IN THE HIGH COURT OF SINDH AT KARACHI

Present: **Mohammad Ali Mazhar** and **Agha Faisal**, **JJ**.

A.P. Moller Maersk
vs.
The Commissioner Inland Revenue
(ITRAs 22, 27 till 32 & 34 till 40 of 2014)

Safmarine Container Line
vs.
The Commissioner Inland Revenue
(ITRAs 51 till 64 of 2014 & 74 till 75 of 2018)

For the Applicants	:	Barrister Khalid Javed Khan
For the Respondent	:	Mr. Kafeel Ahmed Abbasi, Advocate
		Mr. Zulfiqar Ali Jalbani, Advocate (in ITRAs 74 & 75 of 2018)
Date of Hearing	:	06.11.2018, 19.02.2018 & 17.04.2019
Date of Announcement	:	31.05.2019

JUDGMENT

Agha Faisal, **J**: The present ITRAs primarily agitate the controversy whether income derived from container detention charges ("**CDC**"), container service charges ("**CSC**") and termination handling charges ("**THC**") falls within the category of profits in respect of operation of ships in international traffic. The applicants contend that the aforesaid revenue streams fall within the category, whereas, the respondent tax department has argued to the contrary.

2. Briefly stated, the facts germane to the present controversy are that ITRA Nos. 22, 27 to 32 and 34 to 40 of 2014 were filed by the applicants aggrieved by the respective decisions of the Appellate Tribunal Inland Revenue ("**ATIR**"), wherein it was maintained that income from CDC, CSC and THC does not fall within the qualification of profits from operation of ships in international traffic, hence, the applicants were denied the benefit that they claimed in such regard predicated upon their reliance on the Convention between the Denmark

and Islamic Republic of Pakistan for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income ("**Danish DTT**"). In so far as ITRA Nos. 51 to 64 of 2014 and 74 to 75 2018 are concerned the grievance was identical, save for the distinction that the benefit claimed was predicated upon the Convention between the Kingdom of Belgium and Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income ("**Belgian DTT**").

While the benefits available under the respective treaties are different, the commonality between the present ITRAs *inter se* is that while the applicants have reportedly been allowed the concession with respect to heads of income recognized by the tax department as pertaining to profits from the operation of ships in international traffic, such benefit has been denied with respect to the CDC, CSC and THC receipts on the premise that such receipts are not expressly stated in the respective treaties to fall within the category of profits from the operation of the ships in international traffic. Since the basic issue is common to all the ITRAs listed herein, hence, all of them were heard conjunctively, therefore, it is appropriate to decide the same vide this common judgment.

3. The questions of law framed in respect of the present ITRAs were similar, save for the reference to the relevant convention and article thereof respectively. We would, with respect, slightly reformulate the said questions of law in order to afford a generic nature thereto, hence, facilitating the determination of the subject ITRAs vide this common judgment. In view hereof, and in reliance upon the Division Bench judgments of this Court in the case of *Commissioner (Legal) Inland Revenue vs. E.N.I. Pakistan (M) Limited, Karachi* reported as *2011 PTD 476* and *Commissioner Inland Revenue, Zone-II, Karachi vs. Kassim Textile Mills (Private) Limited, Karachi* reported as *2013 PTD 1420*, we do hereby reformulate and frame the following questions of law to be determined herein:

> *"1. Whether, in the present circumstances, the income under the nomenclature of CDC, CSC and THC qualifies within the definition of profits from operation of ships in*

international traffic, in terms of the provisions of the Belgian DTT and the Danish DTT.

2. Whether, in the present circumstances, the learned ATIR, and the fora below, erred in law and misconstrued the provisions of the Ordinance and the respective treaties in denying the applicability of the Article 8 of the relevant convention to income in respect of CDC, CSC and THC.

3. Whether the respective impugned orders of the learned ATIR, and the orders passed by the fora below, are not sustainable in law."

4. Barrister Khalid Jawaid Khan appeared on behalf of the applicants and submitted that income from CDS, CSC and THC was an indivisible constituent of the broad classification of profits from the operation of ships in international traffic. Learned counsel submitted that the Income Tax Ordinance, 2001 ("**Ordinance**") provides a specific exclusion in respect of income covered under double taxation treaties and argued that the respective decisions of the learned ATIR were delivered otherwise than in consonance with the law. Learned counsel submitted that it is well settled law that tax avoidance treaties take effect and prevail over the provisions of general municipal taxation laws. It was the basic argument of the learned counsel that CDC, CSC and THC are essential and integral constituents of receipts in respect of operations of ships in international traffic just like other operations of loading, transportation and unloading of cargo. Per learned counsel the respondent tax department is basing its view on the archaic verbiage of double taxation treaties in the historic past, wherein individual constituents of a larger heading used to be specified in verbose detail. It was submitted that post development of the maritime law such voluminous classifications have been replaced with definitive phrases in modern days treaties, interpretation whereof stands duly established by law, practice and usage. It was argued that once a matter falls within the ambit of an exemption, as was said to be the case presently, then full effect must be given to the exemption clause. In view of the foregoing, it was prayed that the questions of law must be answered in the affirmative and in favour of the applicants.

5. Mr. Kafeel Ahmed Abbasi, Advocate appeared on behalf of the respondent tax department and supported the respective decisions of the learned ATIR, wherein the receipts pertaining to CDC, CSC and THC were held to be fall outside the exemption provided by the respective treaties. Learned counsel submitted that in any event a double taxation treaty is not an exemption as it is a mere arrangement which is given effect by the respective parties on a reciprocal basis. Learned counsel submitted that in the Convention between the Islamic Republic of Pakistan and the Republic of Malta for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income tax ("**Maltese DTT**") specific mention was made in respect of CDC, CSC and THC and that such express reference was conspicuously absent from the Belgian DTT and Danish DTT, hence, the applicants were rightly held to be disentitled to the exemption sought. It was vehemently argued that section 3 of the Ordinance prescribed that the Ordinance shall override all other laws and in pursuance thereof no treaty or convention could be given precedence over the Ordinance. Learned counsel submitted that there was no question of the applicability of any double taxation treaty as the applicants were required to be taxed, under section 101 of the Ordinance, on the entirety of their proceeds notwithstanding any categorization of constituents thereof. It was thus contended that the applicants were required to be charged income at the rate of 35 percent, however, they were being charged 8 percent solely on the basis of an agreement entered therewith. With respect to the Danish DTT it was submitted that the said treaty was only effective for ten years and it expired in 2018 in any event. In view of the foregoing, it was argued that the decisions maintained by the learned ATIR was in due consonance with the law and ought to be maintained and upheld, hence, the questions framed herein may be answered in the negative and in favour of the respondent.

6. We have heard the respective learned counsel and have also considered the law and documentation to which our surveillance was solicited. The facts pertaining to ITRA 51 of 2014 are representative of the facts pertaining to all the ITRAs listed supra, therefore, it may suffice to confine the factual narration to the facts manifest from the said ITRA.

The Deputy Commissioner Inland Revenue passed an order ("**DCIR Order**") wherein the tax exemptions claimed by the applicant in respect of CDC, CSC and THC were denied. The operative constituent of the DCIR Order is reproduced herein below:

> "…it is concluded that the exemption of tax is to be determined strictly in accordance with the plain reading of words used in the statue rather than stretching its scope on the basis of a reference not specified in the Ordinance. Thus, on the basis of factual position that receipts on account of THC/DC are undisputedly Pakistan source income as defined under section 101(3) of the Income Tax Ordinance, 2001, and to avoid any litigation that could arise due to difference of opinion of the Department and the taxpayers, the best available option to is to follow mutually agreed scheme of tax as prescribed under MOU dated 26.5.1997, referred to above.
>
> In view of the foregoing facts, income earned on account of CSC/THC/CD by the taxpayer is to be taxed @8%."
>
> (Underline added for emphasis.)

The DCIR Order was assailed before the Commissioner Inland Revenue and the same was maintained vide the order dated 26.08.2013 ("**CIR Order**"). It may be prudent to reproduce the relevant content of the CIR Order herein below.

> "Here in the instant case, the appellant has not been able to establish that as per Double Tax Treaty between government of Pakistan-Belgium the receipts earned from CDC, THC, and CSC were specifically exempted. For this reason I hold that the Officer Inland Revenue acted in accordance with the law in subjecting to tax the receipts earned from CDC, THC, and CSC @8% for the reason that the aforesaid receipts were not specifically exempted in the relevant treaty…….
>
> (Underline added for emphasis.)
>
> On going through the DTT between Pakistan and Belgium, it is observed that the receipts on account of THC/CDS/CSC are not specifically covered under exemption. Since the interpretation of these heads of receipts in exemption is not specific, the appellant's contention that the same are exempt and should not be subjected to tax is not well founded.
>
> It would not be out of place to mention here that sensing the gravity of this legal aspect regarding non-availability of specific grant of exemption in respect of receipts on account of THC/CDC/CSC under the DTT and

> owing to the Memorandum of Understanding dated 26.05.1997, reproduced at page No.38 of this order and mentioned by DCIR in the impinged order that the other representative of Pakistan Ship Agents Association i.e. (1) United Marine Agencies (Pvt.) Ltd. C/O Hamburg Sud Germany (2) United Marine Agencies (Pvt.) Ltd. C/O RCL Feder Pte Ltd. Singapore (3) M/s Sharaf Shipping agency (Pvt.) Ltd. C/O TS Lines Japan (4) Yaseen Shipping Lines (Pvt.) Ltd. C/o STX Pan Ocean Co Seoul Korea (5) MSC Agency Pakistan (Pvt.) Ltd. C/O Mediterranean Shipping Co Switzerland (6) Maritime Agency (Pvt.) Ltd. C/O Kawasaki Kisen Kaisha Ltd. Japan (7) NYK Lines Pakistan (Pvt.) Ltd. C/O NYK Lines Tokyo Japan (8) Sharaf Shipping Agency (Pvt.) Ltd. C/O WEC Lines Holland and (9) Sea Log (Pvt.) Ltd. C/O China Shipping Container Lines Ltd are paying tax @8% on such receipts.
>
> However, the learned AR of the appellant has not been able to distinguish the circumstances, which lead the appellant for exemption from tax on receipts on account of THC/CDC/CSC instead of 8% as agreed to resolve the controversy in terms of Memorandum of Understanding dated 26.05.1997.
>
> Therefore, under the circumstances of the instant case, discussed supra, I hold that the appellant company was under legal obligation to pay tax @8% on accounts of receipts earned from CDC, THC, and CSC….
>
> (Underline added for emphasis.)
>
> For the foregoing reasons, I hold that the impugned orders passed under section 124/143(2) and 143(2) does not suffer from legal/factual infirmities to warrant any interference. The same is hereby confirmed.

The CIR Order was assailed before the learned ATIR Karachi and vide order dated 20.02.2014 the learned ATIR was pleased to dismiss the appeals ("**ATIR Order**"). The relevant constituent of the ATIR Order is reproduced herein below:

> "8. We have heard the learned representatives from the sides, perused impugned order, the orders passed by the Taxation Officer under Section 124/143(2) of the Ordinance, 2001 and other relevant available record of the case….
>
> 9. The previous controversies in the instant case was the issue that whether consideration for carriage of goods or passengers received or receivable by a shipping company in Pakistan embarked outside Pakistan is chargeable under the Income Tax Ordinance, 2001 or not? further, as to whether the Treaty for the Avoidance of Double Taxation and prevention of fiscal evasion with respect to taxes on income

through SRO No.231(1)/59 dated 04.06.1959 covers the goods booked in Pakistan for disembarkation in the other country or not?

10. The issue has already been dilated upon and discussed in detail by the Division Bench of this Tribunal vide order dated 27.01.2007 in ITA No.1236/KB/2006 (Tax Year 2006) which has been followed in a number of cases by this Tribunal including in ITA No.1236/KB/2006 dated 27.01.2007 as well as ITA Nos.305,208,311 etc./KB/2009 dated 26.06.2009, ITA Nos.85, 87, 91, 94, 131 to 133, 370 to 382, 945, 948 & 951/KB of 2009 and 2010 dated 28.05.2010 and ITA Nos.414 to 422, etc./KB/2010 dated 12.08.2010. The view remains that income of said transaction is chargeable in Pakistan and the Tax treaty between the two countries Pakistan and Belgium applicable on these cases also does not provide any exemption to other charges in Pakistan. Thus a remote reference is available in the earlier decision of this Tribunal mentioned supra.

11. Presently the main issue before us is whether (THC), (CDC) and (CSC) would be treated at par with freight charges for the purpose of 50% reduction in the applicable tax rate? All said and done. We fully agree to the referred judgment of the Honorable supreme court of Pakistan reported as 14 Tax 281 (SC Pak), 98 Tax 69 (SC Pak) and Honorable Lahore High court reported as 91 Tax 245 (HC Lhr) as relied upon by the Taxation Officer and the learned CIR(A) that exemption from tax has to be in express words and it can neither be implied nor stretched. Our emphasis is on the fact that where the exemption was desired by any contracting state it was specifically mentioned by counting the related activities.

12. Following is the summary of some treaties mentioning or not mentioning the ancillary activities.

Treaties explicitly granting exemption to ancillary income.

- DTT between Pakistan and Malta signed on 8th October, 1975 and Enforce on 20th December, 1975.
- DTT between India and Denmark enforce on 13.06.1989.
- DT between India and Belgium enforce on 01.10.1997
- DTT between India and Malta enforce on 08.02.1995

Treaties granting exemption to ancillary income through special protocol.

- DTT between India and Germany
- DTT between India and Japan

Treaties not granting exemption to ancillary income

- DTT between Pakistan and Denmark enforce on 22.10.1987.
- DTT between Pakistan and Belgium signed on 17.03.1980 and enforce on 02.09.1983
- DT between India and Australia enforce on 30.12.1991
- DTT between India and Bangladesh enforce on 27.05.1992.

13. Moreover, the tax department entered in an MOU dated 26.05.1997 with the Shipping Agents Association wherein it is resolved that if the ancillary income if not covered by bilateral treaty, it shall be taxed in terms of section 7 of the Ordinance, 2001 at the specified rate of 8% of gross receipts. This MOU is being implemented by the contracting parties without any controversy and the taxpayer has not repudiated the other existing benefits from the accepted interpretation of double taxation treaties.

14. In the context of foregoing, we find no substance in the appeals of taxpayer and these are accordingly rejected."

Aggrieved by the ATIR Order, upholding the orders rendered by the fora below, the applicant filed the present ITRA seeking interpretation of the law in a manner inconsistent with that maintained by the learned ATIR and the fora below.

7. A perusal of the DCIR Order, CIR Order and the ATIR Order reveals that the respective fora had allowed the applicants the benefit of the tax treaties in so far as freight, or any other head considered by the tax department to fall within the category of profits from the operation of ships in international traffic, was concerned. It is thus apparent that the tax department does not dispute the applicability of the respective treaties but simply maintains that CDC, CSC and THC do not fall within the relevant definition in the respective treaties. It may be pertinent to initiate a deliberation in this regard by recognizing the definitions of the terms CDC, CSC and THC, in order to ascertain whether the same were required to fall under the classification of profits from the operation of ships in international traffic. The said definitions have been reproduced in the CIR Order and are referred to in seriatim herein below.

Container Detention Charges are the amounts collected on account of rent of container, which is charged if a customer holds the

said container beyond the stipulated time required to discharge the goods at the intended port of disembarkation. Container Service Charges are collected by shipping lines on account of services in respect of containers which may be required due to discharge of goods at the destination. It is stated to be a requirement of the Hague and Rotterdam Rules that only neat and clean containers in perfect conditions may be shipped on board. The Terminal Handling Charges are collected by shipping lines on account of terminal charges incurred / to be incurred at the port of disembarkation.

The ATIR Order has maintained the consistent view that CDC, CSC and THC do not qualify for any benefit since the respective treaties for avoidance of double taxation, being the Belgian DTT and the Danish DTT do not contain an express provision in such regard, whereas, the Maltese DTT specifically includes the said receipts.

8. It is considered appropriate to reproduce the relevant provisions of the Maltese DTT, Belgian DTT and the Danish DTT in order to illustrate the findings of the learned ATIR:

Maltese DTT

"Article 8
Shipping and Air Transport

(1) Profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

(2) Notwithstanding the provisions of paragraph (1) of Article 7, profits derived from the operation of ships or aircraft used principally to transport passengers or goods exclusively between places in a Contracting State may be taxed in that State.

(3) The provisions of paragraphs (1) and (2) shall also apply to profits referred to in those paragraphs derived by an enterprise of a Contracting State from its participation in a pool, a joint business or in an international operating agency.

(4) For the purpose of this article, profits derived from the operation of ships or aircraft in international traffic also include income derived from:

(a) the rental, lease or maintenance of ships or aircraft;

(b) the rental, lease, use or maintenance of containers, trailers for the inland transport of containers and other related equipment;

(c) training schemes, management and other services: Provided that such income –

(i) accrues to a resident of a Contracting State whose income is wholly or mainly derived from the operation of ships or aircraft in international traffic; and

(ii) is paid by a resident of the other Contracting State whose income is also wholly or mainly derived from the operation of ships or aircraft in international traffic.

(Underline added for emphasis.)

(5) Notwithstanding the other provisions of this Article, profits from the operation of a ship in international traffic derived by a company which is a resident of Malta having more than 25 per cent of its capital owned, directly or indirectly, by persons not residents of Malta, may be taxed in Pakistan unless the company proves that the profits derived from the operation of such ship are subject to Malta tax without regard to any relief therefrom as provided for in section 86 of the Merchant Shipping Act, 1973, or in any identical or similar provision."

Belgian DTT

"Article 8
Shipping and Air Transport

1. Profits of an enterprise of a contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

(Underline added for emphasis.)

2. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, joint business or an international operating agency."

Danish DTT

"Article 8
Shipping and Air Transport

1. Profits from the operation of aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. With respect to profits derived by the air transport consortium Scandinavian Airlines System (SAS), the

provisions of paragraph 1 shall apply but only to such part of the profits as corresponds to the participation held in that consortium by Det Danske Luftfartsselskab (DDL), the Danish partner of Scandinavian Airlines System (SAS).

3. Profits from the operation of ships in international traffic may be taxed in the Contracting State in which the effective management of the enterprise is situated. However, such profits derived from sources within the other Contracting State may also be taxed in that other State in accordance with its domestic law, provided that for the first five years for which this Convention is effective, the tax so charged in that other State shall be reduced by 50 per cent and for the next five years it shall be reduced by 25 per cent."

(Underline added for emphasis.)

It is prima facie apparent from a bare perusal of the text employed in the relevant treaties that the provision for CDC, CSC and THC is expressly incorporated in the Maltese DTT, specifically in Article 8(4) thereof. While perusal of the corresponding text of the Belgian DTT and the Danish DTT demonstrates that no individual categorization is employed; on the contrary the benefit is required to be given in respect of profits from the operation of ships in international traffic. It was contended by the learned counsel for the applicants that CDC, CSC and THC constitutes an integral part of receipts in the operation of international traffic based upon the guidelines issued by the Organization for Economic Cooperation and Development ("**OECD**") . On the contrary the learned counsel for the respondent had submitted that OECD guidelines were inapplicable in Pakistan.

9. The Organization for Economic Cooperation and Development is defined, in *Judicial Interpretation of Tax Treaties, by Carlo Garbarino* and published by *Edward Elgar Publishing Limited United Kingdom*, as a forum where governments can compare policy experiences, seek answers to common problems, identify good practices and work to coordinate domestic and international policies. OECD reportedly works with governments to understand what drives economic, social and environmental changes and measures productivity and global flows of trade and investment. In addition thereto the OECD prescribes international standards on a wide range of things, from agriculture inclusive without limitation and tax. *Garbarino* writes that model conventions and commentaries are released by the OECD from time to

time and the said model has become the standard of reference of application of bilateral treaties. The reach of the OECD framework is described by the author as having extended beyond the OECD area, as it is employed as a basic document of reference in negotiations between member and non-member countries and also between non-member countries.

Convergence or divergence in respect to the OECD model is said to be achieved at the level of individual treaties concluded by countries or through law-in-action, such as judicial decisions or administrative guidelines which may be inspired by or refer to the OECD commentary. Judicial recognition takes place *inter alia* when OECD interpretative solutions or principles may circulate through judicial transplants activated by domestic courts.

The applicants had placed before us OECDs Model Tax Convention 2010 and drew the Court's attention to the commentary on Article 8 concerning the taxation of profits from shipping, inland water ways transports and air transports. It is considered appropriate to reproduce the relevant constituents of the said commentary, relied upon by the applicants.

> "4. The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities commentary on article 8 model tax convention (condensed version) – ISBN 978-92-64-08948-8 – © OECD 2010 175 which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic as long as they are ancillary to such operation.
>
> 4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.
>
> 4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to

> such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.
>
> ……
>
> 9. Containers are used extensively in international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers are usually either directly connected or ancillary to its operation of ships or aircraft in international traffic and in such cases fall within the scope of the paragraph. The same conclusion would apply with respect to profits derived by such an enterprise from the short-term storage of such containers (e.g. where the enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers."

(Underline added for emphasis.)

Article 8 of the OECD convention is discussed by *Garbarino* and the benefit conferred is recognized to encompass the core activity and extended activities ancillary thereto. Therefore, the profits referred to are described as those arising from the core activity, i.e. transportation of cargo by ships in international traffic, and also those arising out of the ancillary, supplementary and / or incidental activities that permit, facilitate and / or support the international traffic operations.

The treatise on *Double Taxation Conventions* by *Sweet & Maxwell 2013 Edition*, employed by us to supplement the views of *Garbarino*, illumines the definition of profits from operation of ships in detail. It is extrapolated that initially the reference is to profits from carriage of cargo but that the definition also encompasses profits which by reason of their proximate relationship are required to be placed in the same category. The income derived *Inter alia* from providing containers for transportation, transferring containers to and from a ship, transportation on board ship, unloading the containers and providing containers for transportation from the port of destination to the customer are said to fall within the broader category of the profit from operation of ships as the said income is considered auxiliary to the core income.

It is imperative to record at this juncture that the ATIR Order expressly recognizes the category of income ancillary to profits from

operation of ships in international traffic, categorizing the heads of CDC, CSC and THC therein, and furthermore that it is not the case of the respondent tax department that CDC, CSC and THC have not been recognized as a part of receipts from the operation of ships in international traffic by OECD, however, it is the respondent's case that OECD guidelines are inapplicable in Pakistan. The question that follows now is whether the OECD model has been accorded judicial recognition in Pakistan.

10. The learned counsel for the applicants had relied upon a Division Bench Judgment of this Court in *A.P.Moller vs. Taxation Officer of Income Tax & Another* reported as *20122 PTD 1460* ("***AP Moller***"), upheld by the honorable Supreme Court in *A.P.Moller vs. Commissioner of Income Tax, Zone I, Karachi & Another* reported as *2012 SCMR 557* ("***AP Moller II***"), in order to bulwark his argument that the OECD guidelines were given due judicial recognition in Pakistan. Surprisingly, the learned counsel for the respondent also relied upon the same judgment in augmentation of the contrary argument of the tax department.

Munib Akhtar, J authored *AP Moller* and his articulation pertinent to the present controversy is reproduced herein below:

> "……However, before examining the relevant provisions of the DTAs in detail, it is important to consider, in general, the nature of such agreements, and the principles involved in interpreting and applying them.
>
> 31. Double taxation has been authoritatively described as follows:
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> > "International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods. Its harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries." (OECD, Model Tax Convention on Income and on Capital, condensed version, July 2008)
>
> It is in order to avoid double taxation and its harmful effects that states enter into double taxation agreements (DTAs). The nature of such agreements has been explained thus:
>
> > "Double tax treaties are international agreements that give rise to international obligations between sovereign states. The interpretation and application of such treaties is governed by the general rules of international public law (whether customary or as codified in the Vienna Convention) in the same way as any other political or economic treaty. However, double tax treaties differ from other economic or political treaties in that they are intended to operate within the domestic legal systems of

> the contracting states. In this sense, a double tax conventionhas a dual character as an international agreement that binds two nation states and as domestic law that binds subjects within its scope." (Nabil Orow, Comparative Approaches To The Interpretation Of Double Tax Conventions, (2005) 26 Adelaide Law Review, pp. 73-102, available at: <http://www.austlii.edu.au/au/journals/AdelLawRw/2005/4.pdf>)

Thus, the first and foremost point to keep in mind regarding DTAs is that they 'are international agreements or treaties and are to be interpreted in the same manner as any other treaty. What is the correct approach to take in this regard? The question is of particular importance in the Pakistani context, where the well-settled rules of interpretation applicable to fiscal statutes require the courts (especially in relation to charging provisions) to take a strict approach, applying the words of the statute literally, and without taking into consideration the intent behind the legislation. This may be regarded as the basic rule. It is of course well settled that if two reasonable views are possible, the one favouring the taxpayer will be adopted, but this rule is itself an outcome of the basic rule. Exemption from taxation is also strictly construed in the sense that the onus lies on the taxpayer to show that he is exempt, and if two reasonable interpretations are possible, the one favouring the Revenue will be adopted. As will be seen, these are not however, the principles which apply in relation to an international treaty like a DTA. It would therefore, in principle, be wrong to interpret a DTA as though it were simply a fiscal statute.

32. International judicial consensus is clear that DTAs are to be construed broadly and liberally. Before citing some of the relevant authorities, it would be appropriate to set them in the proper context, for which purpose the following extracts from Nabil Orow, op. cit., can be usefully kept in mind:

> "Although double tax treaties are incorporated into domestic law, <u>their interpretation must be cognisant of their essentially international character and their contractual character. In this sense the process of treaty interpretation is not concerned with the search for meaning consistent with the objects and purposes of a particular sovereign/legislature, but rather with the search for meaning that is consistent with the mutual intent and expectations of the sovereign contracting parties</u>. The relevant mutual intent and expectations, once identified, may then be imputed to the legislature whose statutory instrument is under consideration by its national courts.
> .....
> <u>In an attempt to reconcile diverse legal and taxation systems, differences in language and legal conceptions, the text of double tax treaties is often expressed in relatively general terms</u>.... The generality of the language used to express the intent of the treaty parties permits greater flexibility in the operation of double tax treaties, and leaves scope for discretion to each party with respect to the specific steps necessary to implement their respective obligations.
>
> General expressions of principles by their nature rely on judicial interpretation to define their content and focus their legal scope and practical application. <u>In discharging that function, it is critical that the respective national courts adopt broad and flexible principles of interpretation unconstrained by technical or rigid domestic rules and precedents</u>." (pp. 80-81; emphasis supplied)

33. In Crown Forest Industries Ltd. v. Canada (1995) 2 SCR 802, the Canadian Supreme Court cited with approval the following passage from a decision of the Federal Court of Canada:--

> "Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to <u>implementing the true intentions of the parties</u>. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned." (para.43; emphasis in original)

In McDermott Industries (Aust) Ply Ltd. v. Commissioner of Taxation (2005) FCAFC 67, the Federal Court of Australia held as follows:--

> "37. Double tax treaties are bilateral treaties entered into between two states. As such they are to be interpreted in accordance with the

> requirements of the Vienna Convention on the Law of Treaties ... ('the Convention') and in particular Article 31 of the Convention.
>
> 38. The application of the Convention has been discussed by McHugh J in Applicant A v. Minister for Immigration and Ethnic Affairs [1997] HCA 4; (1997) 190 CLR 225 and in Thiel v. Commissioner of Taxation (1990) HCA 37; (1990) 171 CLR 338, the latter case being concerned with the interpretation of the double taxable agreement between Australia and Switzerland. The leading authority in this Court on interpretation of double taxation agreements is Lamesa [(1997) FCA 785). It is unnecessary here, to set out again what is there said. The following principles can be said to be applicable:
>
> Regard should be had to the 'four corners of the actual text'. The text must be given primacy in the interpretation process. The ordinary meaning of the words used are presumed to be 'the authentic representation of the parties' intentions': Applicant A at 252-3.
>
> The courts must, however, in addition to having regard to the text, have regard as well to the context, object and purpose of the treaty provisions. The approach to interpretation involves a holistic approach.
>
> International agreements should be interpreted 'liberally'. Treaties often fail to demonstrate the precision of domestic legislation and should thus not be applied with 'taut logical precision'."

Finally, in Union of India and another v. Azadi Bachao Andolan and another (2003) 273 ITR 706, the Indian Supreme Court, while interpreting the provisions of the DTA between India and Mauritius, observed (in the section of the judgment titled `Interpretation of Treaties') as follows:

> "120. The principles adopted in interpretation of treaties are not the same as those in interpretation of statutory legislation. While commenting on the interpretation of a treaty imported into a municipal law, Francis Bennion observes:
>
> 'With indirect enactment, instead of the substantive legislation taking the well-known form of an Act of Parliament, it has the form of a treaty. In other words the form and language found suitable for embodying an international agreement become, at the stroke of a pen, also the form and language of a municipal legislative instrument. It is rather like saying that, by Act of Parliament, a woman shall be a man. Inconveniences may ensue. One inconvenience is that the interpreter is likely to be required to cope with disorganized composition instead of precision drafting. The drafting of treaties is notoriously sloppy usually for very good reason. To get agreement, politic uncertainty is called for.
>
> ...The interpretation of a treaty imported into municipal law by indirect enactment was described by Lord Wilberforce as being unconstrained by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptation. This echoes the optimistic dictum of Lord Widgery CJ that the words are to be given their general meaning, general to lawyer and layman alike the meaning of the diplomat rather than the lawyer.' (Francis Bennion, Statutory Interpretation, Pg. 461 (Butterworths, 1992 (2" Ed.))
>
> 121. An important principle which needs to be kept in mind in the interpretation of the provisions of an international treaty, including one for double taxation relief, is that treaties are negotiated and entered into at a political level and have several considerations as their bases. Commenting on this aspect of the matter, David R. Davis in Principles of International Double Taxation Relief Pg.4 (London Sweet and Maxwell, 1985), points out that the main function of a Double Taxation Avoidance Treaty should be seen in the context of aiding commercial relations between treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues between them in respect of income falling to be taxed in both jurisdictions."

34. In our view, the foregoing extracts lay down the relevant principles and the correct approach to be taken while interpreting and applying a double taxation agreement. Two more points need to be made. Firstly, the Organization for Economic Cooperation and Development (OECD) has, since 1963, developed a model double taxation treaty or conviction ("the OECD Model"), which has been

> regularly updated and suitable redrafted since its first publication. Since 1980, the United Nations has also published a model double taxation treaty ("the UN Model"), which is designed specifically with developing countries in mind. The UN Model is based largely on the OECD Model. Along with the OECD Model, the OECD also publishes (and regularly updates) a commentary ("the OECD Commentary"), which is regarded as an authoritative guide to the model (the extract quoted in para 31 supra is taken from the Commentary). The United Nations has also published a commentary on the UN Model ("the UN Commentary") which relies heavily on the OECD Commentary. In at least some jurisdictions, the courts have specifically held that the OECD Commentary may be referred to while interpreting DTAs which are based on the OECD Model. (See Nabil Orow, op. cit., pp. 94-95, and especially Thiel v Federal Commissioner of Taxation (1990) HCA 37; (1990) 171 CLR 338, referred to therein. See also, e.g., National Westminster Bank, PLC v. United States (2008) 512 F.3d 1347 (US Court of Appeals, Federal Circuit), where an earlier version of the Commentary was considered and relied on.) Obviously, this also applies in the case of those DTAs which are based on the UN Model. Almost all modern treaties follow these models, and this is true of the Danish DTA and the French DTA. In interpreting and applying these DTAs therefore, reference can usefully be made to the OECD and UN Models and the commentaries on these models. (The UN Commentary can be found at:http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002084.pdf)…
>
> 39. Article 8 of the OECD Model leaves no doubt that in terms thereof, profits from operating ships and aircraft in international traffic are taxable only by and in the Contracting State in which the enterprise has its place of effective management. It is to be noted that the Article uses strong mandatory language ("shall" and "only"). Thus, the other Contracting State has totally renounced its right to tax such profits. It is to be noted that this renunciation means that even if the Contracting State in which the enterprise has its place of effective management chooses not to tax the enterprise's profits at all, the other Contracting State can do nothing. The renunciation is absolute and not conditional or contingent. This is not necessarily as one-sided as it may seem, at least in relation to aircraft. To take an example from the French DTA, if Pakistan has totally given up its right to tax the profits earned by Air France from international traffic, France has equally totally given up its right to tax the profits earned by Pakistan International Airlines from such traffic."

(Underline added for emphasis.)

It is apparent from the foregoing that the OECD guidelines, including the commentary with respect to Article 8 relied upon by the applicants, have been accepted by an earlier Division bench of this Court for reference while interpreting double taxation treaties. It is also manifest that the judgment referred to supra was also maintained by the honorable Supreme Court in *AP Moller II*, wherein it was held that the treatment given by the learned High Court to the questions raised in the reference applications appears to be correct and thus merits no interference. We are bound by the ratio expounded by the earlier Division Bench of this Court (upheld by the honorable Supreme Court), hence, maintain that the OECD guidelines and commentary are an appropriate tool to employ in the interpretation of double taxation treaties and agreements.

11. While the ratio of *AP Moller*, referred to supra, has been held by us to be applicable in the present circumstances, it remains for us to demystify the respondent's reliance upon the very same judgment.

AP Moller dealt with double taxation treaties entered into with Denmark, France and Japan. It is poignant to note that the Danish DTT is also the subject matter herein and since the reference applications with respect to the Danish and French double taxation treaties were dismissed in the aforesaid judgment, while the references with regard to the Japanese double taxation convention allowed, the learned counsel for the tax department appears to have presumed that the ratio augments his arguments, however, such is not the case.

The issue before the Court, in *AP Moller*, was not with regard to specific ingredients of the definition of profits from operations of ships in international traffic; but the issue was whether the profit, in the said circumstances, was taxable in Pakistan or otherwise. The questions were answered in favour of the applicants in so far as the Danish and French double taxation treaties were concerned and vice versa in the case of the Japanese double taxation convention. However, the reference applications with respect to the Danish and French double taxation treaties were answered against the applicants since taxing rights for the category of income, subject matter of the claim therein, was found to be with Pakistan and not with the other treaty state.

The circumstances in the present applications are totally different as the tax department upholds the applicability of the benefit claimed by the applicants under the respective treaties but states there receipts under CDC, CSC and THC do not qualify thereunder. This is manifest from the orders culminating in the ATIR Order wherein the benefit with regard to freight etc. has not been denied on the premise that the applicants are entitled thereto under the respective treaties. It is thus observed that the respondent's reliance upon *AP Moller* is unmerited.

12. Adverting to the Maltese DTT, relied upon by the tax department for denial of benefit to the applicants, it is observed that the delineation of activities subject to benefit thereunder is not exhaustive. Article 8 mentions profits derived from shipping in international traffic and

subsection 4 thereof provides *inter* alia for activities listed thereunder. It is thus gleaned that even the Maltese DTT, executed back in 1975, does not exclude the possibility of other heads of receipts falling under the broader category of profits subject to benefit thereunder. The Belgian DTT and Danish DTT have eschewed the inclusion of defining some of the constituents of the broader head of profits and have simply confined the iteration to stating just the category itself. The OECD guidelines prescribe that the primary constituent of profits from shipping in international traffic is the profit directly obtained from the transportation of passengers or cargo by ships that operate in international traffic. However, as international transport has evolved shipping enterprises invariably carry out a large variety of activities to permit, facilitate or support their operations. The OECD guidelines prescribe that the profit from activities facilitating international shipping operations are encompassed in the category of profits from operation of ships in international traffic so long as such activities are ancillary to international shipping operations.

The ATIR Order has already determined CDC, CSC and THC to activities ancillary to operation of ships in international traffic, hence, there is no need to enter into an independent determination to substantiate the same conclusion. At this juncture it is pertinent to record our concurrence with the learned ATIR in so far as maintaining that CDC, CSC and THC are in fact ancillary to operation of ships in international traffic. Therefore, if the activities giving rise to CDC, CSC and THC are ancillary to operation of ships in international traffic, it would follow that profits derived therefrom may also fall within the category of profits from operation of ships in international traffic.

13. It is imperative to consider the scheme of the Ordinance in so far as the present controversy is concerned in order to appreciate the final nuances thereof. The starting point in this regard is section 7 of the Ordinance constituent whereof is reproduced herein below:

> "7. Tax on shipping and air transport income of a non-resident person.
>
> (1) Subject to this Ordinance, a tax shall be imposed, at the rate specified in Division V of Part I of the First Schedule, on every non-resident person carrying on the business of operating ships or aircrafts as the owner or charterer thereof in respect of:

> (a) the gross amount received or receivable (whether in or out of Pakistan) for the carriage of passengers, livestock, mail or goods embarked in Pakistan; and
>
> (b) the gross amount received or receivable in Pakistan for the carriage of passengers, livestock, mail or goods embarked outside Pakistan.
>
> (2) The tax imposed under sub-section (1) on a non-resident person shall be computed by applying the relevant rate of tax to the gross amount referred to in sub-section (1).
>
> (3) This section shall not apply to any amounts exempt from tax under this Ordinance."

It is pertinent to note that the applicability of the aforementioned section has been specifically made subject to the Ordinance. Learned counsel for the respondent had argued that Section 3 of the Ordinance states that the same shall apply notwithstanding anything to the contrary contained in any law for the time being in force and also that there was no exemption provided in terms of the treaties subject matter herein. We concur with the argument that the benefits under the convention would not qualify as exemptions for the reason that an exemption could only be applicable if the tax liability were to be established in the first instance. In this context it was argued by the learned counsel for the applicants that Section 53 of the Ordinance and the Second Schedule thereto does not refer to the tax treaties and treaties as such bilateral arrangements preclude the existence of liability in the first place, hence, the question of exemption does not arise. The relevant provision of the Ordinance which deals with the agreements for avoidance of double taxation is section 107 of the Ordinance, contents whereof is reproduced herein below:

> "107. Agreements for the avoidance of double taxation and prevention of fiscal evasion.-- (1) The Federal Government may enter into a tax treaty, a tax information exchange agreement, a multilateral convention, an inter-governmental agreement or similar agreement or mechanism for the avoidance of double taxation or for the exchange of information for the prevention of fiscal evasion or avoidance of taxes including automatic exchange of information with respect to taxes on income imposed under this Ordinance or any other law for the time being in force and under the corresponding laws in force in that country and may, by notification in the official Gazette, make such provisions as may be necessary for implementing the said instruments.
>
> (1A) Notwithstanding anything contained in any other law to the contrary, the Board shall have the powers to obtain and collect information when solicited by another country under a tax treaty, a tax information exchange agreement, a multilateral convention, an inter-governmental agreement, a similar arrangement or mechanism.
>
> (1B) Notwithstanding the provisions of the Freedom of Information Ordinance, 2002 (XCVI of 2002), any information received or supplied, and any concomitant communication or correspondence made, under a tax treaty, a tax information exchange agreement, a multilateral convention, a similar arrangement or mechanism, shall be confidential

> (2) Subject to section 109, where any agreement is made in accordance with sub-section (1) the agreement and the provisions made by notification for implementing the agreement shall, notwithstanding anything contained in any law for the time being in force, have effect in so far as they provide for at least one of the following:
>
> (a) relief from the tax payable under this Ordinance;
>
> (b) the determination of the Pakistan-source income of nonresident persons;
>
> (c) where all the operations of a business are not carried on within Pakistan, the determination of the income attributable to operations carried on within and outside Pakistan, or the income chargeable to tax in Pakistan in the hands of nonresident persons, including their agents, branches, and permanent establishments in Pakistan;
>
> (d) the determination of the income to be attributed to any resident person having a special relationship with a non-resident person; and
>
> (e) the exchange of information for the prevention of fiscal evasion or avoidance of taxes on income chargeable under this Ordinance and under the corresponding laws in force in that other country.
>
> (3) Notwithstanding anything contained in sub-sections (1) or (2), any agreement referred to in sub-section (1) may include provisions for the relief from tax for any period before the commencement of this Ordinance or before the making of the agreement."

The insertion of specific provision in respect of agreements for avoidance of double taxation demonstrates that the said category is dealt with under an express provision of the Ordinance itself and thus it would follow that the provisions of section 7 read with section 107 of the Ordinance would provide the statutory sanction for availing of benefits under such fiscal treaties. *AP Moller* has maintained that when interpreting a double taxation treaty it is necessary to bear in mind which method has been adopted in relation to the income under consideration. Section 107 of the Ordinance provides the statutory gateway through which a double taxation treaty is given effect in the municipal law. Subsection (2) provides that a duly notified double taxation treaty has overriding effect insofar as its terms deal with or provide for any of the matters enumerated in clauses (a) to (e) thereof. Now it is normally said that in case there is a conflict between a provision of a double taxation treaty and a section of the Ordinance, it is the former that will prevail. However, this formulation is subject to the consideration that the matter is not so much of resolving a conflict between two clashing provisions, but of a harmonization of tax treatment. If income is taxable in two different jurisdictions, the relevant double taxation treaty seeks to remove this disharmony by either removing the income altogether from one of the tax

jurisdictions, or by recognizing that the tax is to be shared between the two jurisdictions, and making suitable provision for tax allowances or credits. Therefore, it is our considered view that the provisions of the Ordinance specifically cater for double taxation agreements, hence, the same could not be construed, as being in derogation and / or in supersession of the Ordinance.

14. Learned counsel for the respondent had argued that the income of the applicants is required to be taxed under section 101 of the Ordinance and that no benefit accrues thereto from the respective treaties. We respectfully are unable to concur with this argument as the same *prima facie* is inconsistent with the findings contained in the ATIR Order. It is clear that the ATIR order disallows the claim of the applicants only in so far as CDC, CSC and THC are concerned, however, it is not the position taken that the respective treaties do not apply. This observation is cemented by the fact that benefit has already been given to the applicants in respect of profits deemed to fall within the tax department's interpretation of profits from the operation of ships in international traffic.

15. There was another argument employed by the learned counsel for the tax department stipulating that the applicants have already forgone their rights to claim benefit under the respective treaties by entering into an agreement with the tax department. The agreement in question is recorded in the minutes of the meeting of the Advisory Committee of Pakistan Ships Agents Association and Income Tax Companies Zone IV, Karachi dated 26.05.1997 wherein the understanding relevant to the present purposes is reproduced herein below:

> "3. As regards taxation of container service charges/detention charges it was argued that such receipts will be taxed @ 8% uniformly, <u>except in the cases which are covered by avoidance of Double Taxation Treaty</u>. The cases covered by Treaty will be examined, individually, on the merit with legal provisions contained in the treaty and decision will be made strictly in accordance with law. The association will ask all the members in this respect to declare container services/detention charges and pay tax @8 of the gross receipt for the year 1996-97.

(Underline added for emphasis.)

It is apparent from a bare perusal of the operative constituent of the agreement between the parties that the taxability at the rate of 8 percent was only applicable in cases not covered by avoidance of

double taxation treaties. In this regard we maintain that the claim of the applicants for appropriate treatment under the relevant treaties is in no manner circumscribed by the agreement referred to supra.

16. Learned counsel for the tax department had concluding with the argument that the Danish DTT was only effective for ten years, hence, it expired in 2018; consequently the appellants in the ITRAs wherein the Danish DTT was relied upon did not have any *locus standi* to prefer a claim. We have already reproduced the operative constituent of the Danish DTT supra and there is no indication therein of the treaty being enforced only for a period of ten years. Article 8(3) thereof stipulates that profits derived from sources within the other Contracting State may also be taxed in that other State in accordance with its domestic law, provided that for the first five years for which this Convention is effective, the tax so charged in that other State shall be reduced by 50 per cent and for the next five years it shall be reduced by 25 per cent. This stipulation does not signify that the Danish DTT was effective only for a period of ten years, hence, challenge to the *locus standi* of the relevant applicants is not sustainable in our opinion.

17. The well settled rules of interpretation with respect to fiscal statutes require Courts to apply the words of the statute literally, however, if two reasonable interpretations are possible then the one favoring the taxpayer is required to be preferred (*AP Moller*). A subsequent Division Bench of this Court, in *Citibank NA vs. Commissioner Inland Revenue & Another* reported as *[(2015) 111 Tax 82 (H.C.Kar.)]* articulated this principle of interpretation and observed that in the realm of fiscal statutes and in particular considering a charging provision, the boundary in such situation tends to be drawn in favor of the tax payer.

In the present circumstances there was no cavil to the applicability of the respective treaties in the case of the applicants; the only question that pervaded the successive stages of appeal was whether profits derived from activities admittedly ancillary to the operation of ships in international traffic could be construed as integral constituents of the larger classification of profits from the operation of ships in international traffic. The preponderance of authority coupled with the reasoning

discussed herein above guides us to answer to the said question in the affirmative.

18. In view of the rationale contained herein, the three (3) questions framed for determination by this Court are answered in the affirmative, hence, in favour of the applicants and against the respondent. These ITRAs stand disposed of in the above terms. A copy of this decision may be sent under the seal of this Court and the signature of the Registrar to the learned Appellate Tribunal Inland Revenue, as required by section 133(5) of the Ordinance.

J U D G E

J U D G E

*Farooq PS/**