HIGH COURT OF BOMBAY

Director of Income tax (International Taxation)

v.

Commonwealth Development

IT APPEAL NO. 1058 OF 2011

JULY 9, 2012

JUDGMENT

S.J. Vazifdar, J. – This is an appeal under section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal dated 25th February, 2010, in respect of the assessment year 1998-99, dismissing the appellant's Income-tax Appeal No. 1987/Mum/2006 and the respondent's cross-objections.

2. The appeal is admitted on the following substantial question of law :

"Whether the ITAT erred in deleting the addition made by the Assessing Officer amounting to Rs. 77,14,828/- on account of up front appraisal fees under section 143(3) of Act ?"

3. The respondent is a statutory company established under the laws of of the United Kingdom. It filed its return of income for the assessment year 1998-99 on 5th August, 1999, declaring an income of Rs. 13,17,82,890/-. After taking into account, the TDS, a refund of Rs. 21,78,079/- was claimed. The Joint Commissioner of Income-tax passed an order under section 143(3) and served a notice of demand under section 156 for Rs. 30,86,180/-. The Assessing Officer, *inter-alia*, added to the total income, the sum of Rs. 77,14,828/- received by the respondent towards upfront appraisal fee.

4. It is necessary first to indicate what the upfront appraisal fee is. The assessee advances loans, *inter-alia*, to Indian companies. Before doing so, it examines the creditworthiness of the borrower and the financial efficacy of advancing the credit facilities. To do so, it appraises the applicant for the loan. The report is then considered by the respondent's various departments to enable them to decide whether or not to advance the loan/credit facilities. The respondent charges the applicants, a fee for carrying out the appraisal. This fee is termed as the upfront

appraisal fee (hereinafter referred to as “the said fee”). It covers the cost of the appraisal and expenses incidental thereto and in connection therewith.

5. It is important to note two things. Firstly, the applicant for the facility is normally not furnished a copy of the report. Secondly, the fee is charged irrespective of whether the loan/credit facility is advanced to the applicant or not. The following table demonstrates this :

S. No.	*Name of Investee*	*Amount (Rs)*	*Nature of proposed investment*	*Status of the deal*
1.	DLF Power Ltd	11,85,175	Preference Shares and Senior Debt	Failed
2.	Gujarat Pipavav Port Limited	9,74,250	Equity.	Successful
3.	Punjab Wireless Systems	12,08,151	Equity and/or Quasi Equity and Senior Debt	Failed
4.	STI India Limited	19,28,426	Convertible Bonds and Equity	Successful
5.	Kondapalli Power Corporation	24,18,826	Equity and Senior Debt	Successful
	Total	77,14,828		

The upfront appraisal fees were received by the respondent from the applicants at Sr. Nos. 1 and 3, but the loan transactions were not entered into with them.

6. These upfront appraisal fees were brought to tax under the head “Income from other sources”. The JCIT held the receipts to be either interest as defined in Article 12 or in the nature of fees for technical services as defined in Article 13 of “The Convention Between The Government Of The Republic Of India And The Government Of The United Kingdom Of Great Britain And Northern Ireland For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income And Capital Gains” (hereinafter referred to as “the DTAA”).

7. Mr. Suresh Kumar, the learned counsel appearing on behalf of the appellant firstly submitted that the upfront appraisal fees (hereinafter referred to as “the fee”)

fall within the definition of “interest” under Section 2(28A), which reads as under :-

“**Definitions. –** In this Act, unless the context otherwise requires.

……..

(28A) “interest” means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised;”

8. The submission is not well founded. The fee is not payable in respect of any moneys borrowed or debt incurred. It is the debt itself. If any money was payable in respect thereof, it could have been held to be interest. However, admittedly, no amount was paid by the applicants in respect of the said fee.

9. Nor can the payments be said to be service fees or other charges “in respect of moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized”. This is so irrespective of whether or not the loan transactions were entered into between the respondent and the applicants.

10. (A) Where the loan transaction was not entered into, the said fee could not be said to have been in respect of moneys borrowed for moneys were not even lent. It was, therefore, not in respect of a debt incurred for it was the debt itself. Nor could the said fee be said to have been charged or made in respect of any credit facility which had not been utilized for the credit facility had not even been sanctioned, leave alone advanced.

(B) The position would be the same even where the loan transactions had been entered into between the respondent and the applicants. The said fee was charged prior to and entirely independent of the loan transaction that was subsequently entered into. The parties had agreed that the respondent would be entitled to the said fee irrespective of whether the loan transaction was entered into or not. Interest was separately charged by the respondent in respect of the moneys lent pursuant to the agreements that were entered into. Nor can the fee be said to be in respect of credit facilities granted but not utilized for the said fees preceded the credit facility and had nothing to do with it. It was paid towards the appraisal work which by its very nature was entirely different from the loan transaction. It was to

enable the respondent to decide whether the loan ought to be granted to the borrower or not.

11. Mr. Suresh Kumar submitted that a single agreement had been entered into between the respondent and the applicants for the payment of the said fee as well as the terms and conditions of the credit facilities to be granted by the respondent. He submitted, therefore, that the said fee must be deemed to be in respect of the loan granted.

12. We will assume that a single agreement was entered into. It is, however, not disputed that the respondent was not thereby bound to sanction the credit facilities. Admittedly, the respondent was entitled to appraise the project and decide whether or not to sanction the credit facilities. In some cases, it decided to sanction the same and in some cases, it decided not to do so. Obviously, the terms and conditions in respect of the credit facilities would come into effect only upon and in the event of the respondent deciding to sanction the credit facility and the applicant agreeing to avail of the same. The payment of the said fee was fixed and mandatory and neither dependent upon nor connected with the loans advanced. It had to be paid even if the loan transaction was not entered into. It did not vary even if the loan transaction was entered into. The fact that a single agreement was entered into, therefore, would make no difference.

13. It is pertinent to note that it was not the department's case that the upfront appraisal fee was a camouflage for interest. Indeed, even the assessment order does not suggest the same. The facts on record militate against the same. The assessment order itself recognises the fact that the respondent examined the creditworthiness of the Indian companies and its projects for which the loans were required.

14. Mr. Suresh Kumar then submitted that the said fee falls within Article 12(5) of the DTAA.

15. We intend relying upon our judgment dated 9th July, 2012 in Income Tax Appeal No.1026 of 2011 in *The Director of Income Tax* v. *M/s. Credit Suisse First Boston (Cyprus) Ltd., i*n which we construed Article 11(4) of the India-Cyprus DTAA which is similar to Article 12(5) of the India-UK DTAA. The difference between the two Articles is not material to the question before us. The difference in Article 12(5) is the addition and the absence of certain words which we will underline.

INDIA – UK DTAA

ARTICLE 12 – Interest

…….

5. The term “interest” as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11 (Dividends) of this Convention.”

NOTE : The underlined words do not appear in Article 11(4) of the India-Cyprus DTAA.

“**INDIA-CYPRUS DTAA**

ARTICLE 11 – Interest -

1. ……..

4. The term “interest” as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.”

NOTE : The underlined words do not appear in Article 12(5) of the India-UK DTAA.

16. In our judgment dated 9th July, 2012 in Income Tax Appeal No.1026 of 2011 in *The Director of Income Tax* v. *M/s. Credit Suisse First Boston (Cyprus) Ltd.*, we held as under :-

“25. Clause (4) of Article 11 defines interest. The principal or governing words in Article 11(4) are “interest means income from debt-claims of every kind”. These words predicate the existence of a debtor-creditor relationship. Clause 4 relates to interest “from” debt-claims. In other words, the income must arise out of, on account of a debt-claim. It is important to note the difference between the debt-claim itself and any accretion thereto, such as interest. Once this distinction is

noted, it is easy to appreciate that the price realised upon the sale of the debt-claim itself is not interest. Interest arises from and on the terms of the debt-claim/security and would be on revenue account. The sale proceeds upon a transfer or assignment of the security arise not from but on account of and represents the debt claim/security itself."

The observations apply equally to Article 12(5) of the India-UK DTAA. The differences between the two Articles are not material to the ambit of the term "interest" for the purpose of this case. The upfront appraisal fee is not income from a debt-claim. It is the debt itself. It is rightly not even suggested that it arises out of or on account of a debt-claim. The said fee, therefore, does not fall within the ambit of Article 12(5) of the DTAA.

17. Mr. Suresh Kumar then submitted that the said fee falls within Article 13(4)(c) of the DTAA, which reads as under :-

"**ARTICLE 13 – Royalties and Fees for Technical Services.**

…….

4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5 of this Article, the term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical and consultancy services (including the provision of services of technical or other personnel) which ;

…….

(*c*) make available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design.

18. He firstly submitted that the Tribunal had not dealt with this aspect at all. This would not be entirely fair as it appears that the point was not pressed before the Tribunal. The Commissioner of Income Tax (Appeals) dealt with this issue. The order of the Tribunal does not refer to this point. No application was made to the Tribunal in this regard. The appeal memo filed by the appellant before the Tribunal states only this:

"On the facts and circumstances of the case and in law, the ld. CIT(A) has erred in deleting the addition made by the A.O. Amounting to Rs. 77,14,828/-"

This is an omnibus ground. On the basis of this ground, we are unable to accept the contention that the point was raised before the Tribunal. In any event, we permitted Mr. Suresh Kumar to address us on this aspect of the matter and have decided the same.

19. The submission that the upfront appraisal fee constitutes fees for technical services within the meaning of those words in Article 13(4)(c) is unsustainable. The said fees did not constitute payment in consideration of the respondent rendering any technical or consultancy services to the applicant/borrowers. As we have noted earlier, the entire appraisal process was to enable the respondent to take a decision as to whether the credit facilities ought to be advanced to the applicants or not. The respondent did not thereby or even while doing so, impart any technical or consultancy services to the applicants. Understandably, the appellants were unable to indicate anything that even remotely suggested that during the appraisal or by the appraisal report, the respondent made available to the applicants or the borrowers, any technical knowledge, experience, skill, know-how or processes or that the same consisted of development and transfer of any technical plan or technical design. In fact, it was quite the contrary. The process involved the respondent appraising itself of various aspects of the applicant for the credit facilities which would obviously involve an appraisal of the applicants existing assets, tangible as well as intangible, including its technical knowledge, experience, skill, know-how and the quality of its processes and technical abilities. By no stretch of imagination can it be said that the respondent imparted to the applicants or the borrowers, any technical services, much less technical services of the nature referred to Article 13(4)(c) of the DTAA.

20. The Tribunal thus rightly upheld the findings of the CIT (Appeals) that the income on account of the upfront appraisal fees was business income and as the respondents did not have a permanent establishment in India, the same could not be charged to tax in India under Article 7 of the DTAA.

21. The appeal is, therefore, dismissed. There shall be no order as to costs.