ACADEMY OF TAX LAW
learn • share • connect

INTERNATIONAL TAX
CASE SUMMARY

INTERQUEST INFORMATICS VS PAKISTAN

NOVEMBER 2024

ACADEMY OF TAX LAW

PUBLISHING SERVICES

This Publication is copyrighted under the Berne Convention.

No reproduction or use of this material is allowed without prior permission

Copyright©, 2025 - Academy of Tax Law (Division of International Institute for Tax And Finance)

First Edition Published on 22 January 2025

Published by Academy Of Tax Law

CONTACT US
www.academyoftaxlaw.com | info@academyoftaxlaw.com

HEAD OF ACADEMICS

Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court: Supreme Court of Pakistan

Case No: Civil Review Petitions No. 988–1001/2023

Applicant: Interquest Informatics Services

Defendant: The Commissioner of Income Tax

Judgment Date: 28 November 2024

Full Judgment: CLICK FOR FULL JUDGMENT

View Online: CLICK TO VIEW SUMMARY ONLINE

JUDGMENT SUMMARY

The case revolves around the taxation treatment of receipts received by Interquest Informatics Services, a Netherlands-incorporated company, under agreements with Schlumberger Seaco, Inc., operating in Pakistan. Interquest claimed the receipts as "business profits," invoking Article 7 of the Netherlands-Pakistan Double Taxation Convention (DTT) to exempt them from Pakistani taxation. However, the Pakistani tax authorities treated these as "royalties" under Article 12, subjecting them to a 15% income tax.

The case passed through the Income Tax Appellate Tribunal, which upheld the tax authority's stance. The Sindh High Court subsequently ruled in Interquest's favour, asserting that the receipts were not royalties. However, in 2023, a Supreme Court majority judgment overturned the High Court's ruling, reinstating the Tribunal's decision. The present review petition challenges this majority judgment, highlighting errors in fact and law.

The review petition argued that the Supreme Court erroneously dismissed the High Court's jurisdiction in addressing questions of law and misinterpreted critical treaty provisions. The review Bench examined these claims and identified several errors apparent on the record. These included misjudgments about alternate remedies under the DTT, an erroneous assumption of material facts regarding receipts' nature, and reliance on a stricter interpretation of the treaty's "royalties" clause.

The Bench ruled in favour of the petitioner, overturning the majority judgment. It concluded that the receipts were "business profits," not taxable as "royalties" under Pakistani law. This decision reinstates the High Court's earlier ruling, emphasizing the dynamic interpretation of DTTs to promote equitable international tax practices.

KEY POINTS

OF THE JUDGMENT

BACKGROUND

Interquest Informatics Services entered into agreements with Schlumberger Seaco, Inc., a company operating in Pakistan, to lease FLIC tapes and provide software rental services. The agreements, executed in 1986 and 1995, outlined payments made to Interquest for the use of these tapes. Interquest classified these receipts as business profits and sought exemption from tax in Pakistan under Article 7 of the Netherlands-Pakistan DTT.

The tax authorities, however, disagreed with this classification. They argued that the receipts fell under the definition of royalties as outlined in Article 12 of the treaty. Consequently, the income was subjected to a 15% withholding tax.

This disagreement led to a series of legal challenges. The Income Tax Appellate Tribunal and tax officers upheld the classification of the income as royalties, but the Sindh High Court reversed these decisions. The Court held that the payments were business profits and not subject to taxation in Pakistan under the DTT.

The revenue authority appealed to the Supreme Court, which issued a majority judgment overturning the High Court's decision. It reinstated the Tribunal's ruling, a decision that prompted Interquest to file the present review petition, alleging errors in the interpretation of treaty provisions and procedural missteps.

KEY POINTS
OF THE JUDGMENT

CORE DISPUTE

The fundamental issue in this case revolved around the classification of payments made by Schlumberger Seaco, Inc. to Interquest Informatics Services under two agreements: one for the lease of FLIC tapes and another for software rental. The tax authorities in Pakistan classified these payments as "royalties" under Article 12 of the Netherlands-Pakistan Double Taxation Convention (DTT), subject to a 15% withholding tax. Interquest contended that these payments were instead "business profits," exempt from taxation under Article 7 of the treaty, as the company did not maintain a permanent establishment (PE) in Pakistan.

A major point of contention arose from the interpretation of the term "royalties" within the DTT. Pakistani authorities relied on the broader definition provided under the UN Model Tax Convention, which included payments for "information concerning industrial, commercial, or scientific experience." Interquest argued that this clause was inapplicable as the payments were for operational use of software, not for the transfer of intellectual property rights or proprietary knowledge.

The Income Tax Appellate Tribunal and Sindh High Court faced conflicting interpretations of the agreements and treaty provisions. The Tribunal upheld the tax authorities' stance, while the High Court sided with Interquest, ruling that the payments were not royalties. The Supreme Court initially overturned the High Court's decision in a majority judgment but later reconsidered its stance in the present review. The dispute highlights the complexities of treaty interpretation in cross-border transactions and the significance of precise contractual language.

KEY POINTS
OF THE JUDGMENT

COURT FINDINGS

The Supreme Court's review Bench identified critical errors in the majority judgment, focusing on procedural missteps and misinterpretations of the treaty. The Bench found that the majority judgment failed to address the questions of law referred by the Tribunal and misclassified the payments as royalties.

First, the Bench criticised the reliance on the UN Model Tax Convention's broader definition of royalties, noting that the specific circumstances of the case did not align with this framework. The payments for leasing FLIC tapes and software rental were operational in nature, not payments for intellectual property or proprietary knowledge. This misclassification overlooked the evidence and contravened principles of treaty interpretation.

Second, the Bench emphasised the procedural misapplication of alternate remedies under the treaty, such as the mutual agreement procedure (MAP). The majority judgment incorrectly suggested that the availability of alternate remedies diminished the High Court's jurisdiction to address legal questions. The review Bench clarified that the appellate jurisdiction of the High Court is distinct and cannot be supplanted by alternate remedies.

Lastly, the review judgment highlighted the importance of dynamic treaty interpretation. Courts must consider the object and purpose of tax treaties, promoting international cooperation while safeguarding national tax bases. The review Bench concluded that the payments were "business profits," exempt from taxation under Article 7 of the DTT, thereby reinstating the High Court's ruling.

This outcome underscored the need for balanced interpretations and adherence to procedural norms, providing clarity for similar future disputes.

KEY POINTS
OF THE JUDGMENT

OUTCOME

The Supreme Court's review Bench overturned its previous majority judgment, reinstating the Sindh High Court's decision. The review concluded that the payments received by Interquest Informatics Services were "business profits," not "royalties," as initially classified by the tax authorities. Consequently, these payments were exempt from taxation under Article 7 of the Netherlands-Pakistan DTT.

Key findings included:

1. The payments were operational in nature, not related to intellectual property or proprietary knowledge, and thus fell outside the treaty's definition of royalties.
2. The High Court's jurisdiction to address Tribunal-referred questions of law was valid and necessary. Alternate remedies under the treaty, such as MAP, did not diminish this jurisdiction.
3. Dynamic treaty interpretation is essential, balancing the object and purpose of international tax treaties with the need to prevent double taxation and economic distortions.

For Interquest, the ruling eliminated the 15% withholding tax liability, affirming the company's position. For Pakistani revenue authorities, the judgment highlighted the importance of precise treaty application and adherence to procedural norms.

The outcome carries broader implications for cross-border taxation. It reinforces the principle that income classification must align with the substantive nature of transactions and treaty provisions. The judgment serves as a precedent for future disputes, promoting equitable taxation and fostering international cooperation.

TP METHOD
HIGHLIGHTED (IF ANY)

Although this case primarily involved treaty interpretation rather than direct transfer pricing (TP) application, the underlying principles reflect key TP concepts, particularly regarding income classification and economic substance. The tax authorities' classification of payments as royalties mirrors challenges often faced in applying the transactional net margin method (TNMM) or other TP methods.

In TP disputes, accurate delineation of transactions is critical. Here, the authorities argued that payments under the agreements fell within the definition of royalties, akin to disputes over royalty and service payments under TP frameworks. The classification relied heavily on the agreements' wording, demonstrating the importance of precise and unambiguous documentation—a core TP principle.

The case also illustrates the overlap between TP and treaty disputes. Had the agreements explicitly detailed the nature of payments as operational rather than involving intellectual property, the classification might have been less contentious. This aligns with TP best practices, where robust intercompany agreements reduce the likelihood of misclassification and disputes.

The review judgment highlights the need for consistent application of economic substance principles across both TP and treaty contexts. For multinationals, this means ensuring that transactional documentation aligns with treaty provisions and arm's length principles. For revenue authorities, it emphasises adopting nuanced approaches to classification and ensuring that treaty interpretations align with global TP standards.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

The dispute presented several contentious issues, primarily centred on treaty interpretation and procedural matters:

1. **Treaty Interpretation:** The classification of payments as royalties was based on an expansive interpretation of the term under the UN Model Tax Convention. Interquest argued that the payments were operational, falling outside the treaty's definition.

2. **Jurisdictional Disputes:** The majority judgment incorrectly dismissed the High Court's jurisdiction to address Tribunal-referred questions of law. This procedural error became a focal point in the review.

3. **Misclassification of Income:** The tax authorities' reliance on the broader UN Model definition of royalties ignored the narrower scope of the OECD Model, leading to incorrect classification.

4. **Alternate Remedies:** The majority judgment placed undue emphasis on the availability of alternate remedies under the treaty, such as MAP, which detracted from the substantive legal issues.

5. **Dynamic Interpretation:** The majority judgment's rigid approach to treaty provisions conflicted with principles of dynamic interpretation, which aim to balance tax rights between source and residence countries.

These issues underscore the complexities of cross-border taxation, particularly when treaty provisions and domestic tax laws intersect.

EXPECTED
OR CONTROVERSIAL?

The majority judgment issued in 2023 was controversial for several reasons. It adopted a rigid and expansive interpretation of the Double Taxation Treaty (DTT) provisions, particularly the classification of payments under the term “royalties.” This approach diverged from established global norms, creating uncertainty for multinational enterprises (MNEs) operating in Pakistan.

The judgment placed significant emphasis on the UN Model Tax Convention, which includes broader definitions of royalties, rather than the OECD Model, which offers a narrower and more widely accepted framework. This reliance on the UN Model led to the misclassification of payments for operational use as royalties, contradicting the economic realities of the transactions.

The decision also attracted criticism for procedural shortcomings. By dismissing the Sindh High Court’s jurisdiction to address questions of law referred by the Tribunal, the majority judgment ignored established procedural norms. This disregard for appellate oversight created a perception of judicial overreach, undermining confidence in the legal process.

Furthermore, the emphasis on alternate remedies under the treaty, such as the mutual agreement procedure (MAP), was viewed as an unnecessary diversion from the substantive legal issues. This approach risked setting a precedent that could dissuade courts from addressing complex treaty disputes directly.

The review judgment rectified these errors, bringing the decision in line with global best practices. It underscored the importance of dynamic treaty interpretation and procedural integrity, reaffirming the High Court’s ruling. While the controversy surrounding the original judgment raised concerns about judicial consistency, the review decision restored clarity and fairness, reinforcing the importance of equitable taxation principles in cross-border disputes.

SIGNIFICANCE
FOR MULTINATIONALS

For multinational enterprises (MNEs), the Pakistan vs. Interquest Informatics case underscores the critical need for precise documentation and robust compliance with double taxation treaties (DTTs). The central dispute over income classification highlights the challenges MNEs face when dealing with jurisdictions that adopt expansive interpretations of treaty provisions.

This case demonstrates the importance of understanding the interplay between local tax regulations and international treaties. Payments that are operational in nature must be clearly documented to avoid misclassification as royalties or other taxable categories. Ambiguities in agreements can lead to significant tax liabilities, as seen in this case, where a 15% withholding tax was imposed due to the authorities’ interpretation.

Moreover, the judgment serves as a reminder that tax disputes often hinge on procedural nuances. MNEs must ensure that legal counsel addresses all relevant procedural and substantive issues during litigation. Engaging with transfer pricing and tax treaty experts can provide MNEs with the necessary guidance to navigate complex treaty frameworks.

The review decision also highlights the broader implications of rigid treaty interpretations. MNEs must proactively manage their global tax risk by implementing internal controls and processes that align with international best practices. This includes periodic reviews of intercompany agreements, ensuring compliance with both domestic and international tax regulations.

Ultimately, the case reinforces the need for multinationals to adopt a proactive approach to tax compliance, emphasising the importance of clarity, consistency, and collaboration with tax experts to avoid disputes and optimise global tax efficiency.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue authorities, the Pakistan vs. Interquest Informatics case offers critical insights into the balance between safeguarding national tax bases and fostering international economic cooperation. The case serves as a cautionary tale about the potential consequences of overly aggressive interpretations of double taxation treaties (DTTs).

The authorities' classification of operational payments as royalties reflected a narrow focus on immediate revenue generation at the expense of treaty principles. This approach risked undermining investor confidence, as inconsistent treaty application can create uncertainty for multinationals operating in the country. The review judgment corrected this misstep, reaffirming the need for nuanced and equitable treaty interpretations.

The case also highlights the importance of procedural adherence in tax disputes. The majority judgment's dismissal of the High Court's jurisdiction to address Tribunal-referred questions was deemed a procedural error, emphasising the role of appellate oversight in ensuring fair outcomes.

Revenue authorities must align their practices with international tax norms to promote economic collaboration. Misclassifications or overreach in treaty interpretation can discourage foreign investment, particularly in developing economies that rely on cross-border trade and investment to drive growth.

Additionally, the case underscores the need for tax authorities to prioritise capacity building and training in treaty interpretation and transfer pricing principles. Developing expertise in these areas can enhance the effectiveness of tax administration, reducing disputes and fostering a more predictable tax environment.

The judgment serves as a reminder that equitable taxation practices not only support revenue generation but also contribute to a stable and attractive investment climate, benefiting the broader economy.

RELEVANT CASES

GOOGLE IRELAND VS IRELAND

This is an unreported case.

The Google Ireland case focused on the classification of advertising revenues under the provisions of Irish tax law and double taxation treaties (DTTs). The Irish tax authorities treated payments received by Google from advertisers as royalties, subject to withholding tax, arguing that they constituted payments for accessing intellectual property embedded in Google's advertising platforms. Google contended that these revenues were operational payments representing business profits, which were exempt under the treaty since it did not have a permanent establishment (PE) in the taxing jurisdiction

This dispute parallels Pakistan vs. Interquest Informatics as both involved the classification of cross-border payments under DTT provisions, with tax authorities adopting an expansive interpretation of "royalties" to increase tax revenue. In both cases, the companies argued that the payments were business profits, exempt from withholding tax. The outcomes of these cases stress the importance of precise income classification based on the substance of transactions rather than the form, aligning with the review Bench's emphasis on dynamic treaty interpretation.

GLAXOSMITHKLINE VS IRS

In GlaxoSmithKline Holdings (Americas) Inc. v. Commissioner, the U.S. Internal Revenue Service (IRS) challenged GSK's intercompany pricing arrangements, alleging they undervalued U.S. taxable income and failed to adhere to the arm's length principle. GSK argued that its pricing practices were consistent with international standards and appropriately allocated income between its U.S. and U.K. entities.

This case relates to Interquest Informatics as both involve disputes over the classification of payments and the economic substance of transactions. While GSK focused on transfer pricing and arm's length principles, Interquest addressed the distinction between royalties and operational income under a double taxation treaty. Both cases highlight the need for robust documentation to delineate the nature of payments and ensure compliance with international tax laws.

GLAXOSMITHKLINE VS UK

This case is analogous to Interquest Informatics as it dealt with income classification disputes and the role of the arm's length principle in determining the nature of payments. Both cases emphasised the importance of aligning transactional terms with treaty definitions and transfer pricing norms. While GlaxoSmithKline highlighted the overlap between transfer pricing and treaty disputes, it also reinforced the need for consistency in applying treaty provisions and ensuring that documentation reflects the true economic nature of transactions. Similarly, in Interquest, clear contractual terms could have avoided the misclassification of payments.

PART 3

PREVENTION

ENGAGING EXPERTS

Engaging tax treaty and transfer pricing experts is indispensable for multinational enterprises (MNEs) operating in multiple jurisdictions. These experts bring critical insights into the complexities of tax treaties, ensuring accurate classification of income streams and adherence to both domestic and international tax laws. The Pakistan vs. Interquest Informatics case illustrates how the absence of precise documentation and expert guidance can lead to costly disputes.

Experts play a pivotal role during the structuring phase of transactions, ensuring that intercompany agreements and cross-border contracts are drafted in a manner that aligns with treaty provisions and global tax norms. For instance, in this case, clearer agreements distinguishing operational payments from royalties could have avoided misclassification by Pakistani tax authorities.

In the event of disputes, experts provide strategic advice and robust legal arguments, helping MNEs address procedural nuances and complex legal challenges. Their knowledge of treaty interpretation, including distinctions between the UN and OECD Model Tax Conventions, can be decisive in litigation. For example, had Interquest leveraged expert input earlier, it might have preempted the tax authorities' reliance on the UN Model's broader definition of royalties.

Moreover, experts assist in navigating alternative resolution mechanisms like the mutual agreement procedure (MAP), ensuring that disputes are resolved efficiently without escalating to costly litigation.

By engaging experts, MNEs can reduce tax risks, protect their global operations, and ensure compliance with ever-evolving tax regulations, reinforcing their ability to maintain a competitive edge in the international market.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

Preventative measures are essential for MNEs to minimise tax risks and avoid disputes like Pakistan vs. Interquest Informatics. Implementing robust tax governance frameworks can preemptively address issues of misclassification and misinterpretation.

One critical step is establishing a tax steering committee, as highlighted on the next page. These committees bring together key stakeholders—such as tax professionals, legal advisors, and financial executives—to oversee the organisation's global tax strategy.

Periodic reviews of intercompany agreements are another key preventative measure. Such reviews ensure that the agreements clearly outline the nature of payments—whether operational fees, royalties, or reimbursements—and align with treaty definitions. This clarity can prevent misclassification, as occurred in the Interquest case, where operational payments were mistakenly treated as royalties.

Additionally, implementing robust tax risk management processes is vital. This involves regular compliance audits, documentation of transactions, and proactive engagement with tax authorities to clarify ambiguities. Training sessions for internal teams on treaty application and transfer pricing principles further strengthen compliance.

Finally, MNEs should consult with experts to stay abreast of international tax developments, such as evolving definitions under the UN and OECD Model Tax Conventions. By adopting these measures, MNEs can safeguard their operations, mitigate the risk of disputes, and maintain compliance with global tax standards, fostering a stable environment for international business growth.

DOWNLOAD FREE BOOK

TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies" by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like this case.

DOWNLOAD FREE E-BOOK

DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE

The eBook "Driving Tax Compliance: The Essential Role of a Tax Steering Committee" by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

INTERNATIONAL TAX

CASE SUMMARY

ACADEMY OF TAX LAW

Copyright © 2024/2025
International Institute for Tax and Finance Ltd (I/I/T/F) Academy of Tax Law

This publication was accurate at time of publishing.
It may be necessary for reasons beyond the control of the organisers to alter the content.