I.T.A. NO. 458 OF 2005

IN THE HIGH COURT AT CALCUTTA

Special Jurisdiction (Income Tax)
Original Side

PRESENT:
The Hon'ble JUSTICE KALYAN JYOTI SENGUPTA

The Hon'ble JUSTICE I.P. MUKERJI

ABN AMRO BANK, N.V.

Versus

COMMISSIONER OF INCOME TAX
WEST BENGAL – III, KOLKATA & ANR.

Judgment on: 23rd December 2010

I.P. MUKERJI, J.

This is an Appeal under Section 260A of the Income Tax Act, 1961 (in short "the Act") against the Order of the Income Tax Appellate Tribunal (in short "the tribunal") dated 22nd August 2005.

Before discussing the merits of this Appeal, a reference to section 90 of the Act is necessary. It empowers the Central Government to enter into an agreement with a foreign government to interalia avoid double taxation in India as well as in that foreign country. In such case where an agreement has been entered into, the said Act will only apply to the assessee, if the Act is more beneficial than the agreement.

The appellant before us is a foreign company incorporated in Netherlands and having its principal branch office in India at ITC Center, 4th Floor, Russel Street, Kolkata 71.

We are here concerned with only a limited transaction made by this bank and the effects thereof, for the purpose of computing its income.

In course of its banking activities the appellant's said branch in India remits substantial funds to its head office as payment of interest. While the appeal was being argued, it was submitted by Mr. R.N. Bajoria, learned senior Advocate for the appellant, that there is a continuous process of the said branch receiving interest from its head office and other branches and remitting of interest by the branch to the head office and other branches. This interest accrues according to him on funds of the head office or the branch as the case may be, treated to be held by the other unit.

There was a convention between the Governments of India and Netherlands for inter alia avoidance of double taxation. The said convention became operational from 21st January 1989. In exercise of powers under Section 90 of the Act the Central Government by a notification dated 27th March 1989 amended by a notification dated 30th August 1999 gave effect to it.

Now, the articles of this convention have assumed great significance in deciding the issues in this appeal. There are principally only two issues in this appeal, namely, 1. Whether interest payment made by the Indian branch of the appellant

to its head office abroad was to be allowed as a deduction in computing the profits of the appellant's branch in India? 2. Whether in making such payment to the head office, the appellant's said branch was required to deduct tax at source under Section 195 of the said Act?

For deciding the above issues detailed considerations have to be made of the Act and the convention. But before discussing the effect of the convention some very important provisions of the Act have to be noted.

First is the definition of "person" in section 2(31) of the Act. Sub section (vii) includes an artificial juridical person within the definition of "person". Section 2(42) defines "resident" as a person who is resident in India within the meaning of section 6. Non resident has been defined in Section 2(30) as a person who is not a "resident" and includes a person who is not ordinarily resident within the meaning of clause (6) of Section 6. Section 5 of the Act deals with total income. Sub section 2 of Section 5 defines the income of a non resident as income received or deemed to be received in India or accrues or arises or deemed to accrue or arise in India. The charging section is section 4. The total income of a person who is resident in India is defined in section 5 as all income received or accrued in India or deemed to have been so in this country. Under section 9(1) (i) explanation (1)(a) the income of a business which arises or accrues in India attributable to operations into this country are to be taken as income. Under section 40 (a) (i), interest which is payable out side India on which tax has not

been deducted is not to be deducted in computing the income chargeable under the head profits and gains of business.

RIVAL CONTENTIONS:

The following submissions were made on behalf of the Appellant by Mr R.N.Bajoria, learned Senior Advocate.

He has taken us extensively through the International Agreement and all the relevant clauses which we shall deal with under the heading 'Discussion and Findings'

He has contended that the agreement should prevail over the Act relying on the decision of the Supreme Court in the case of **Union of India vs Azadi Bachao Andolan and Anr** reported in **263 ITR 706.**

He has further said that the Head Office and the Permanent establishment in India, i.e. the branch are to be treated as different entities for the purpose of taxation. The Indian branch is to be treated like a separate assessee, by creating a fiction .Under the said agreement while computing profit from business the said two entities have to be treated separately. Interest remitted from India can be deducted as an expense. No tax is to be deducted as, for such purpose, the Indian branch and the foreign Head Office are one entity. Further the profit of the Indian establishment has to be computed proportionately to the total profit on the basis of profit which is properly attributable to India. He has cited the

decisions of the Supreme Court in **Commissioner of Income Tax and Anr vs Hyundai Heavy Industries Co Ltd & Ors** reported in **291 ITR Pg 482**, **Sir Kikabhai Premchand vs Commissioner of Income Tax (Central)Bombay** reported in **24 ITR 506**, **Anglo French Textile Company Ltd vs Commissioner of Income Tax Madras** reported in **25 ITR 27** and **Betts Hartley Huett and Co Ltd vs Commissioner of Income Tax,West Bengal-II Calcutta** reported in **116 ITR425** and **Director of Income Tax (International taxation) vs Morgan Stanley and Co** reported in **(2007)162 Taxman 165.**

Mr D.K. Shome Learned Counsel for the Respondents has shown us various provisions of the Act as well as the agreement. His foremost contention is that under s 195 (1) there was an obligation of the Indian branch to deduct tax at source while remitting interest to the head office and having not done so, the deduction cannot be granted under section 40(a) (i) of the Act. The detailed submissions of the counsel will be reflected in the "Discussion and findings".

He has further contended that the head office and the permanent establishment in India are to be taken as separate entities. Under the treaty interest cannot be allowed as a deduction.

He has contended that in considering an appeal under section 260A of the Act, the court should follow the principles followed in determination of second Appeals.

DISCUSSION AND FINDINGS

Under section 90 of the Act, the Government of India has entered into the above agreement with the government of Netherland for relief of tax and avoidance of double taxation. The appellant is an assessee to whom such agreement applies. Therefore, for the purpose of relief of tax which is related to avoidance of double taxation, a more beneficial provision amongst rival provisions in the agreement and the Act will apply to the assessee. We are not here concerned with a detailed interpretation of the agreement and relevant provisions of the Act. But, we are here concerned with making the necessary interpretation of the agreement read with the Act for the purpose of resolution of the issues involved in this appeal.

The Supreme has said in the case of Union of India vs Azadi Bachao Andolan (supra).

> **"A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a double taxation avoidance agreement. When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would operate even if inconsistent with the provisions of the Income tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the Legislature to make a departure from the general principle of chargeability to tax under section 4 and the general principle of ascertainment of total income under section 5 of the Act, then there was no purpose in making those sections "subject to the provisions" of the Act. The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under section 90 towards implementation of the terms of the DTAs which would automatically override the provisions of the Income-tax Act in the matter of ascertainment of chargeability to income-tax and ascertainment of total income, to the extent of inconsistency with the terms of the DTAC."**

Such issues, as noted above, are very limited. First, is the question of separate taxable entities. If one is to make an interpretation of the word "assessee" in section 2(7) read with the definition of "person" in 2(31), a branch of a company not being an artificial juridical person is not to be taken as a separate assessee/entity. But under Article 5(2) of the convention or agreement defining "permanent establishment" a branch is to be taken as a permanent establishment and if it is further read with article 7, this permanent establishment or branch is to be treated as a separate unit. Article 7(2) specifically states that it is to be considered as a distinct and separate enterprise and its profits are to be so computed, as profit properly attributable to such a permanent establishment. In the calculation of such profit by a banking enterprise interest paid can be taken as a deduction by virtue of article 7(3) read with article 11(7).

Anglo French Textile Company Ltd vs Commissioner of Income Tax Madras reported in **25 ITR 27(supra)** a foreign company was an assessee. It had its registered office in London. It had a mill in Pondicherry which manufactured yarn. It had appointed a company in Madras as their agents. The manufactured goods were sold mostly in British India and partly outside British India. The contracts for such purposes were made in British India, the payments were also received there. The Supreme Court in that case held that the income in the taxable territories in the particular year and income outside the taxable territories had to be proportionately allocated for the purpose of taxation. In **Sir**

Kikabhai Premchand vs Commissioner of Income Tax (Central) Bombay reported in **24 ITR 506(supra)** the Supreme Court held that each assessment year is to be treated as a self-contained accounting period and the income tax authorities can only take into consideration income, profits and gains made in that year and they are not concerned with potential profits which may be made in another year any more than they are concerned with losses which may occur in the future.

However, in **Betts Hartley Huett and Co Ltd vs Commissioner of Income Tax,West Bengal-II Calcutta** reported in **116 ITR 425(supra)** a Division Bench of our court was concerned with a transaction between the London head office of the assessee and its branch in India. The question before the court was whether it was sale. The court held in construing the transaction that the head office and the branch office being parts of the same entity there could not be a sale by the head office to itself, that is, the branch office.

But in our view, this particular Division Bench judgment does not answer the issues involved in this appeal because according to the international agreement, the head office and the branch are treated as separate entities for the purpose of assessment. What would be the effect of an alleged sale by the head office to the branch is not in issue here and, therefore, we are not called upon to determine its effects. But the remittance of interest is made on the premise that the head and the branch offices are separate entities and interest is payable by the branch to the head office. Under this agreement this branch is described as a

permanent establishment, treating as if as a separate entity. Therefore, as far as the remittance of interest is concerned it cannot be said that the branch or permanent establishment and the head office are one entity. Neither can the permanent establishment nor the branch, and the head office be treated as one entity for the purpose of deduction of tax under section 195 (1), as explained below.

The Supreme Court in **Commissioner of Income Tax and Anr vs Hyundai Heavy Industries Co Ltd & Ors** reported in **291 ITR Pg 482** specifically stated the principles on which profits of a company had to be apportioned between the head office and the permanent establishment in India for the purpose of taxation. Therefore on the basis of the above decisions and the international agreement the permanent establishment of the foreign company in India is to be treated as if it were an assessee. The permanent establishment is to be taken as an assessee and the foreign company or the head office is not to be treated as such assessee and the income to be computed accordingly on the above principles of proportionality, in as much as, the above agreement is applied with the Act the foreign company cannot be an assessee. Its assessable income is the assessable income of the branch and the other income or expense which it receives or makes is to be computed separately as attributable to the foreign company, not being such permanent establishment. The question of apportionment was also dealt with by the Supreme Court in **Director of Income Tax (International taxation) vs Morgan Stanley and Co** reported in **(2007)162 Taxman 165.**

According to the revenue under section 195 (1), the appellant's head office is to be treated as a foreign company. When the appellant remitted interest to such head office, it ought to have deducted tax under section 195 (1). Having not so deducted the appellant is not entitled to claim the benefit, of such deduction, under section 40(a)(i).

Under article 7 read with definition of article 5, the permanent establishment is to be taken as an assessee for the purpose of computation of business profits. Further, under sub article 3(b) of Article 7 payment of interest can be claimed as a deduction.

An unnecessary complication has been created by the interpretation made of section 40 (a) (i) of the Income Tax Act read with section 195 of the Act by both the appellant and the respondents. First of all, a proper meaning has to be ascribed to the expression "chargeable" under the provisions of this Act. Section 195(1) says that, if any interest is paid by a person to a foreign company, which interest is chargeable under the provisions of this Act tax should be deducted at source. The word "chargeable" is not to be taken as qualifying only the phrase "any other sum" only but it qualifies the word "interest" also. This interpretation is supported by the phrase in parenthesis, namely, not being income chargeable under the head "salaries". Therefore, the meaning of this section is that such interest must be chargeable under the provisions of this Act. To simplify the

matter, this interest must be accounted for or credited in the account of some person who is chargeable under the Act. In other words, this remittance of interest must result in an income which is chargeable under the Act. In those circumstances tax may be deducted at source. But where this interest is not so chargeable, no tax is deducted. In this case, by virtue of the above convention, the head office of the appellant is not liable to pay any tax under the Act. Therefore, in our opinion, there was and still is no obligation on the part of the appellant's said branch to deduct tax while making interest remittance to its head office or any other foreign branch.

Therefore, in the circumstances there is no scope for any argument that for the purpose of computation of expenditure the branch and the head office are to be taken as separate entities but for the purpose of payment of tax to be deducted at source on interest payment, it is to be taken as one bank and no deduction is to be made as sought to be made by the learned counsel for the appellant. Such contentions are totally unfounded in our opinion. The permanent establishment and the head office have to be taken as separate entities for all purposes. But in the making of payment of interest no tax has to be deducted under section 195(1), for the reasons above.

Therefore, if no tax is deductible under section 195(1) section 40(a)(i) of the Act will not come in the way of the appellant claiming such deduction as from its income. Therefore, in the circumstances the appellant would be entitled to

deduct such interest paid, as permitted by the convention or agreement, in the computation of its income.

In view of our above findings there is no conflict at all between the agreement and the Act. It is only the tax authorities, the tribunal and to some extent the parties who have put a very complicated meaning to the provisions in the convention read with the Act.

The appeal is allowed to the above extent. That the assessment of the income of the appellant for the relevant period is to be done in accordance with the findings made in this judgment.

Urgent certified photocopy of this judgment/ order, if applied for, be supplied to the parties subject to compliance with all requisite formalities.

I agree,

(I.P. MUKERJI, J.)

(KALYAN JYOTI SENGUPTA, J.)