CHAPTER I

A CRITICAL NOTE ON THE PROPRIETY AND LEGALITY OF THE *VODAFONE*'S NOTICE TO THE GOVERNMENT OF INDIA

VODAFONE context: Invocation to the BIT: Vodafone has no case: Let not prickly constitutional questions be raised

I

VODAFONE cannot invoke BIT to foreclose the Parliamentary action in TAX Matters

It is reported that Vodafone has served on our Government a 'Dispute Notice' initiating the process for setting afoot an international arbitration against our Government's efforts to get a law enacted retrospectively to undo the effect of our Supreme Court's decision in the Vodafone Case. We all know how the U.K. based Vodafone acquired the share of the Cayman Island-based CGP through the corporate intermediary device, a subsidiary company, incorporated in the Netherlands. This strategy resembles the way Vodafone Group Plc of the U.K. acquired Mannesmann in Germany through a Luxembourg subsidiary to amass profits there and to evade the British tax. It is good that the British Government acted against such manoeuvres with a partial success. But in this Chapter I concentrate only on the propriety and legality of initiating a process towards international arbitration.

As the said subsidiary company is incorporated in the Netherlands, it has invoked the provisions of bilateral investment treaty between the Republic of India and the Kingdom of the Netherlands for the promotion and protection of investments.

In my considered view the Notice aforementioned is wholly misconceived because the said bilateral investment treaty does not pertain to matters relating to the imposition, levy and recovery of taxes. The very first sentence in the main Judgement delivered by Chief Justice Kapadia makes the character of the issues involved in the *Vodafon*e litigation amply and authoritatively clear: He records: "**This matter concerns a tax dispute** involving the Vodafone Group with the Indian Tax Authorities ……."

Two provisions of this Indo-Netherlands BIT treaty are worth noticing:

(i). The Article 1 defines "investments" as meaning " every kind of asset invested in accordance with the national laws and regulations of the Contracting Party in the territory of which the investment is made…..". The language amply suggests that the law of the land is supreme, and those who invest in this country are not above the laws existing from time to time. No treaty can create an enclave on our soil where our law and Constitution are brought to the vanishing point.

(ii). The Article 4 of the said BIT makes this point amply and specifically clear. This Article grants 'National treatment' and ' most favoured nation treatment' After spelling out mutual rights and obligations of the contracting parties, it

specifically excludes, per the provisions of sub-Article 4 of the BIT, the tax laws and tax treaties from the province of the Agreement. After mentioning such rights and duties in sub-Article (1), and (2), the Agreement states in sub-Article (4):

> "The provisions of paragraphs 1 and 2 in respect of the grant of national treatment and most favoured nation treatment shall also not apply in respect of any international agreement or arrangement relating wholly or mainly to taxation or *any domestic legislation or arrangements consequent to such legislation relating wholly or mainly to taxation*." (Italics supplied)

In effect, the terms of Agreement exclude tax laws and tax agreements (which expression includes 'tax arrangement').

II

There are great constitutional reasons, shared by most countries, why 'taxation' and 'tax treaties' cannot be controlled by the Agreements done in exercise of the executive power simplicitor. The treaties are done in exercise of the executive power, whereas 'taxation' is wholly the preserve of Parliament. In India, the Government of India could act in the executive domain only under Article 53 of the Constitution that grants it the executive power. 'Taxation' comes within Article 265 of our Constitution which is the exercise of the legislative power. India signs a tax treaty only because Parliament has authorized the Government to do so by conferring power to do under Section 90 of the Income-Tax Act, 1961. The constitutional position in England and in the most other countries is no different. The reasons for this state of affairs are thus summarized at p. 219 of my Autobiographical Memoir, *On the Loom of Time*:

> "The most distressing point I have noticed, both as a member of the Indian Revenue Service for more than three decades, and as an Advocate for more than a decade at the High Court and the Supreme Court, is the general non-realization of the great constitutional fact that 'taxation' is, apart from a method to raise resources, a most powerful way to subject the executive government to an effective democratic control through Parliament. *The New Encyclopedia Britannica* aptly observed:
>
> > "The limits to the right of the public authority to impose taxes are set by the power that is qualified to do so under constitutional law. ….. The historical origins of this principle are identical with those of political liberty and representative government – the right of the citizens. The nature and relevance of the Parliamentary control on 'taxation' generally, and the 'direct taxes', in particular, has been thus brought out by Hood

Phillips[12]: "It was supposed to have been settled by Magna Carta and by legislation in the reigns of Edward I and Edward III that taxation beyond the levying of customary feudal aids required the consent of Parliament. One of the central themes of English constitutional history was the gaining of control of taxation and national finance in general by Parliament, and in particular the Commons; for this control meant that the King was not able to govern for more than short periods without summoning Parliament, and Parliament could insist on grievances being remedied before it granted the King supply. This applied at least to direct taxation….. In England even tax treaties are done only after getting Parliamentary approval. In England there is a system under which Parliamentary supremacy over the exercise of the executive power of treaty-making is maintained in the following two ways:

(a) by providing that a tax agreement is to be made only in terms of the law; and

(b) by providing that no tax treaty can be made without a Resolution by the House of Commons having exclusive control over taxation. Parliamentary control on taxation is considered so important that in the major countries of the world the tax treaties (I mean Double Taxation Avoidance Agreements), are done only with Parliamentary approval.

Our Executive Government possesses ample powers for economic management, and for policy formulations pertaining to trade and investments. But it has absolutely no power to do such things, howsoever desirable, by invoking the provisions of the Income-tax Act, unless it can draw power from some specific provisions under the Act itself. This is evident also from the state practice that tax treaties are always legislated. The position that emerges from most constitutions can be stated, in brief, thus:

. (a) US legal practice. The United States Constitution provides in Article VI, cl. 2 The U.S Senate must approve a tax treaty before it is made operational.

(b) German Legal practice

"In Germany, a tax treaty is enacted in accordance with Art. 59 Abs. and Art 105 of the Grundgesetz (the Federal Constitution). [Klaus Vogel on Double Taxation Conventions, 3rd ed. p. 24].

(c) Canada : A tax treaty is by enactment viz. Canada-U.S. Tax Convention Act, 1984. Discussed in Crown Forest Industries v. Canada

(d) Australia: Every tax treaty is enacted under International Tax Agreements Act 1953

(e) U.K.: A tax treaty is enacted through an Order in Council in accordance with section 788 of the Income and Corporation Act 1988 which prescribes: "Before any Order in Council proposedto be made under this section is submitted to Her Majesty in Council, a draft of the Order shall be laid before the House of Commons, and the Order shall not be so submitted unless an Address is presented to Her Majesty by the House praying that the Order be made

(f) In other countries tax treaties are enacted.
[Philip Baker F-1 to F-3]

(g) Treaty practice in different countries with different constitutional provisions materially differs. Oppenhheim's International Law pp 52-86

III

Besides, there are two more reasons for which Vodafone must not take the step of moving matter to the international arbitration.

(1). Article 4 (5) of the BIT clearly stipulates that "Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party. Provided that dispute resolution under Article 9 of this Agreement shall only be applicable in the absence of a normal, local, judicial remedy being available."

And none can doubt that India has a well-organized judicial system which rises up to the highest standards, and is well-equipped to respond to all conceivable situations**.**

(2). The right course for Vodafone, or others sailing in the same boat, is to seek remedies by moving the Indian courts. Georg Schwarzenberger has aptly put it that "under the customary international, individuals and companies are bearers of rights and duties under municipal law", hence are bound to subject themselves to our domestic courts. Only during the days of the East India Company, we had agreed to two judicial systems: one for the natives, and the other for the British. India must not agree to a situation when a cause emanating on account of nexus with the territory of India, is brought before some foreign for a by ignoring our judicial system. This system protected and promoted their trade and investment; hence they must trust it. The colonialists were accustomed to distrust the courts of the territorial jurisdictions

as they were not sure that the territorial courts would be servile to the imperialists' interests. We know how during the days of the East India Company, we witnessed : one system of courts for the natives, and other system for the foreigners to safeguard their interests. In China too somewhat similar situation was brought about after establishing their privileges including the most-favoured-nation (MFN) which ensured trading equality This was brought about through the Treaty of Nanking, the Treaty of Wanghia (with the United States in 1844), and the Treaty of Whampoa (with France in 1844). Later on the colonial power obtained certain benefits of extraterritoriality also. This had the effect of exempting them "from the application or jurisdiction of local law or tribunals."

(3) If an aggrieved party turns out a foreign resident, endowed with the competence to seek remedy at a foreign fora, yet, in my view the domestic channel cannot be circled out as neither under the WTO Treaty, nor under the Agreements done under its umbrella, nor under the bilateral investment protection agreements to which India is a party, nor under any tax treaties into which India has entered, there is any provision [like Article 1121 **(** Conditions Precedent to Submission of a Claim to Arbitration) of the North American Free Trade Agreement (Canada, United States, or Mexico)] that excludes, or waves, the ,local remedy rules,.George Schwarzenberger in *A Manual of International Law* (5th ed.pp. 46-47) formulates certain core propositions to show how the so-called International Lawyers have tried to subjugate the democratic constitutions:

> "The doctrine of the supremacy of international law over municipal law appeals to the *amour proper* of international lawyers and has its attractions *de lege ferenda.* In *lex lata,* it corresponds to reality on the –always consensual –level of international institutions, in particular international courts and tribunals."

'*Amour proper'* means "Respect for oneself" which easily turns into egoistically pursuit to aggrandize power and status. Schwarzenberger states: On scanning the trends of times we can say: men always need some idiotic fiction in the name of which they can face one another. Once it was religion, then it was the States, and now the Market. This has led to a situation well captured in the following lines from Noam Chomsky's *Hegemony or Survival* (p. 13):

> 'The whole frame-work of international law is just "hot air", legal scholar Michael Glennon writes: 'The grand attempt to subject the rule of force to the rule of law" should be deposited in the ashcan of history –a convenient stance for the one state able to adopt the new non-rules for its purposes, since it spends almost as much as the rest of the world combined on means of violence and is forging new and dangerous paths in developing means of destruction, over near-unanimous world opposition'"

We reject that endeavour as it is, in effect, the strategy of those who want to build corporate *imperium* by subjugating democratic polity. The private

foreign investors must not be allowed to sue sovereign governments directly at the foreign fora to embarrass the Government but also, in effect, to humiliate the people. Sovereignty cannot be privatized, though all the corporations are conspiring to acquire that for themselves. If ever it happens, it would destroy our Constitution and democracy. If we allow cooperate operators to exercise what under the customary public international law belongs to the sovereign states, we would be facilitating the emergence of the heartless corpoatocracy which seldom bothers for human rights, and seldom bothers for the welfare of people

IV

The so-called international arbitration is a farce in which the corporates, only they, can call the tune

Restricting myself to BIT litigations[1], I quote to endorse what the Pakistan Attorney General is reported to have said:[2]

> "Pakistan's Attorney General, Makhdoom Ali Khan, explained that such treaties have been treated simply as photo-opportunities, "when some-one is coming over for a visit and an 'unimportant' document has to be signed." As reported by Investment Treaty News, Khan recently told a crowd of investment experts that "These are signed without any knowledge of their implications. And when you are hit by the first investor-state arbitration you realize what these words mean."

The ITUC Briefing note on Bilateral Investment Treaties examined four BIT disputes concerning Argentina, Tanzania[3], Bolivia and South Africa at great detail.[4] It tells us in detail the reasons which make the Bilateral Treaties, as being done in the world, so problematic.

> "**First** of all,…., the protections given to foreign investors and the way these protections can be enforced mean that developmental or public interests, or interests of national investors, are made secondary to foreign investor interests. **Secondly**, although the investment treaties are signed between two governments, the investors of one state can challenge the other state's government if their interests are at stake. In general, governments might tend to be rather reluctant and to think twice before bringing another country to dispute settlement, but experience shows that investors clearly do not. **Thirdly**, a balance between rights and obligations of investors is absent. The treaties provide protection of investors' interests and rights, but do not enter into commitments on obligations of investors, for example in terms of their

---

[1] See for texts of BITs http://www.unctadxi.org/templates/DocSearch.aspx?id=779

[2] Quoted from The Food & Water Watch

[3] Also visit http://icsid.worldbank.org/ICSID/FrontServlet

[4] **http://www.unctad.org/sections/dite/iia/docs/bits/netherlands_india.pdf**

> contribution to sustainable development, respect for local laws and regulations, workers' rights and so forth. …And **fourthly**, in the case of disputes, most of these treaties refer to international dispute settlement mechanisms whose record demonstrates a bias towards the interests of foreign investors. The dispute mechanisms available are all non-transparent, secretive, and arrive at decisions that do not take into account their developmental impact. Moreover, the costs involved and payments in case of loss are often soaring and could drain government budgets, including for social spending, health and education."

The Food & Water Watch, a nonprofit consumer rights organization, based in Washington, DC, has shown, on comprehensive examination, how the World Bank's Investment Court, Free Trade Agreements, and Bilateral Investment treaties have unleashed a New Era of Corporate power. It has summarized the consequences of the corporate domination as revealed in the litigations at such foreign fora. :[5]

> "This report examines how global corporations have increased their power through rules and institutions designed to provide unprecedented and sweeping protections to private foreign investors. These increasingly controversial protections are promoted by the World Bank and other international financial institutions, codified by bilateral investment treaties and free trade agreements, and enforced through international arbitration tribunals. Civil society groups – including labor, environmental and human rights groups have been harshly critical of these rules, charging that they elevate the narrow interests of global corporations above social and environmental goals. They have been joined by an increasing number of legislators around the world, including in the United States, who have attacked these measures as fundamentally undemocratic. And now, new political leaders, particularly in South America, are beginning to explore ways of challenging these excessive investor protections and putting forth proposals for more just trade and investment regimes."

I had the opportunity to study how these arbitral tribunals work at the international plane. I assert with full responsibility that by no standards they are 'courts'. They might have some pretentious trappings of a 'tribunal', but it is a strange tribunal. The administrators who play the role of the judges are selected only by those whose heart bleeds for the MNCs and their mentors. Their 'jurisprudence' knows only their economics, is wholly unfamiliar with human rights and democratic values. The proceedings there are secret; lawyers do not appear as lawyers; public representation or intervention in the arbitral proceedings is denied; transparency is excluded. We all know what happens in secret chambers. Anything can happen but not Justice. Hence we

---

[5] foodandwater@fwwatch.org

www.foodandwaterwatch.org
also see **www.world-psi.org**

must reject a recourse to such arbitrations. Supervision by the regular courts must not be excluded.

In the Section I of this Chapter, I have pointed out that the issues involved in *Vodafone* pertain to 'taxation' that is not within the province of the BIT. We have to guard against one mischief that the MNC can think of playing. It may try to initiate proceedings leaving to the arbitral body to decide whether issues pertaining 'taxation' come within the province of BIT. We must reject it. If we accept this plea, we would get trapped. They are sure to decide in favour of Vodafone. If we believe otherwise, we would act the way the Mughals and the Nawabs had acted once upon a time hoping that they would get just treatment from the stooges of the imperial power: the East India Company. This also be noted that it is not a case that 'taxation' is not covered by the BIT; it is because it is not POSSIBLE for the Executive Government to touch any aspect of tax law unless the specific authority to do so is obtained. These great constitutional principles are so well established that all negotiating parties are presumed to have public knowledge. Even Article 46 of the *Vienna Convention on the Law of Treaties* contemplates, as one of the grounds for the invalidation of treaties, when "consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties" if " that violation was manifest and concerned a rule of its internal law of fundamental importance." No rule in the democratic countries world over is more fundamental than this that the Executive lacks competence to enter into any treaty that affects "taxation".

V

AS I READ ON THE WALL: THE BITs MAY BE TURNED INTO bits

It is possible to question through a PIL before our superior courts the competence of our Government to enter into treaties like BITs and the WTO as on many points they violate our Constitution's Basic Structure, and go counter to the restraints put on the powers of the organs created by it. I believe the following fundamental principles of our constitutional law condition and control the executive's treaty-making power.

> The Sovereignty of the Republic of India is essentially a matter of constitutional arrangement which provides structured government with powers granted under express constitutional limitations.
>
> The Executive does not possess any "hip-pocket" of unaccountable powers", and has no *carte blanche* even at the international plane.
>
> The executive act, whether within the domestic jurisdiction, or

> at the international plane, must conform to the constitutional provisions governing its *competence.*
>
> The direct sequel to the above propositions is that the Central Government cannot enter into a treaty which, directly or indirectly, violates the Fundamental Rights or the Basic Structure of the Constitution; and if it does so, that treaty must be held *domestically inoperative*

Not many lawyers even notice that our Constitution is unique in an important way. Under our Constitution all the organs are constitutionally created, only with conferred powers. All powers of all organs are wholly under the Constitution's restraints. This is the effect brought about by the Articles 53, 73, 245, 246, 253, 265, 363, 368, 372, and 375 of our Constitution is that . Our Constitution contains no provisions for limitations on national sovereign powers, in the interests of international co-operation, as is the case in the constitutions of *Belgium* (Art 25bis*), Denmark* (Art 20), *Italy* (Art 11), the *Netherlands* (Art 92), *Spain* (Art 93), the *Federal Republic of Germany* (Art 24), nor it lacks the *terms of prohibition* as fetters on the Executive's Treaty-Making Power [as it was found in the U.S. Constitution noted by Justice Holmes to sustain the *Migratory Bird Treaty Act of 1918]*,

After much controversy, the U.S. Supreme Court declared that where an international treaty contravenes Constitution, it is the treaty that must prevail within the domestic jurisdiction. It held that the Constitution is supreme whether the Executive Governments acts at the international plane or within the domestic jurisdiction. There are better Constitutional reasons under our Constitution than under the U.S Constitution. In the USA, the Supreme Court in *Reid v. Covert* [ILR 24 (1957) p. 549] [6] 'held [7] the provisions of certain treaties unconstitutional (*Oppenheim* p. 77 fn. In *Reid* 354 U.S. 1 (1957) Justice Black had observed:

> "There is nothing in this language which intimates that treaties do not have to comply with the provisions of the Constitution. Nor is there anything in the debates which accompanied the drafting and ratification of the Constitution which even suggests such a result. These debates as well as the history that surrounds the adoption of the treaty provision in Article VI make it clear that the reason treaties were not limited to those made in 'pursuance' of the Constitution was so that agreements made by the United States under the Articles of Confederation, including the important treaties which concluded the Revolutionary War, would remain in effect. It would be manifestly contrary to the objectives of those who created

---

[7] Although a Status of Forces Agreement may give the sending state a right to exercise jurisdiction the law of that state may not permit it to exercise that right. The conclusion was reached by the U S Supreme Court in relation to the scope of the jurisdiction of US courts martial, which were on constitutional grounds held not to have jurisdiction in peacetime over civilian dependents or employees accompanying members of US forces abroad. (vide *Oppenheim* p. 1160 fn. 24)

> the Constitution, as well as those who were responsible for the Bill of Rights—let alone alien to our entire constitutional history and tradition—to construe Article VI as permitting the United States to exercise power under an international agreement without observing constitutional prohibitions. In effect, such construction would permit amendment of that document in a manner not sanctioned by Article V."

Our Supreme Court in *Ram Jethmalani & Ors. v. Union of India & Ors*. of 4/07/2011 [2011 (6) SCALE 691] strikes the same note when it says:

> **"Treaty-Making Power:** "It is now a well recognized proposition that we are increasingly being entwined in a global network of events and social action. Considerable care has to be exercised in this process, particularly where governments *which come into being on account of a constitutive document*, enter into treaties. The actions of governments can only be lawful when exercised within the four corners of constitutional permissibility. No treaty can be entered into, or interpreted, such that constitutional fealty is derogated from." (Italics supplied)

This outsourcing of judicial power to the international fora (that too in the field of 'taxation') contravenes the BASIC Structure of our Constitution (being the supremacy of the Constitution and the Rule of Law that presupposes the judicial system as established through our Constitution), Outsourcing of the administration of justice is bad; outsourcing this even to the arbitral bodies is alarming. This violates the Rule of Law and the Supremacy of Our Constitution. This sort of provision in BIT brings to mind the obnoxious Article XVI (4) of the Agreement Establishing the WTO which obligates:

> "Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements."

***