup> Moreover, as these principles (laws) are applied to achieve economic purposes like taxes,

<sup>98</sup> Sol Picciotto, Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation, 24 *S&L S* (2015) 166.

<sup>99</sup> *Ibid.*, 167.

<sup>100</sup> *Ibid.*

<sup>101</sup> Sol Picciotto, Constructing Compliance: Game Playing, Tax Law, and Regulatory State, 29 *L & Policy* (2007) 15.

<sup>102</sup> Principles are more influential in situations that require flexibility and rules for predictability. But principles could reduce uncertainty if they cohere with the other principles; refer to, Joseph Raz, Legal Principles and the Limits of Law, 81 *Yale L J* (1972), 838, 842.

there is an increasing tendency to comply with the letter rather than spirit/ creative compliance (for instance treaty shopping) of the law.<sup>103</sup> Third, these principles being norms, they involve a value judgement<sup>104</sup> and therefore should depend on the shared values (fair) and purposes that underlie the principle. This has implications for understanding creative compliance as well because such compliance could be the result of a differing view of the values it aims to promote.<sup>105</sup> These views about indeterminacy could help better analyse the processes involved in the creation of these tax laws and the behaviour of nations.

First, the OECD, the club of capital exporters, has been the main actor in the creation of the present tax rules. Thus the capital exporters were willing to enter into tax treaties on terms which benefit them. Second, as mentioned at the outset, there has been limited participation by much of the capital importers (developing countries) in the making of ITL. Yet, this has not held back coordination between the capital exporting and importing nations using these laws, and this despite the ‘symbolic power in the text’<sup>106</sup> having been captured by the capital exporters (through principles like “efficiency” and primacy of “residence”). Therefore, the laws and the commentaries have been presented as principled interpretation of the accepted texts or these principles have been shown to “cohere” with the texts and its objectives. Importantly, this has also helped bestow legitimacy to these laws.<sup>107</sup> Thus the objective of creating practice and promoting “equity” as a principle is to include the views of a larger group of nations and therefore to capture the power.

Second, to look at the objectives behind such a principle, the objective of a DTA is said to be the avoidance of double taxation and information exchange. But as the court has opined in the *Azadi Bachao Andolan* case, the developing countries can view DTAs as an instrument for “development” as well. As mentioned earlier, the Model Tax Conventions contain broad principles which need explication through case laws. This also implies that the considerations while determining a principle is not limited or arises because that principle is inherently so.<sup>108</sup> For instance, if one is looking at Art 3 (2) of the MTCs, the

<sup>103</sup> Picciotto, *supra* note 96, 170.

<sup>104</sup> Lon L Fuller, Positivism and Fidelity to Law: A Reply to Professor Hart, 71 *Harvard L Rev* (1958) 670.

<sup>105</sup> Picciotto, *supra* note 96, 173.

<sup>106</sup> Bourdieu, *supra* note 10, 818.

<sup>107</sup> Here legitimacy means the stability and the capability to change progressively; refer to, Franck, *supra* note 11, 7.

<sup>108</sup> Kaplow, *supra* note 61, 589.

implication of range of consideration would become clear – '[a]s regards the application of this convention... any term not defined therein shall, *unless the context otherwise require*, have the meaning that it has at the time *under the law of that state* for the purposes of the taxes to which the convention applies'. Hence the courts should be aware that the ambit of principles being wide, it would make the measurement of compliance difficult – implying compliance with the letter. It would therefore not be wrong to say that such compliance is seen in these two cases as well (using tax havens to reduce tax payments). Hence, although the court is supportive of investments for development, it should also be aware that this need not *per se* leads to higher taxes.

Importantly, new practice also gains legitimacy if such practice can be explained as achieving the objectives set to be achieved by a state while entering the tax treaty. Generally, there is an unsubstantiated belief that DTAs help attract investments, and therefore nations enter into DTAs. But it is worth remembering that investments include both FDI and FII and the latter remains untaxed because of its mobile nature. Similarly in economic theory, especially Keynesians<sup>109</sup> believe that tax cuts would lead to investments, leading to higher incomes which would then induce savings to fuel further reinvestments. This policy has been pursued by the International Monetary Fund and World Bank<sup>110</sup> as well and had to be subsequently altered.<sup>111</sup> Therefore, a blind adherence to the attraction of investments by interpreting a DTA by its letter rather than spirit would not lead to development.

Third, by supporting a division based on equity – would that lead to laws based on shared values? As seen earlier, present discussions about “equitable” division have been lost on the question of value added in a particular jurisdiction. Although such questions have been discussed they have been termed as being factual (example transfer pricing issues – it is difficult to exactly pin point which jurisdiction has added what amount of profit and all formulas have been proven to be unworkable). Looking at the decisions in the *Azadi Bachao Andolan* and *Vodafone* cases, it would not be wrong to infer that the court was unwilling to upset the MNCs. Thus although a formulaic sharing of taxes will elude immediate resolution, it is not a question to be pursued in the short term. On the

<sup>109</sup> Beryl W Sprinkel, Role of Monetary-Fiscal Policies, Increasing Understanding of Public Problems and Policies, *Policies* (1963) 15 <<http://econpapers.repec.org/article/agsiupapp/default13.htm>>.

<sup>110</sup> Peter Gibbon, The World Bank and the new politics of aid, 5 *European J Dev Research* (1993) 37.

<sup>111</sup> World Bank, *World Development Report 1999–2000: Entering the 21st Century The Changing Development Landscape* (OUP, New York, 2000) 25, 200–210.

contrary, the national courts would be better equipped to explain whether an “equitable” division would cohere with the purpose (development) for which a state enter a DTA and also the objectives that IEL aspires to achieve.

First, there is the scarcely discussed question of entitlements and this justifies a larger share to the developing countries. Second, there is a lot of tax evasion and double non-taxation happening; thus, there is a larger divisible pool of revenues. Third, since there is no factual link between investments and the signing of a DTA, and by creating practice the developing countries would emphasise the “developmental” aspirations for signing a DTA. Importantly, such an “equitable” division while cohering with development would also cohere with “efficiency” because the idea is only to raise additional revenues through reduced tax evasion or double non-taxation. In fact, an argument of “development” was fleetingly mentioned by the court in the *Azadi Bachao Andolan* case but ignored in the *Vodafone* case. Therefore, by relying on “equity” from a development perspective it would help promote shared values or “international” equity.

## 5 Conclusion

An analysis of the above-mentioned decisions, and even as per the existing national rules it may be difficult to say that the Supreme Court has erred. However, there are serious questions that need further examination. First, even a cursory reading of the two decisions is bound to bring out contradictions in its formula to distinguish tax evasion. In the first case, the court found in favour of the MNC to indulge in limited tax evasion (treaty shopping has an element), because the investments routed into the national economy were interpreted as effecting development. In the second case, the court relies on the limited judicial anti-avoidance rule (lifting the corporate veil) available in India and finds against tax evasion, and yet again favouring the MNC. Similarly, it propounds the amount of taxes paid as a yardstick in this formula. However, as shown in Section 1, it is not impossible to challenge this reasoning.

Second, as a national court administering ITL, the Supreme Court has failed on two accounts. First, it has shown scant understanding of the intermeshed nature of the national and international tax laws and its own role in the development of ITL. Second, it has relied on the

economic principle of “efficiency” and thereby investments to the total exclusion of an “equitable” division of taxes. Yet, it has unwittingly relied on development to justify treaty shopping. Similarly, arriving at an interpretation favouring “development” in the *Azadi Bachao Andolan* case, without any justifications is “incoherent” for two reasons. First, there is an avowed understanding within the international tax regime to limit treaty shopping and the use of tax havens. Second, the development espoused by the court is premised on efficiency of investments which may not favour the revenue interests of the capital importer *per se*. Thus, there is a failure to appreciate how a “legitimate” law or legal argument may be constructed to circumvent the efficiency principle.

Third, the court outrightly rejects “equity” in fiscal laws. In fact, “equity” or a division based on “equity” would only mean a division that takes the territorial claims or the “rights” more seriously – as foregone entitlements. Moreover, it would also emphasise and clarify the “context” in which international tax division should be understood and interpreted (especially when developing countries are involved) by courts. Above all, International Tax Law is an element of International Economic Law, and ‘equity’ is well entrenched in both IEL and its other elements. Since cases are envisioned as a method to develop ITL, and in the absence of an international tax court, the national courts play an integral part in this process. Thus, the Supreme Court was well within its bounds to borrow into the principle of “equity” from IEL, as that would have cohered with the principles of IEL.

Certainly these two disputes were opportunities for the Supreme Court to create practice favouring “development” or “equity” and thereby a developing country perspective. But its failure to capitalise on this situation should not be seen as an absolute failure either. The academic community may well have some questions to answer.

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