**IN THE INCOME TAX APPELLATE TRIBUNAL**
**MUMBAI L BENCH, MUMBAI**

**Before Shri Pramod Kumar (Accountant Member),**
**and Shri R S Padvekar (Judicial Member).**

ITA No. 2508/Mum/08
Assessment year 2008-09

***Ashapura Minichem Limited*** ***…….Appellant***
***Jeevan Udyog Bhawan, 3rd floor***
***Dr D N Road, Mumbai 400 001***

***Vs.***

***Assistant Director of Income Tax***
***- International Taxation 1 (1), Mumbai*** ***……. Respondent***

Appellant by : Shri Rajan Vora, and
Smt Sheetal Shah
Respondent by : Shri Ajit Kumar Sinha and
Shri S K Mahapatra

**O R D E R**

**Per Pramod Kumar:**

1. By way of this appeal, the appellant has called into question correctness of Commissioner (Appeals) order dated 25th February 2008, in the matter of ascertainment of tax withholding liability on the appellant in respect of a payment of US $ 1,000,0000 made to a China

based company by the name of China Aluminum International Engineering Corp Ltd (CAIECL, in short) on the following grounds :-

***On the facts and in the circumstances of the case, the learned Commissioner of Income Tax (Appeals), confirming the action of the Assessing Officer in directing to deduct tax at source from foreign remittance,***

***1. erred in confirming the action of the AO in holding that the payment made to China Aluminum International Engineering Corp Ltd, towards bauxite testing chares is 'fees for technical services' in view of paragraph 4 of Article 12 of DTAA between India and China, as well as per the provisions of Section 9(1)(vii) of the Income Tax Act, 1961;***

***2. should have appreciated that the final report of the bauxite testing in respect of the same sent by appellant from India, was prepared by the foreign company in China, and hence the income does not accrue or arise in India and not taxable in the hands of the foreign party; and***

***3. failed to appreciate that the receipt in the hands of the foreign company is in the nature of business income and since the foreign company does not have a permanent establishment in India, the income is not chargeable to tax in India and no liability to deduct tax on part of the appellant has arisen.***

2. The material facts, giving rise to this appeal before us, are as follows. The appellant before us is an Indian resident company by the name of Ashapura Minichem Limited (*hereinafter referred to as 'AML' or 'the Indian company'*) and this company entered into an agreement, on 5th April 2007, with a China based company by the name of China Aluminum International Engineering Corp Ltd ( *hereinafter referred to as 'CAIECL' or 'the Chinese company'*). Under the said agreement, the Indian company, which was in the process of building a alumina refinery with a capacity of 1000 kt/y using Bauxite from Gujarat State, was to pay US Dollars one million in consideration of bauxite testing services by the Chinese company in its laboratories and for preparation of test reports, so that the process parameters, in accordance with the test reports, could be defined by the Indian company. These test reports of bauxite samples were to cover complete chemical composition of bauxite, physical phase constitution of bauxite, abradability test of bauxite, pre- desilication of

bauxite, digestion performance test and red mud settling performance test. At the time of making remittance of US $ 1,000,000 for these bauxite testing services to the Chinese company, the Indian company moved an application under section 195 to the Assistant Director of Income Tax – International Taxation Circle 1 (1) [hereinafter referred to as 'the Assessing Officer'] requesting him to certify and declare that no tax withholding is required to be made from the aforesaid remittance. It was contended by the AML that the Chinese company could be taxed in India only in terms of the provisions of the India China Double Taxation Avoidance Agreement[1] (hereinafter referred to as 'the treaty' or 'the Indo Chinese tax treaty'), which, being beneficial to the assessee, override the provisions of the Indian Income Tax Act, 1961 (hereinafter referred to as 'the Act'). It was further submitted that the receipts on account of bauxite testing service charges were in the nature of business profits of the Chinese company which, in view of the provisions of Article 7 of the treaty, could be taxed in India only in the event of the Chinese company having a permanent establishment in India. Since the Chinese company did not have any permanent establishment in India, according to the AMCL, the business profits of the Chinese company could not be taxed in India. It was further submitted that since the Chinese company did not have any tax liability in India, no taxes are required to be withheld from the remittance to the said company. None of these submissions, however,

[1] *(1995) 214 ITR Statutes 160*

impressed the Assessing Officer. He held that the services rendered by the Chinese company were in the nature of 'fees from technical services' under Article 12 of the Indo China tax treaty, as also under section 9(1)(vii) of the Indian Income Tax Act,1961. The Assessing Officer thus concluded that in terms of the treaty provisions, the Indian company was to withhold tax @ 10% of the gross amount of remittance to the Chinese company. Aggrieved by the stand so taken by the Assessing Officer, the Indian company challenged this tax withholding liability and carried the matter in appeal before the Commissioner (Appeals ), but without any success. The assessee is aggrieved and is in further appeal before us.

3. The basic thrust of assessee's contentions is that, since no part of the testing services was rendered in India, the Chinese company did not have any tax liability in India in respect of the bauxite testing charges. By way of a detailed note, it is submitted that in order to attract taxability under section 9 (1)(vii) of the Income Tax Act, 1961, not only that the services should be utilized in India, but should also be rendered in India. In support of this proposition, learned counsel for the assessee has made a reference is made to the Hon'ble Supreme Court judgment in the case of Ishikawajima Harima Heavy Industries Ltd. vs. DIT[2] and of Hon'ble jurisdictional High Court's judgment in the case of Clifford Chance Vs

[2] *(288 ITR 408)*

DCIT[3] . As far as taxability under the domestic law is concerned, learned counsel primarily relies upon his exhaustive written submissions filed before us. Coming to the taxability under the applicable treaty provisions, it is submitted that even in terms of the provisions of Article 12 of India China tax treaty, taxability of royalty can only arise when not only the services are used in India but also rendered in India. According to the learned counsel, the only other situation in which impugned receipt can be taxed in India, under Article 7 of the applicable tax treaty provisions, is when the said income is earned in the course of business carried on by the assessee in India though a permanent establishment in India. Learned counsel submits that it is not even the case of the revenue that the Chinese company had any permanent establishment in India, and, therefore, the business profits of the Chinese company cannot be taxed under Article 7 of the tax treaty. He fairly accepts that, in case impugned receipt is to be taxed under Article 12 as 'fees for technical services', the existence, or non existence, of the permanent establishment will be wholly irrelevant. He, however, contends that Article 12 cannot be applied on the facts of the present case, because unless the services rendered by resident of one of the contracting States (i.e China in the present case) are rendered in the other contracting State (i.e India in the present case), the payment for these services cannot be subjected to tax in that source state (i.e. India in the present case). It is submitted that

[3] *(318 ITR 297)*

since the testing services are entirely rendered in China, and since no part of services is rendered in India, the testing services could not be brought to tax in India in terms of provision of Article 12 of the tax treaty. It is contended that, unlike the provisions in most other tax treaties, the taxability of fees for technical services in the India China tax treaty has an additional requirement of 'place of performance' in the source country, to be satisfied before it can be taxed as fees for technical services in the source country. He takes us through the provisions of Indo China tax treaty, China Pakistan Tax Convention, India Israel Tax Convention , India South Africa Tax Convention and India Germany Tax Convention. He does all this to highlight that India China tax treaty is unique in its wordings and its scope – so far as the taxability of fees for technical services is concerned. When his attention was invited to the deeming fiction under Article 12 (6) of the treaty, which requires the 'fees for technical services' as deemed to have arisen in the State of which payer is resident, learned counsel submitted that 'fees for technical services', for the purpose of Article 12 (6), cannot have any other meaning than the meaning assigned under article 12(4) and, under article 12(4), place of performance test is to be satisfied before FTS can be taxed in the source state. It is repeatedly emphasized that Article 12 (6) can come into play only when the 'fees for technical services' meets the definition assigned to the said term under Article 12 (4) and since 'place of performance test' must be met in order to meet the definition

under Article 12 (4), unless the services are rendered in the other Contracting State, the same cannot be covered by Article 12 (6). When it is pointed out by us that this approach will render Article 12(6) meaningless, since, in such a case, deeming clause to the effect that 'services are deemed to have arisen in the other Contracting State' can only be invoked when services are performed in that other Contracting State – something which is patently absurd, learned counsel submits that if words of the treaty result in an absurdity, at best, to that extent, it is to be treated as unworkable. We cannot change the entire complexion of treaty provision in the name of making a segment thereof workable. Learned counsel thus urges us to hold that, in terms of the provisions of the applicable tax treaty, the payment in question were not liable to be taxed in India. Learned Departmental Representative, on the other hand, relies upon the orders of the authorities below, takes us through the same, and urges us to confirm the same. As far as taxability under the domestic law is concerned, it is submitted that in case we are to proceed on the basis that the royalties or fees for technical services can only be taxed in India only when not only the services are utilized in India, but also rendered in India, the source rule will cease to have any meaning. It is contended that the judgments of Hon'ble Supreme Court in the case of Ishikawajima[4] and of Hon'ble Bombay High Court in the case of Clifford

[4] *(supra)*

Chance[5] are clearly contrary to the legislative intent and the doubts, if any, have been set at rest by the retrospective amendment in Explanation to Section 9(1)(vii), as introduced by the Union Budget. It is submitted that once the proposed amendments are carried out, these judicial precedents will no longer constitute good law. *(We may add that the proposed amendments relied upon by the learned Departmental Representative, on which have also heard the learned counsel for the assessee, are since carried out and legislative process for the same is duly completed.)* As far as learned counsel's arguments on treaty provisions are concerned, learned Departmental Representative mainly contends that the deeming provision of Article 12(6) is quite clear and categorical, and we are urged to give it a sensible and reasonable meaning which makes the provision workable rather than making the provision redundant. It is submitted that when payment is made to a Chinese enterprise is made by an Indian enterprise, the 'fees for technical services' is deemed to have arisen in India. In case we are to proceed on the basis that such deeming provision can only be invoked when the services by Chinese enterprise are rendered in India, this deeming clause will be rendered meaningless, as one cannot deem something which exists in reality anyway. Whichever way we examine the issue – whether under the Income Tax Act, 1961 of under the India China tax treaty, according to the learned Departmental Representative, the payment for

[5] *(supra)*

testing fees is liable to be taxed in India. We are thus urged to confirm the findings of the authorities below and decline to interfere in the matter.

4. We have given our careful consideration to the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

5. As regards the taxability under the domestic law, we have noted that section 9(1)(vii) provides that " income by way of fees for technical services payable by, inter alia, "a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India" will be deemed to accrue or arise in India. There is also no dispute that the fees received by the assessee is covered by the scope of 'fees for technical services' under Explanation 2 to Section 9(1)(vii) which provides that " for purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)". There is also no

dispute that the exclusion clause set out in the said definition is not attracted.

6. The case of the assessee, however, is that since the services are not rendered in India, the provisions of Section 9(1)(vii) cannot be invoked. The main support for this proposition is assessee's reliance on on Hon'ble Bombay High Court's judgment in the case of Clifford Chance vs. DCIT[6]. It is, therefore, necessary to deal with this case in some detail.

7. In the case of Clifford Chance, the appellant, an English law firm, was rendering legal services in connection with three projects in India, namely, Bhadravati Power Project, Vizag Power Project and Raviva Oil and Gas Field Project. While the claim of the assessee was that only such portion of the fees received, in connection with these projects is taxable in India as is attributable to services performed in India, the Assessing Officer opined that the total fees received for the India Project, whether the work was done in India or outside India, was taxable in India. When this dispute finally travelled before the Hon'ble Bombay High Court, it was, inter alia, contended by the assessee that "the place of utilization of service is not relevant but place of performance of the service is what

[6] *(supra)*

would be determinative (*of taxability*)……." and reliance was placed on Hon'ble Supreme Court's judgment in the case of Ishikawajima Harima Heavy Industries Ltd. vs. DIT[7] Their Lordships noted that the taxability is to be determined under section 9(1)(vii) of the Act, and observed as follows :

> **"The apex court had occasion to consider the above question in the case of Ishikawajima Harima [2007] 288 ITR 408 (SC), wherein, while interpreting the provisions of section 9(1)(vii)(c) of the Act, the Supreme Court held as under (page 444) :**
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> > **"Section 9(1)(vii)(c) of the Act states that 'a person who is a non-resident, where the fees are payable in respect of services utilized in a business or profession carried on by such person in India, or for the purposes of making or earning any income from any source of India'."**
>
> **Reading the provision in its plain sense, as per the apex court it requires two conditions to be met—the services which are**

[7] *supra*

**the source of the income that is sought to be taxed, has to be rendered in India, as well as utilized in India, to be taxable in India. Both the above conditions have to be satisfied simultaneously. Thus for a non-resident to be taxed on income for services, such a service needs to be rendered within India, and has to be part of a business or profession carried on by such person in India.**

**In the above judgment, the apex court observed that (page 444):**

> **"section 9(1)(vii) of the Act must be read with section 5 thereof, which takes within its purview the territorial nexus on the basis whereof tax is required to be levied, namely, (a) resident; and (b) receipt of accrual of income". According to the apex court, the global income of a resident although is subjected to tax, the global income of a non-resident may not be. The answer to the question would depend upon the nature of the contract and the provisions of the DTA. What is relevant is receipt or accrual of income, as would be evident from a plain reading of section 5(2) of the Act subject to the compliance with 90 days rule.**

**As per the above judgment of the apex court, the interpretation with reference to the nexus to tax territories also assumes significance. Territorial nexus for the purpose of determining the tax liability is an internationally accepted principle. An endeavour should, thus, be made to construe the taxability of a non-resident in respect of income derived by it. Having regard to the internationally accepted principle and the DTAA, no extended meaning can be given to the words "income deemed to accrue or arise in India" as expressed in section 9 of the Act. Section 9 incorporates various heads of income on which tax is sought to be levied by the Republic of India. Whatever is payable by a resident to a non-resident by way of fees for services, thus, would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish a basis for imposition of ax. Whereas a resident would come within the purview of section 9(1)(vii) of the Act, a non-resident would not, as services of a non-resident to a resident utilized in India may not have much relevant in determining whether the income of the non-resident accrues or arises in India. It must have a direct link between the services rendered in India. When such a link is**

**established, the same may again be subjected to any relief under the DTAA. A distinction may also be made between rendition of services and utilization thereof.**

**With the above understanding of law laid down by the apex court, if one turns to the facts of the case in hand and examines them on the touchstone, section 9(1)(vii)(c) which clearly states…where the fees are payable in respect of services utilized in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India". It is thus, evident that section 9(1)(vii)(c), read in its plain, envisages the fulfillment of two conditions : services, which are source of income sought to be taxed in India must be (i) utilized in India, and (ii) rendered in India. In the present case, both these conditions have not been satisfied simultaneously.**

8. It is thus clear that the judgment of Hon'ble Bombay High Court[8] rests on the legal premises that, under section 9(1)(vii), "services, which are source of income sought to be taxed in India, must be (i) utilized in India; and (ii) rendered in India" and the conceptual premises that

[8] *Clifford Chance Vs DCIT (supra)*

"territorial nexus for the purpose of determining the tax liability is an internationally accepted principle". Learned counsel has laid lot of emphasis on these two principles.

9. The legal proposition canvassed by the learned counsel, however, does no longer hold good in view of retrospective amendment w.e.f. 1st June 1976 in section 9 brought out by the Finance Act, 2010. Under the amended Explanation to Section 9(1), as it exists on the statute now, it is specifically stated that the income of the non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of section 9(1), and shall be included in his total income, whether or not (a) the non-resident has a residence or place of business or business connection in India; or (b) the non-resident has rendered services in India. It is thus no longer necessary that, in order to attract taxability in India, the services must also be rendered in India. As the law stands now, utilization of these services in India is enough to attract its taxability in India. To that effect, recent amendment in the statute has virtually negated the judicial precedents supporting the proposition that rendition of services in India is a *sine qua non* for its taxability in India.

10. The concept of territorial nexus, for the purpose of determining the tax liability, is relevant only for a territorial tax system in which taxability in a tax jurisdiction is confined to the income earned within its borders. Under this system, any foreign income that is earned outside of its borders is not taxed by the tax jurisdiction, but then apart from tax heavens, the only prominent countries that are considered territorial tax systems are France, Belgium, Hong Kong and the Netherlands, and in those countries also this system comes with certain anti abuse riders. In other major tax systems, the source and residence rules are concurrently followed. On a conceptual note, source rule of taxation requires an income sourced from a tax jurisdiction to be taxed in this jurisdiction, and residence rule of taxation requires income, earned from wherever, to be taxed in the tax jurisdiction in which earner is resident. In the US tax system, this residence rule is further stretched to cover US taxation of all its citizens – irrespective of their domicile, and the source rule is also concurrently followed. It is this conflict of source and residence rules which has been the fundamental justification of mechanism to relieve a taxpayer, whether under a bilateral treaty or under domestic legislations, of the double taxation - either by way of exclusion of income from the scope of taxability in one of the competing jurisdictions or by way of tax credits. Except in a situation in which a territorial method of taxation is followed, which is usually also a lowest common factor in taxation policies of tax heavens, source rule is an integral part of the taxation

system and any double jeopardy, due to inherent clash of source and residence rule, to a taxpayer is relieved only through the specified relief mechanism under the treaties and the domestic law. It is thus fallacious to proceed on the basis that territorial nexus to a tax jurisdiction being *sine qua non* to taxability in that jurisdiction is a normal international practice in all tax systems. This school of thought is now specifically supported by the retrospective amendment to section 9.

11. It is thus clear that Hon'ble Bombay High Court's judgment in the case of Clifford Chance[9] is no longer good law, as there have been amendments in law in consonance with the school of thought discussed above and these amendment unambiguously negate the principle of territorial nexus which is the understructure of line of reasoning adopted by the Hon'ble Courts above. It is no longer necessary that, in order to invite taxability under section 9(1)(vii) of the Act, the services must be rendered in the Indian tax jurisdiction. In our considered view, therefore, the income of the Chinese company, by way of impugned receipt of fees for technical services from an Indian company, is to be deemed to accrue or arise in India under Section 9(1)(vii) of the Act. It is accordingly liable to be taxed in India under the domestic tax law.

[9] *(supra)*

12. The next issue to be examined by us is whether or not the income earned by the Chinese company is liable to be taxed in India under Article 12 of the India China tax treaty.

13. Article 12 of the India China tax treaty provides as follows:

***Royalties and fees for technical services***

*1. Royalties or fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State.*

*2. However, such royalties or fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that Contracting State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 10 per cent of the gross amount of the royalties of fees for technical services.*

*3. The term "royalties" as used in this Article means payment of any kind received as a consideration for the use of or the right to use, any*

*copyright of literary, artistic or scientific work including cinematograph films and films or tapes for radio or television broadcasting, any parent, trade mark design or model, plan secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.*

*4. The term "fees for technical services" as used in this Article means any payment for the provision of services of managerial, technical or consultancy nature by a resident of a Contracting State in the other Contracting State, but does not include payment for activities mentioned in para-graph 2(k) of Article 5 and Article 15 of the Agreement.*

*5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties of fees for technical services arise, through a permanent establishment situated therein, or performs in that other Contracting State independent personal services from a fixed base situated therein; and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent*

*establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.*

*6. Royalties or fees for technical services shall be deemed to arise in a Contracting State when the payer is the Government of that Contracting State, a political subdivision a local authority thereof or a resident of that Contracting State. Where, however the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contacting State a permanent establishment or a fixed best in connection with which the liability to pay the royalties or fees for technical services was incurred, and such royalties or fees for technical services are borne by such permanent establishment or fixed base then such royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.*

*7. Where by reason of a special renlationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services, having regard to the use right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned*

*amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.*

14. A plain reading of the above treaty provisions show that under Article 12 (4) shows that what is covered by the basic definition of the expression 'fees for technical services' is the "provision of services of managerial, technical or consultancy nature" by a resident of a Contracting State in the other Contracting State. In other words, technical services being provided by resident of one of the contracting state in the other contracting state is what will be covered by the basic rule under Article 12 (4). The expression 'provision of services' is not defined or elaborated anywhere in the tax treaty. The argument of the learned counsel is that 'provision of services' should be construed as 'rendition of services', but we will come to that aspect a little later.

15. It is also important to take note of the deeming fiction under Article 12(6) of the treaty. This article, inter alia, provides that, "Royalties or fees for technical services shall be deemed to arise in a Contracting State when the payer is the Government of that Contracting State, a political subdivision a local authority thereof or a resident of that Contracting State". In other words, irrespective of the *situs* of technical services having been rendered, according to this treaty provision, the

fees for technical services will be deemed to have accrued in the tax jurisdiction in which person making the payment is located. That is a typical manifestation of the source rule that we have discussed earlier in this order in the context of domestic law provisions, and which, in principle, requires taxability of an income in the tax jurisdiction in which it is sourced. Normally, the source of an income is the country in which person making the payment is located. There could, of course, be situations in which a payment related to business or profession being carried out in one country is being made by a resident of another country who is carrying out such business or profession in the first country. In these situations, even though the payment is not received from a resident of the first country, the true source of earning is located in the first country. Second limb of Article 12(6) takes care of such situations and makes the manifestation of source rule even more unambiguous. It provides that even when person making the payment is not resident of the other contracting state but the payment is being made by him in connection with a permanent establishment or fixed base in the other contracting state, such royalties and fees for technical services will be deemed to have accrued in the other contracting state. In such a situation, the true source jurisdiction will be that other contracting state even though the payment may be made from outside both the contracting states, and, therefore, the income is deemed to have accrued in that other contracting state.

16. When we put it to the learned counsel that in view of the deeming fiction of Article 12(6), it is not really necessary to go into the broader question about the merits of his arguments on the scope of Article 12(4) and proceed on the basis that the payments made by an Indian company will be deemed to have arisen in India even under the Indo China tax treaty, he has submitted that once a fees for technical service is not covered by the basic provisions of Article 12(4), which is confined to services having been rendered in the source state, there is no occasion of invoking Article 12 (6). It is submitted that the deeming provision for Article 12(6) is confined to what is already covered by 'royalties and fees for technical services' which are neatly defined in Article 12(4) and it does not seek to extend the scope of the said basic definition. It is only after 12(4) is satisfied that the deeming fiction can be invoked. He invites our attention to corresponding article of China Pakistan tax treaty[10] , i.e. Article 13, which does not have any such deeming fiction but which provides that "the term 'fees for technical services', as used in this Article, means any consideration (including any lump sum consideration) for the provision of rendering of any managerial, technical or consultancy services by a resident of one of the contracting state in the other contracting state". It is pointed out that in China Pakistan tax treaty, there is no additional source rule, i.e. deeming fiction, for the fees for technical services, even though there is a deeming

[10] *93 TNI 250-8; Doc 93-31887*

fiction of source rule for 'royalties'. It is thus pointed out that Chinese tax treaties, which do not generally have 'fees for technical services' clause, have a 'place of performance test', or negation of source rule, in several tax treaties. We are urged to recognize this underlying principle in Chinese tax treaties. It is also pointed out that this phenomenon is not unique to Chinese tax treaties. Our attention is invited to India Israel tax treaty[11] which provides, under Article 13(5), that 'fees for technical services' will be deemed to arise in a contracting state only when services are rendered in that state and the payer is resident of that state. A reference is then made to India Saudia Arabia tax treaty in which a specific provision for taxability of 'fees for technical services' is said to be altogether absent, which, according to the learned counsel, shows that it is not at all necessary that the source rule must extend to all payments for fees for technical services.

17. We are unable to see any merits in this line of arguments either. Whether a particular income is to be covered by the benefits of a tax treaty or not is essentially a decision at the level of the Governments and it depends on several considerations - all of which do not necessarily reflect sound taxation or sound economic policies. Just because India does not seek a source taxation right in tax treaty with Saudia Arabia, or because Pakistan gives up a source taxation right in tax treaty with China,

[11] *96 TNI 162-41; Doc 96-23188*

it cannot influence as to what is the scope of India China tax treaty. It is not at desirable to be influenced with what has been decided in other tax treaties entered into by the contracting states. As regards the references to India Israel and India Saudia Arabaia tax treaties[12] , therefore, these are tax treaties with different countries and whatever is decided in these tax treaties does not influence the scope of tax treaty before usAs far as China Pakistan tax treaty[13] is concerned, we have noted that while China Pakistan tax treaty refers to "**provision of rendering of** any managerial, technical or consultancy services *(emphasis supplied by us)"*, India China tax treaty refers to "**provision of** services of managerial, technical or consultancy services". The scope the expression 'provision of services' has to be something wider than 'provision of rendering of services'. If at all this contrast with China Pakistan tax treaty shows something, this contrast shows that the India China tax treaty intends to follow the source rule, while China Pakistan tax treaty gives up the source rule for fees for technical services. The difference between these two clauses can hardly be missed, and it becomes all the more clear when one takes into account the fact that while there is a deeming fiction clause in Article 12(6) of India China tax treaty, taking care of the situations in which payments are made by persons not resident in the other contracting state, though they have a permanent establishment or fixed base in the other contracting state, there is no such corresponding clause in China

[12] *supra*
[13] *supra*

Pakistan tax treaty. It is thus clear, from the material placed before us, that while India China tax treaty follows the source rule in the matter of fees for technical services, Pakistan China tax treaty does not do so. That's a conscious choice by the respective Governments, and just because China Pakistan have negotiated a bilateral tax treaty in a particular manner, it does not mean that India China tax treaty should also be construed on the same basis.

18. We have also noted that any other meaning being assigned to the scope expression 'fees for technical services' will render Article 12(6) meaningless. When we put this proposition to the learned counsel for the assessee, he could not point out any situations in which, in such a situation, Article 12(6) will have any application but then he added that merely because a provision will be rendered infructuous, he should not be shy of giving the treaty a correct literal interpretation. We donot think that will be a correct approach for us. In the case of Hindalco Industries Ltd Vs ACIT[14] this Tribunal had an occasion to set out the principles on the basis of which tax treaties are to be interpretated. Summarzing these principles, and speaking through one of us (i.e. the Accountant Member), this Tribunal has observed as follows:

**The school of thought emerging from the above discussions**

[14] *94 ITD 242*

**leads us to conclude that the principles governing interpretation of tax treaties can be broadly summed up as follows :**

*** A tax treaty is an agreement and not taxing statute, even though it is an agreement about how taxes are to be imposed. The principles adopted in the interpretation of statutory legislation are not applicable in interpretation of treaties.**

*** A tax treaty is to be interpreted in good faith in accordance with the ordinary meaning given to the treaty in the context and in the light of its objects and purpose.**

*** A tax treaty is to required to be interpreted as a whole, which essentially implies that the provisions of the treaty are required to be construed in harmony with each other.**

*** The words employed in the tax treaties not being those of a regular Parliamentary draughtsman, the words need not examined in precise grammatical sense or in literal sense. Even departure from plain meaning of the language is permissible whenever context so requires, to avoid the absurdities and to interpret the treaty *ut res magis valeat quam pereat* i.e., in such**

**a manner as to make it workable rather than redundant.**

*** A literal or legalistic meaning must be avoided when the basic object of the treaty might be defeated or frustrated insofar as particular items under consideration are concerned. Words are to be understood with reference to the subject-matter, i.e., *verba accopoenda sunt secundum subjectum materiam*.**

*** It is inevitable that interpreter of a tax treaty is likely to be required to cope with disorganised composition instead of precision drafting. Therefore, the words employed in the treaty are to be given a general meaning - general to lawyers and general to layman alike.**

*** When a tax treaty does not define a term employed in it, and the context of the treaty so requires, it can be given a meaning different from domestic law meaning thereof. The meaning of the undefined terms in a tax treaty should be determined by reference to all of the relevant information and all on the relevant context. There cannot, however, be any residual presumption in favour of a domestic law meaning of a treaty term.**

(Emphasis supplied by us by underlining)

19. In view of the above, a literal interpretation to a tax treaty, which renders treaty provisions unworkable and which is contrary to the clear and unambiguous scheme of the treaty, has to be avoided. In any case, even on merits, we are of the considered view that the scope of the expression 'provision for services' is much wider in scope that the expression 'provision for rendering of services' and will cover the services even when these are not rendered in the other contracting state, as long as these services are used in the other contracting state. Therefore, the technical services in question are clearly covered by Article 12(4) of the treaty. This position is further clarified, and is specifically covered by the deeming fiction under Article 12(6) as well. The impugned payment to the Chinese company, therefore, is covered by the scope of "fees for technical services" within meanings assigned to that expression under Article 12 of the Indian China tax treaty, and is taxable in India as such.

20. For the detailed reasons set out above, we are of the considered view that the impugned payment was taxable in India under the provisions of the Indian Income Tax Act, 1961, as also under the provisions of the applicable India China tax treaty. The tax withholding liability of the appellant, under section 195, being in the nature of vicarious liability, therefore, did extend to deduction of tax at source

from the payment of US $ 1,000,000 made to the Chinese company. We, therefore, approve the conclusions arrived at by the learned CIT(A) and decline to interfere in the matter.

21. In the result, the appeal is dismissed. Pronounced in the open court today on 21st day of May, 2010.

***Sd/xx*** ***Sd/xx***
**(R S Padvekar)** **(Pramod Kumar)**
**Judicial Member** **Accountant Member**

***Mumbai; 21st day of May, 2010.***

*Copy forwarded to :*

1. *The appellant*
2. *The respondent*
3. *Director of Income Tax (International Taxation), Mumbai*
4. *Commissioner (Appeals) , Mumbai*
5. *Departmental Representative, L bench, ITAT, Mumbai*
6. *Guard File*

***True Copy***

*By Order*

*Assistant Registrar*
*Income Tax Appellate Tribunal*
*Mumbai benches, Mumbai*