IN THE INCOME TAX APPELLATE TRIBUNAL
JABALPUR BENCH, JABALPUR

[Coram: Pramod Kumar AM and C M Garg JM]

I.T.A. No.: 251 and 252/JAB/13
Assessment years 2010-11 and 2011-12

Birla Corporation Limited ***…….Appellant***
- Satna Cement Works Unit
PO :Birla Vikas, Satna 485 005 MP
[TAN : JBPB00003D]

Vs.

Assistant Commissioner of Income Tax (TDS)
Jabalpur ***……Respondent***

Appearances by:

D S Damle, A P Srivastava and **Swapan Usrethe**, *for the appellant*
Abhishek Shukla, *for the respondent*

O R D E R

Per Pramod Kumar, AM:

1. These two appeals, pertaining to the same assessee for two consecutive assessment years, call into question correctness of a common order dated 12th September 2013 passed by the Commissioner (Appeals) in the matter demands under section 201 r.w.s. 195 of the Income Tax Act, *1961 (hereinafter referred to as 'the Act')*, in respect of alleged lapses in not withholding tax at source from certain foreign remittances, and were heard together.

2. The impugned orders in respect of the two assessment years, as passed by the Assessing Officer-TDS, are materially similar, but for variations in figures etc, and the appellate order passed by the CIT(A) is a consolidated order for both of these assessment years. As a matter of convenience, therefore, both of these appeals are being disposed of by way of this consolidated order.

2. Grievances raised by the assessee-appellant, as set out in the respective memorandum of appeal, are as follows:

Assessment year 2010-11

1. For that on the facts and in the circumstances of the case, the CIT (A) erred in law and on facts in confirming the order passed by the ACIT (TDS), Jabalpur u/s 201 read with Sec. 195 of the I T Act and thereby confirming the demand of Rs.1,40,10,757 raised on the appellant on account from non-deduction of tax on foreign remittances made for purchase of plant and machineries.

2. For that on the facts and in the circumstances of the case, the CIT (A) was unjustified in law and on facts in confirming the levy of interest u/s 201(1A) of the I T Act even though the appellant had no liability to deduct tax at source in respect of foreign remittances made for purchase of plant and machineries.

3. For that on the facts and in the circumstances of the case, the authorities below were wholly unjustified in holding that the gross amounts paid by the appellant to the foreign suppliers of the plant and machineries represented income of the Non Residents accrued in India and thereby upholding the AO's order in which he had held that the appellant should have deducted tax @ 42.25% of the gross remittance amounts.

4. For that on the facts and in the circumstances of the case, the CIT (A) misdirected himself in upholding the order of the AO by relying wholly on extraneous considerations; irrelevant materials; without properly appreciating the facts of the case and without correctly understanding specific legal provisions contained in the I T Act 1961 as also the relevant DTAAs and in that view of the matter the order passed by the CIT(A) be set aside and/or cancelled.

5. For that on the facts and in the circumstances of the case, the orders of the lower authorities be set aside and/or cancelled since both the authorities below failed to correctly apply the legal provisions and wrongly held that the appellant was liable to deduct tax u/s. 195 of the IT Act even though no income chargeable to tax in India had embedded in the remittances made during the relevant year to foreign parties for supply of plant and equipment.

6. For that on the facts and in the circumstances of the case, the authorities below grossly erred in holding that the appellant had liability to deduct tax before making remittance to the foreign suppliers of plant and machineries by misinterpreting the appellant's contracts/ purchase orders with the concerned parties which clearly indicated that the remittances made in the relevant year pertained only to purchase of plant and machineries supplied entirely from outside India and therefore there being no accrual of income in India, the appellant had no obligation to deduct tax at source from the said remittances.

7. For that on the facts and an the circumstances of the case, the order passed by the ACIT (TDS) Jabalpur u/s 195 read with Sec. 201 of the Act treating the appellant to be "assessee in default" for non deduction of tax u/s 195 be cancelled and consequently demand raised against the appellant be quashed.

Assessment year 2011-12

1. For that on the facts and in the circumstances of the case, the CIT (A) erred in law and on facts in confirming the order passed by the ACIT (TDS), Jabalpur u/s 201 read with Sec. 195 of the I T Act and thereby confirming the demand of Rs.8,74,26,178 raised on the appellant on account from non deduction of tax on foreign remittances made for purchase of plant and machineries.

2. For that on the facts and in the circumstances of the case, the CIT (A) was unjustified in law and on facts in confirming the levy of interest u/s 201(1A) of the I T Act even though the appellant had no liability to deduct tax at source in respect of foreign remittances made for purchase of plant and machineries.

3. For that on the facts and in the circumstances of the case, the authorities below were wholly unjustified in holding that the gross amounts paid by the appellant to the foreign suppliers of the plant and machineries represented income of the Non Residents accrued in India and thereby upholding the AO's order in which he had held that the appellant should have deducted tax @ 42.25% of the gross remittance amounts.

4. For that on the facts and in the circumstances of the case, the CIT(A) misdirected himself in upholding the order of the AO by relying wholly on extraneous considerations; irrelevant materials; without properly appreciating the facts of the case and without correctly understanding specific legal provisions contained in the I T Act 1961 as also the relevant DTAAs and in that view of the matter the order passed by the CIT(A) be set aside and/or cancelled.

5. For that on the facts and in the circumstances of the case, the orders of the lower authorities be set aside and/or cancelled since both the authorities below failed to correctly apply the legal provisions and wrongly held that the appellant was liable to deduct tax u/s. 195 of the IT Act even though no income chargeable to tax in India had embedded in the remittances made during the relevant year to foreign parties for supply of plant and equipment.

6. For that on the facts and in the circumstances of the case, the authorities below grossly erred in holding that the appellant had liability to deduct tax before making remittance to the foreign suppliers of plant and machineries by misinterpreting the appellant's contracts/purchase orders with the concerned parties which clearly indicated that the remittances made in the relevant year pertained only to purchase of plant and machineries supplied entirely from outside India and therefore there being no accrual of income in India, the appellant had no obligation to deduct tax at source from the said remittances.

7. For that on the facts and an the circumstances of the case, the order passed by the ACIT (TDS) Jabalpur u/s 195 read with Sec. 201 of the Act treating the appellant to be "assessee in default" for non deduction of tax u/s 195 be cancelled and consequently demand raised against the appellant be quashed.

3. In substance, thus, grievance of the assessee is that the learned Commissioner (Appeals), on the facts and in the circumstances of this case, erred in upholding the demands raised on the assessee under section 201(1) r.w.s. 195

in respect of related foreign remittances made by the assessee towards purchase of equipment, plant and machinery.

4. To adjudicate on these grievances, a few material facts need to be taken note of. The assessee before us is a unit of Birla Corporation Limited, and is engaged in the business of manufacturing and selling cement. During the scrutiny of tax deduction at source returns filed by the assessee, for the relevant financial period, the Assistant Commissioner of Income Tax-TDS, Jabalpur (**AO-TDS** in short) noticed that the assessee has made certain foreign remittances without deducting tax at source. When assessee was asked the reasons of doing so, it was explained to the AO-TDS that the income embedded in these payments was not chargeable to tax in India as these payments were for imports of plant, equipment and machinery. It was also contended that as the payments were made for purchases, which did not give rise to taxability of related income in India, there was no requirement of tax withholding requirement from these payments. The AO-TDS, however, did not share this perception of facts. He was of the view that the payment was not only for purchases but also for incidental services in connection with installation and commissioning of these machines, and, accordingly, the assessee was required to deduct tax at source from these payments. He was also of the view that even if a part of income included in these payments was liable to be taxed in India, it was incumbent upon the assessee to approach the Assessing Officer, under section 195(2), for determination of income in respect of which tax is to be deducted at source. The AO-TDS noted that these payments were admittedly for composite contracts which includes all the services and other charges and that "**contracts entered into by the** ……. *(assessee)* **for design, manufacture, supply, installation, testing and commissioning of plant would fall under the category of 'works contracts' and leviability of TDS thereon would be effective**". The AO-TDS also was of the view, after going through the agreements and purchase orders submitted y the assessee, that all the orders were not in nature of mere 'supply' of machinery, but "**in addition to the supply part, the orders/ agreements obviously had supervision, inspection and commissioning charges** *element* **etc, for which, in the agreement/order itself, it was admitted that such payments shall be liable to income tax**". The AO-TDS further observed that "**certainly there were**

payments inherent in the nature of services along with each supply type of payments". He was of the view that "**it was duty of the assessee to approach the income tax authorities for apportionment of taxable/non-taxable part of any remittance made to the foreign parties but it** *(the assessee)* **failed to do so**". The AO-TDS once again noted that "**the orders of supply are not mere supply orders**" and that "**there are also some traits/ inherent clauses which connote that the order is of composite nature as services parts are also** *(present)* **therein**". The AO-TDS then proceeded to take up two, what he termed as, examples to substantiate his point. He noted that in the case of supply orders dated 30.9.2010, 22.3.2010 issued to **RHI AG, Vienna**, it is clearly mentioned that RHI supervisors and engineers will be sent for installation of bricks and no charges for the visit of supervisors and engineers will be payable. He thus inferred that, "**cost of services is also vested in the cost of material**". He proceeded on the assumption that the said cost of services was taxable in India and that, accordingly, "**it was duty of the assessee to ascertain the non taxable portion of contract value approaching the income tax authorities, but the assessee failed to do so**". The AO-TDS also referred to the order dated 14.10.2009 placed by the assessee with **Shenyung Heavy Machinery Co. Ltd, China**, which was said to have a specific clause with respect to erection and commissioning of the system, and noted that no taxes have been deducted at source from payments made to this supplier either. The AO-TDS then set out a list of similar cases by stating that "**following are the other companies whose agreements/orders have element of services, supervision, erection and commissioning part in addition to supply part**". These cases, as listed by the AO-TDS, are as follows: **1-MMD Asia Pacific Limited, UK [order dated 12/3/2010], 2-Thermo Fisher Scientific Ecublens SAL Switzerland [order dated 8/5/2010], 3-Rexnord NV, Belgium [order of June 2010], 4-Tangshan Senpu Mine Equipment Co Ltd, China [order dated 16.8.2010], 5-IKN GmbH, Germany [order dated 19.4.2007], 6-PARR Instrument Co, Ilionois [order dated 17.9.2009], 7-RHI AG, Austria [order dated 30.3.2009], 8-Shanyung Heavy Industries Co. Ltd, China [order dated 20.3.2007], and 9-Polysius AG Germany [order dated 15.9.2009].** The AO-TDS, on the basis of the above discussions, concluded that the contract is a composite contract for supply of plant and machinery and also for ancillary services of installation, commission

and erection of such plant and machinery. He referred to Hon'ble Supreme Court's judgment in the case of **Hindustan Shipyard Limited Vs State of AP [(2000) 6 SCC 579]** to highlight that examination of a contract to find out whether it is for sale of goods or works contract must depend on the terms and conditions laid down under the contract. It was also noted that, in the considered opinion of Hon'ble Supreme Court, a contract of the nature that "the contract may be for work to be done for remuneration and supply of materials used in execution for a price" would be a composite contract. On the basis of this analysis, the AO-TDS again reiterated that a portion of foreign remittances for supply or plant and machinery must be held to be in respect of services to be rendered in India, and, thus "accruing in India". Reliance was also placed on Hon'ble Supreme Court's judgment in the case of **Transmission Corporation of India Ltd Vs CIT [(1999) 239 ITR 587]** in support of the proposition that even when foreign remittance is not for pure income, but only an element of income embedded in the remittance, the assessee is required to approach the income tax authorities. A reference was also made to rather recent judgment from Hon'ble Supreme Court in the case of **GE India Technology Centre Pvt Ltd Vs CIT [(2010) 327 ITR 436]** in support of the stand that in cases of composite contracts, it is statutory duty of person making the payment to deduct tax at source from the same. The AO-TDS then proceeded to compute the tax withholding lapse as follows:

A: Assessment year 2010-11

S No.	*Name of the vendor*	*Amount in INR*
1	Polysius AG, Germany	1,48,01,845
2	RHI AG, Austria	1,61,12,160
3	PARR Instrument Co, USA	8,05,273
4	Shanyung Heavy Industry Co Ltd, China	14,57,982
	Total	**3,31,77,260**

The short deduction was computed @ 42.23% on Rs 3,31,77,260 which thus worked out to Rs 1,40,10,757

B: Assessment year 2011-12

Sl No.	*Name of the vendor*	*Amount in INR*
1	Tangshan Senpu Mine Equipment Co Ltd, China	1,88,42,739
2	Polysius AG, Germany	11,50,11,953
3	Rexord NV, Belgium	13,18,491
4	Thermo Fisher Scientific Ecublens SARL, Switzerland	56,67,600
5	MMD Asia Pacific Ltd, UK	1,66,37,051

6	Shanyang Heavy Machinery Co Ltd, China	1,24,80,714
7	RHI AG, Austria	1,63,33,227
8	RHI AG, Austria	2,07,32,088
	Total	20,70,23,865

The short deduction was computed @ 42.23% on Rs 20,70,23,865 which thus worked out to Rs 8,74,26,178.

5. Aggrieved by the demands so raised under section 201 read with section 195, aggregating to Rs 10,14,36,935, treating the assessee as assessee in default for not having deducted tax at source from these payments, assessee carried the matter in appeal before the learned CIT(A) but without any success. Learned CIT(A) rationalized the stand taken by the AO-TDS and added a large number of judicial precedents to support the stand so taken by the AO-TDS. In a lengthy order running into 163 pages, learned CIT(A) confirmed, and in fact fortified, the stand of the AO-TDS, reproduced extensively from several judicial precedents and held that the assessee indeed ought to have deducted tax at source @42.23% on gross basis from all these payments. The broad line of reasoning adopted by the learned CIT(A) was like this. As for the assessee's contention that the taxes have been duly deducted as when payments for supervision charges are made, learned CIT(A) observed that "**in the mercantile system of accounting, a liability is to be accounted for as soon as it is recognized**" and that "**there is no claim that the assessee is following cash system of accounting**". Learned CIT(A) did take note of the assessee's contention that form 15CA and form CB were duly filed, wherever necessary, but rejected this explanation as "vague" on the ground that it is not clear whether the certificates were filed or not and that "where it was necessary" is a vague explanation. Coming to the assessee's explanation that as there was no composite contract for purchase of machinery and services, it was not considered necessary to move for an application under section 195(2), learned CIT(A) was dismissive of this plea by observing, rather caustically, "**where was it found necessary? We are not educated about this at all by the assessee**". The CIT(A) was equally dismissive about the argument that in respect of payment of Rs 143,57,987 to Shen Yang Heavy Machinery Co Ltd was only an advance of 10% for purchase of vertical roller mill for coal grinding and, for this reason, no tax deduction at source was required. He was of the view that " **this** *(plea)* **is a legal accounting absurdity**" and posed the question that "**in**

mercantile system of accounting, would TDS provisions not apply on partly discharged recognized liabilities let alone paid advances". As for the plea that as no income, embedded in these foreign remittances, was liable to tax in India, there was no requirement to deduct the tax at source by the assessee, learned CIT(A) had two objections- first, that 'this (plea) is a factual misunderstanding' as 'the AO clearly holds that section 5(2)(b) applies and the income to the payee is in the nature of business income chargeable to tax in India'; and second, that "**the TDS provision applies on the 'sum' and not the 'income'**". Learned CIT(A) also opined that, "**the assessee goes on to deny that availing of services (which would convert the alleged supply contract into the alleged work contract) was an essential element of agreement** *(and that)* **it was purely optional and the contract was in the nature of contract for sale and not 'works contract'**". Learned CIT(A)'s view was that the entire stated consideration for equipment and services should be accounted for, or deemed to have been accounted for, in the relevant financial years and tax should be deducted in respect from the same on the basis of treating it as a composite contract. This approach could be easily discerned from the following observations of the learned CIT(A):

> "**It is necessary to remind ourselves that in mercantile system of accounting, liability is to be accounted for as soon as it is recognized. It is not the case of the assessee that no such liability was accounted for in the final accounts of the impugned financial year. Hence, in the absence of any pleading/ evidence to the contrary, it has to be assumed that the liability as arisen was recognized and accounted for in the impugned accounting year. This may have been paid over sufficient number of years but once recognition of a crystallized liability has taken place, it should be accounted for and held to be, in fact, accounted for in the course of FY 2009-10 and 2010-11 (for subsequent year itself). Subsequent adjustment entries for the future years would not detract from this aspect.**
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> **The assessee further stated that further payments of $ 7,500 and $ 3,100 were made in the financial years 2011-12 and 2012-13 over and above the contract price for installation of equipments on which prescribed rate of 10% was deducted.**
>
> **It is not, however, the case of the AO that subsequent remittance was not made or TDS was not deducted. <u>His case rests on entirely different foundation that it is composite nature of the contract</u>……**
>
> *(Emphasis by underlining supplied by us)*

6. Learned CIT(A) noted the submissions of the assessee to the effect that in some cases erection and installation of equipment was done by the domestic contractors and as such the payments to the vendor of related equipments cannot be said to be towards any services. He, however, observed that there was a contractual clause with respect to "**services of a seller**" and that these "**wordings create a carefully erected edifice but leave us in no doubt that seller was to provide assembly, erection, commissioning and performance test- by contractor BUT WITH 'TECHNICAL ASSISTANCE OF THE SELLER'**". Learned CIT(A) also rejected the contention of the assessee that it is only when there a taxable income embedded in the foreign remittance that section 195 can come into play, and observed as follows:

> **This contention is apparently contrary with the entire claim of the assessee that section 195(2) is not applicable to it. It is to be noted that the AO can apply section 195(2) only when an application is made to determine the proportion of sum chargeable to tax. Once the assessee contests the application of section 195 itself, the aspect of apportionment does not arise. The concept of income imported into section 195 by the assessee is also difficult to appreciate. The term used in this section is payment of a sum and deduction of TDS thereon. How the assessee is bringing the concept of real income is difficult to understand.**

7. Learned CIT(A) did take note of assessee's reliance on Hon'ble Supreme Court's judgment in the case of Ishikawajma Harima Heavy Industries Ltd Vs DIT (288 ITR 408) and observed as follows:

> **It is significant to note that if this line of reasoning is to be taken, the provisions of GAAR, which are to come into effect from 1.4.2016 too must be taken into account. Reference maybe made to the proposed chapter X-A Section 95, then s.96 about impermissible avoidance arrangements and s. 97 regarding arrangement to lack commercial substance as well as s. 98 about consequence of impermissible avoidance arrangement.**

8. Learned CIT(A) then analyzed each of the purchase contract and noted that even though there is a mention about reimbursement of certain expenses and related per diem payments in the contracts, for visits in connection with the installation and commissioning, each of these contracts puts the vendors under certain obligations with respect to installation and commissioning. On this basis,

he concluded that all the contracts are composite contracts for purchase of goods as also the related services for installation and commissioning etc.

9. Learned CIT(A), in this backdrop, discussed, in great detail, several judicial precedents right from the landmark Supreme Court decision in the case of McDowell's to Voadfone International Holding's rather decent case and used that analysis to support the theory that all these contracts are composite contracts, are used as instruments of impermissible tax manoeuvrings and tax should have been deducted from all these payments. On a somewhat philosophical note, and quite in tune with the tone of these scholarly discussions, he concluded on the following note:

> "**The classic and final word on this issue must belong to the observation of the House of Lords in the case of Regna Vs Inland Revenue Commissioner [(1995) 215 ITR 487 HL]. Para 39 of the said judgment reads as under:**
>
> > **"Every tax avoidance scheme involves a trick and a pretence. It is the task of the revenue to unravel the trick and duty of the court to ignore the pretence".**

10. Aggrieved by the order of the CIT(A), the assessee is now in second appeal before us.

11. We have heard Shri D S Damle and Shri A P Srivastava, appearing along with Shri Swapan Usrethe, for the assessee-appellant, and Shri Abhishek Shula, appearing for the revenue-respondent. We have gone through elaborate written submissions filed by the assessee from time to time- including before the authorities below, we have also perused the material on record and we have duly considered factual matrix of the case in the light of the applicable legal position.

12. During the course of hearing before us, we did notice that there was not much of a discussion in the orders of the authorities below about the taxability, in the light of the provisions of the applicable tax treaties, of the impugned payments. When we asked the parties about reasons of this peculiarity, learned counsel contended that since the amounts are not taxable even under the provisions of the Act, there was actually no need to examine the taxability under the respective tax treaties. It was submitted that whenever any services are

rendered by the vendors for the purposes of installation, commission and supervision services, taxes are duly deducted from the same, and that so far as these payments before us are concerned, these payments are simply for purchase of machines, and plant and machinery. Learned counsel further contended that, in any event, these payments were not taxable under the provisions of the tax treaties either, and sought our permission to address us, in detail, on the same. While it was fairly accepted that very detailed submissions were not made on this aspect of the matter, it was pointed out that the assessee had indeed made a submission, at point no. 69 in the written submission, that since the assessee did not have a permanent establishment in India, no part of its income could be taxed in India. This argument may not have been made in great detail, but the argument was advanced in principle.

13. Learned Departmental Representative, on the other hand, submitted that the onus was on the assessee to make claim for exemption under the provisions of a tax treaty, and the assessee not having discharged the same, opportunity should not be given to the assessee to make out a fresh claim. It was submitted that even though there is a vague reference to the non-existence of the permanent establishment, this aspect of the matter was neither argued in detail nor even specifically taken up before us in the grounds of appeal.

14. It was also pointed out that the revenue's case before us is not that taxes have not been deducted from the payments for installation, commissioning and supervision charges, but that a part of the payment for machines, plant and machinery represents payment of consideration for services rendered in India as there is no separate consideration, save and except for nominal reimbursement of actual costs and allowances of technical personnel visiting the installation site, for services rendered in India.

15. According to learned Departmental Representative, as long as vendor is associated with any work, or its supervision, to be carried out in India and no separate consideration is paid for the same, the sale consideration for such machine, plant and machinery must be held to have an embedded payment for these services which is taxable in India. It is submitted that the arguments of the

assessee do not, even remotely, address with the core issue raised by the revenue authorities. The rendition of services and deduction of tax at source from additional payments made, which are *prima facie* for out of pocket expenses and allowances to technicians, is irrelevant in this context.

16. Learned counsel once again submitted that even though no part of income embedded in payments to the non residents is in respect of any services, and as such not taxable even under the Indian Income Tax Act, the assessee should be granted liberty to argue on all legal issues, including impact of provisions under the respective tax treaties, to defend its case.

17. We have considered it appropriate to hear the parties specifically on the taxability under the respective tax treaties as evident from the following observations made in our record of proceedings:

> ***22nd September 2014***
>
> ***The matter was heard for some time- till 1.30 pm.***
>
> ***We consider it appropriate to hear the parties on the question of taxability of the impugned payments – even if a part of the same is treated as payment towards installation, commission and supervision services relating thereto, under the provisions of respective tax treaties – particularly under PE and FTS clauses. Parties put to notice under proviso to Rule 11 of the Appellate Tribunal Rules 1963.***
>
> ***With the consent of the parties, adjourned to 23/9/14 for hearing to continue***
>
> ***23rd September, 2014.***
>
> ***The matter was heard today, and the hearing will now resume on 26/9/14- as learned DR seeks time to go through the documents filed by AR at the instance of the bench.***
>
> ***With the consent of the parties, hearing will continue on 26/9/14.***
>
> ***26th September, 2014.***
>
> ***Hearing concluded. Reserved for orders.***

18. Learned counsel's suggestion was that we should look at the treaties only when the case of the assessee fails on the provisions of the domestic law.

Whether we examine that aspect of the matter at the stage one or stage two, arguments are nevertheless required to be made on that aspect of the mater as the assessee cannot abandon his reliance on the provisions of the applicable tax treaties. In any case, we are unable to see convincing merits in learned counsel's suggestion, even though we are alive to the fact that such an approach could be of convenience to many persons. As section 90 unambiguously states, so far as a assessees covered by a duly notified tax treaty is concerned, the provisions of the Income Tax Act, 1961 come into play only when those provisions are more beneficial to the assessee. Accordingly, when an assessee has no taxability on the basis of the provisions set out in the applicable treaty, there cannot be any occasion to look at the provisions of the Income Tax Act.

19. While on this aspect, we may also refer to the following observations made by a coordinate bench in the case of **ACIT Vs Epcos AG (28 SOT 412)**:

> ***15. One of the arguments advanced by the learned Departmental Representative is that we should begin by examining taxability, of the income earned by the foreign company, under the provisions of the Indian IT Act (hereinafter referred to as the 'domestic tax legislation' or 'the Act') and, when this income is found to be taxable in terms of the domestic tax legislation, we should hold its taxability as such, unless, of course, the income is exempt from taxation in India under the provisions of the tax treaty. ……***
>
> ***16. Even as we are alive to the fact that the approach suggested by the learned Departmental Representative will not lead to any different results than the one arrived at by any other approach to the issue, we are not inclined to accept the suggestion of the learned Departmental Representative. There is indeed a school of thought which suggests that what needs to be examined first is the taxability under the domestic law i.e. the Indian IT Act and only when the taxability under the domestic law is held to be in existence, one has to see the applicable treaty, if any, to examine whether or not the assessee gets any relief from the provisions of such a tax. This approach, however, was not approved in the landmark Special Bench decision in the case of Motorola Inc. vs. Dy. CIT (96 TTJ 1), wherein the Tribunal had observed that "DTAA is only an alternate tax regime and not an exemption regime" and, therefore, "the burden is first on the Revenue to show that the assessee has a taxable income under the DTAA, and then the burden is on the assessee to show that that its income is exempt under DTAA". We see no meeting ground between observations so made by the Special Bench of this Tribunal in the case of Motorola Inc. (supra) and the approach canvassed by the learned Departmental Representative. As we deal with the domestic tax laws more often it is somewhat reflexive to adopt the approach of examining the taxability on the touchstone of principles laid down under the domestic tax law. In such a case, the question of dealing with the tax treaty provisions becomes relevant only when the first bridge is crossed i.e. when taxability under the domestic law is established. On a conceptual frame, however, this approach may not have many noticeable merits other than our comfort levels. In our considered view, in a cross-border tax situation (i.e. in a***

situation in which economic activities leading to earning an income are carried out in more than one jurisdiction, or in which the source of income and residence of the person earning such an income are in two different tax jurisdictions), first thing to be ascertained is the rights of the taxing jurisdictions over taxability—full or partial—of that income. As the Special Bench of this Tribunal, in the case of Motorola Inc. (supra) appropriately observes, a tax treaty certainly does not constitute an exemption system. Strictly speaking, a tax treaty may not even constitute alternative taxation regime, for the elemental reason that no tax treaty or DTAA, whatever one calls it, can ever impose taxes. A view is thus indeed possible that there cannot be an alternate taxation regime which does not impose taxes. Yet, a tax treaty can be said to be an alternate taxation regime in the sense that it allocates taxing rights of the competing tax jurisdictions. As far as the related tax jurisdictions are concerned, a tax treaty, first and foremost, allocates the rights of taxation of the tax jurisdictions over a tax object. In a cross-border tax situation, there is always a conflict between source rule and residence rule. This conflict develops when a person resident in one of the Contracting States earns income which is sourced from the other Contracting States. ……. it provides for the basis and mechanism of taxability outside the residence jurisdiction. …… One must not lose sight of the fact that there is nothing like an exemption under a treaty. The taxability of a tax subject, i.e., a taxpayer, continues to be in the residence country irrespective of source jurisdiction taxation of an income. …….. Therefore, the real issue is to what extent residence jurisdiction yields taxability of a tax subject to the source country, or, to put it from a source country's perspective to what extent does the source country yield taxability to residence country over a tax subject in respect of a limited tax object in the source country. Therefore, broadly speaking, a tax treaty is primarily a detailed instrument assigning the taxing rights between two, or more, competing tax jurisdictions over a tax subject. Unless a tax jurisdiction has a right to tax an income, it is irrelevant whether or not, under the domestic tax legislation of that tax jurisdiction, the income in question is taxable……

17. In our considered view, therefore, a tax treaty is an alternative taxation regime in the sense that it is an allocation of taxing rights between two, or more, competing tax jurisdictions over a tax object. …….. By implication, in a situation in which India has no right to tax a particular income in the hands of this non-resident covered by a tax treaty, provisions of the Indian IT Act do not come into play at all. One need not examine taxability under the domestic law in such a case. No tax treaty can impose a tax but a tax treaty does something far more fundamental—in case of competing tax jurisdiction claims, which are inevitable corollaries of inherently contradictory source and residence rules a tax treaty decides which tax jurisdiction can levy tax on a tax object, and to what extent it can do so. To examine taxability of a cross-border income in a source tax jurisdiction, without first establishing the right to tax that income by the source tax jurisdiction, is like putting the cart before the horse. Therefore, before proceeding to consider taxability of a non-resident, covered by the provisions of a tax treaty, in terms of the provisions of the domestic tax laws of the source jurisdiction, it is useful to first check whether source jurisdiction has a right to tax that income at all. We would, therefore, prefer to follow the approach of first examining whether or not the source country has right to tax a particular cross-border income, and, in case the right is so established, to examine whether or not the domestic tax, laws of the source country provide for taxation of such an income, and if so, to what extent and in what manner.

18. ……. We did not find any conceptual support or other material whatsoever for 'domestic law first' approach, though, in all fairness, there is literature to support the proposition that this debate as to whether one should see the treaty first or domestic law first is a non-starter. Whichever path we follow, we reach the same

> ***destination anyway; whether or not a cross-border income is taxable in the source country in the light of the domestic tax laws read with the applicable tax treaty, it would not make difference, in the ultimate analysis, whether one examines the case on the touchstone of the scheme of the treaty first and domestic law later, or vice versa. Late Prof. Klaus Vogel, in his oft referred book 'Klaus Vogel on Double Taxation Conventions', has observed that, "only very little legal background, is required to recognize that logically, both the methods or procedure are equivalent". Giving an illustration, he further explains, that "the treaty acts like a stencil that is placed over the pattern of domestic law and covers over certain parts" and adds that "whether the stencil or the pattern is examined first, the same conclusion results, so the order of application can be decided pragmatically case from case". The stand taken by another eminent international tax expert, Ned Sheldon, is also on these lines. In his well-known work 'Interpretation and Application of Tax Treaties', Ned Sheldon has remarked that this "issue can be theorized and philosophized upon, but the inevitable conclusion is that one must consider both domestic law and the treaty" and he concludes that "in practice it does not matter". While we recognize the school of thought canvassed by the learned representatives, we are, for the reasons we have set out in the preceding paras—including the reasons of deference for the Larger Bench of this Tribunal and conceptual foundation elaborated in these paras, of the considered view that in the case of the cross-border tax situation between treaty partner States, logically first thing for a source tax jurisdiction is to establish the right to tax under the applicable tax treaty, and only if such a source tax jurisdiction indeed has right to tax, the next thing is to examine is the taxability under the domestic laws of that State.***

20. In all fairness to the learned counsel for the assessee, however, we must place on record the fact that Shri Damle was able to file detailed written submissions, supported by analysis of tax implications in respect of each payment, with relevant extracts from the applicable treaties, in less than even one day. While did take a stand that this exercise is unwarranted on the facts of this case, once he was asked to address us on the same nevertheless, he was not found wanting in his able assistance. We are, however, somewhat disappointed with the stand taken by the revenue authorities. All sort of hyper technical objections have been raised against the provisions of relevant tax treaties being taken into account by us, but then it is only elementary that once the double taxation avoidance agreements, or the tax treaties- as these are often termed, are notified, such treaties form an integral part of the domestic tax legislation. To the extent a tax treaty applies on the facts of a case, the provisions of the Income Tax Act are applicable only to the extent that such provisions are more beneficial to the assessee. The binding nature of the provisions of the tax treaties is thus beyond any doubt or controversy. Yet, hyper technical objections were raised to even our taking into account the impact of the applicable treaty provisions. It is contended that since the assessee has not raised this aspect of the matter before any of the

authorities below, the assessee should not be entitled to claim treaty protection to recipients of the payments made by the assessee. We are not inclined to uphold these objections. In our considered view, it was one of the most fundamental aspect which ought to have been examined by the AO-TDS himself, before raising a vicarious tax withholding demand, that the recipient non resident is liable to be taxed in India in respect of the income embedded in these payments, and for that purpose, examine the taxability of the recipient under the provisions of the respective tax treaty as well. In any event, it is a purely legal issue and, as is the well settled legal position, a legal issue can certainly be taken up before the Tribunal even for the first time. There cannot be any *estoppel* against the law. We may also add that a copy of the submissions filed by the learned counsel for the assessee was handed over to the learned Departmental Representative on 23rd September 2014 and certain propositions were put to him by the bench, and that learned Departmental Representative has also been heard on the same on 26th September 2014.

21. As we proceed to examine the issue regarding taxability of the impugned payments in India, we may also note that the authorities below have laid great emphasis on certain observations in Hon'ble Supreme Court's landmark judgment in the case of **G E Information Technology Centre Pvt. Ltd.** *(supra)* in support of the proposition that the assessee ought to have applied for determination of tax deductible from these payments, and, in the absence of such an exercise, ought to have deducted tax at source from entire payments. The observations relied upon by the AO and the CIT(A) are as follows:

> **10. In Transmission Corporation case (supra) a non-resident had entered into a composite contract with the resident party making the payments. The said composite contract not only comprised supply of plant, machinery and equipment in India, but also comprised the installation and commissioning of the same in India. It was admitted that the erection and commissioning of plant and machinery in India gave rise to income taxable in India. It was, therefore, clear even to the payer that payments required to be made by him to the non-resident included an element of income which was exigilble to tax in India. The only issue raised in that case was whether TDS was applicable only to pure income payments and not to composite payments which had an element of income embedded or incorporated in them. The controversy before us in this batch of cases is, therefore, quite different. In Transmission Corporation case (supra) it was held that TDS was liable to be deducted by the payer on the gross amount if such payment included in it an amount which was exigible to tax in India. It was held**

> **that if the payer wanted to deduct TDS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented "income chargeable to tax in India", then it was necessary for him to make an application under Section 195(2) of the Act to the ITO(TDS) and obtain his permission for deducting TDS at lesser amount. Thus, it was held by this Court that if the payer had a doubt as to the amount to be deducted as TDS he could approach the ITO(TDS) to compute the amount which was liable to be deducted at source. In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India.**

22. In placing this reliance, what has been overlooked is the fact that in this case, as noted by Hon'ble Supreme Court in GE Technology Centre's case above, "**(i)t was admitted that the erection and commissioning of plant and machinery in India gave rise to income taxable in India**" and that "**(i)t was, therefore, clear even to the payer that payments required to be made by him to the non-resident included an element of income which was exigible to tax in India".** There can be little doubt that once it is an admitted position that a part of income embedded in the payments is exigible to tax in India, the provisions of Section 195 will come into play, but then, in the case before us, the contention of the assessee is that no part of the income embedded in the payments to vendors is taxable in India at all.

23. It is also important to bear in mind the fact that just because payment of erection and commissioning of plant and machinery in India, in the case of **Transmission Corporation of AP** *(supra),* was accepted to be taxable in the facts of that case cannot be construed to mean that such payments are taxable on the facts of all the cases. This decision is not an authority for the proposition that in the case of all equipment purchase contracts wherein erection and commissioning services are to be performed, supervised or assisted by the foreign vendors, the consideration paid for such contracts will have income exigible to tax in India. All that this decision holds is that in the event of any part of the income embedded in the payment being taxable in India, the tax is required to be deducted from such payment. There is no dispute, in the present case, on this proposition about the scope of Section 195. The contention of the assessee is that since no part of the income embedded in the payment is exigible to tax in India, and, it is for this reason that the assessee did not have any obligations to

deduct tax source from the payments in question. As to the scope of taxation of installation and commissioning charges under the scheme of the Indian Income Tax Act, as we will elaborate in a short while, there are number of factors, including, most importantly, time taken in such erection and commissioning work at the Indian site as also the provisions of applicable tax treaties, which govern whether or not such a payment will be taxable in India. The approach of the revenue authorities that all such payments made by the resident assessees to the non-residents, which include consideration for installation and commissioning services, are taxable in India rests on sweeping generalizations- something which can never meet any judicial approval.

24. Coming back to Hon'ble Supreme Court's decision in **Transmission Corporation of AP**'s case *(supra),* a coordinate bench of this Tribunal, in the case of **Maharashtra State Electricity Board Vs DCIT [(90 ITD 793) 2004]** and speaking through one of us (i.e. the Accountant Member), had summed up the implications of this judicial precedent as follows:

> **24. These observations do give a prima facie impression that, in the esteemed views of the Hon'ble Supreme Court, whenever an application under s. 195(2), is not filed, the assessee tax deductor is under a statutory obligation to deduct tax at source computed on the entire payment to non-resident treating the same as income. However, in our considered view and for the reasons, we shall now state, such an interpretation will be fallacious.**
>
> **25. While elaborating upon the ratio of the aforesaid judgment, a co-ordinate Bench of this Tribunal in the case of Raymonds Ltd. vs. Dy. CIT (2003) 80 TTJ (Mumbai) 120 relevant portion at p. 168) has observed as follows:**
>
>> **"A first reading of the judgment of the Supreme Court in the case of Transmission Corporation (supra) no doubt gives the impression that if no application is filed by the assessee under s. 195(2) seeking a determination of the appropriate portion of the sum remitted, income-tax on the gross sum has to be deducted and paid. However, penultimate paragraph of the judgment (p. 596 of the report) the Supreme Court has upheld as correct the answer given by the Andhra Pradesh High Court that the obligation of the assessee to deduct tax at source under s. 195 is limited only to the appropriate portion of income chargeable under the Act. In our humble understanding of the section in the light of the judgment, the position appears to be like this. The sum paid to the non-resident may be either fully or partly chargeable to income tax. If it is fully chargeable (pure income) undoubtedly the tax is to be charged at the appropriate rate on the whole sum and deducted and paid. If the sum is only partly chargeable (embedded or hidden income), the assessee has to apply under s. 195(2) to the AO for determination of the appropriate portion."**

26. We are in considered agreement with the views so expressed by our distinguished colleagues and would only add the observations of their Lordships or the ratio of the judgment do not affect that position that in a case where no portion of payment is exigible to tax, the question of application of s. 195(2) does not arise, because, as the section itself categorically provides that it comes to play "where the person responsible for paying any sum chargeable under this Act (other than salary) to a non-resident considers that whole of such sum would not be chargeable in the case of the recipient. It would thus follow that for invoking s. 195(2), it is a sine qua non that sum being paid to the non-resident is 'chargeable under the provisions of this Act', i.e., IT Act, 1961 whether fully or partly, i.e., the entire sum or the income hidden or embedded therein.

27. As to the connotations of expression 'chargeable under the provisions of this Act', as observed by the Hon'ble Calcutta High Court, in the case of P.C. Ray & Co. (India) (P) Ltd. vs. A.C. Mukherjee (1959) 36 ITR 365 (Cal), and referred to with approval in this very judgment of Hon'ble Supreme Court in the case of Transmission Corporation of AP (supra), "it is not merely amounts, the whole of which are taxable without deduction, that is to say, amounts which Lord Greene called 'pure income profit'.... but amounts of a mixed composition, a part of which only may turn out to be taxable income, are also contemplated". Their Lordships made the observations in the context of, as noted in the text of the judgment itself, "distinction between 'pure income' that is to say, receipts which.... had the 'character of income chargeable itself as such to tax' and receipts against which expenses had to be set off in order to determine whether there was any taxable income". Hon'ble High Court was more specific in subsequent observations to the effect that "... if the amount payable to a non-resident appeared to be, say, income from property or profits and gains of business, profession or vocation or income from other sources, it would come within the purview of the section, but if it was an amount of a kind exempt (under the Indian IT Act) from tax, such as agricultural income, it would be outside its preview". <u>It is thus a settled position that when an income is outside the scope of income taxable under the Indian IT Act, the question of application of s. 195,</u> which is in material respects pari materia with s. 18(3B) of the 1922 Act that the High Court was in seisin of, <u>does not arise</u>. *A fortiorari*, when an income is not exigible to tax in India, by the virtue of the provisions of the applicable DTAA, the deduction of tax under s. 195 of the Act does not come to play at all. It leads us to the conclusion that the expression 'chargeable under the provisions of this Act' cannot include an income, which in terms of the specific provisions of the applicable Double Taxation Avoidance Agreement, is not exigible to tax in India.

(Emphasis by underlining supplied by us)

25. In the case of **G E Technology Centre Pvt Ltd** *(supra)*, Hon'ble Supreme Court came to the same conclusion, and thus upheld the stand so taken by the coordinate bench, by observing as follows:

In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax

> **thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. In our view, the above observations of this Court in Transmission Corporation case (supra) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TDS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of <u>the plain words of Section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the I.T. Act</u>, i.e., chargeable under Sections 4, 5 and 9 of the I.T. Act.**
>
> *(Emphasis by underlining supplied by us)*

26. Clearly, therefore, for application of Section 195, it is *sine qua non* that the payment to non resident must have an element of income liable to be taxed under the Indian Income Tax Act, 1961. In other words, when no part of payment to non resident constitutes an income taxable under the Indian Income Tax Act, 1961, tax withholding obligations under section 195 do not come into play at all.

27. The case of the revenue thus hinges on the fundamental question as to whether or not there is indeed an element of income, embedded in the impugned payments to the non residents, which can be brought to tax under the Indian Income Tax Act, 1961. Of course, by the virtue of Section 90 of the Act, in relation to the assessees to whom a double taxation avoidance agreement *(i.e. tax treaties)* applies, "the provisions of the Act shall apply to the extent they are more beneficial to the assessee" *vis-à-vis* the provision of the related double taxation avoidance agreement. In effect thus, when such an assessee has no tax liability in India by the virtue of the provisions of a DTAA, there cannot be a tax liability under the provisions of the Act either.

28. We have noted that the basic plea of the Assessing Officer, based on which the impugned demands have been raised, is that since a part of consideration paid for the equipment and machinery is towards installation, commissioning or assembly of plant and equipment, such a consideration is liable to tax in India under section 4 and 5 of the Income Tax Act, 1961. These sections provide as follows:

Section 4 - Charge of income-tax.

4. (1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and [subject to the provisions (including provisions for the levy of additional income-tax) of, this Act] in respect of the total income of the previous year of every person:

Provided that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.

(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

Section 5- Scope of total income.

5. (1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or

(c) accrues or arises to him outside India during such year :

Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

29. As Section 5(2)(b) read with Section 4(1) clearly provides, so far as taxability of income in India in the hands of a non-resident is concerned, it extends to, *inter alia*, income, from whatever source derived, accruing or arising to such a non-resident in India during the relevant previous year.

30. In a situation in which a part of the consideration for purchases of plant, machinery or equipment can be attributed to the installation, commissioning or assembly of the plant and equipment, or any supervision activity in connection thereto, to that extent, the consideration paid to the vendor can indeed be taxable in India under section 5(2)(b). That element of the income clearly accrues and arises in India since the related economic activity is performed in India. As the income accrues and arises in India, there is no need to look at the deeming fiction under section 9(1)(vii) which deals only with an income which is **deemed to** *(Emphasis by underlining supplied by us)* accrues or arises in India. Something which accrues and arises in India need not be deemed to accrue and arise in India as well. That precisely seems to be the reason as to why the definition of 'fees for technical services' under Explanation 2 to Section 9 (1)(vii) specifically excludes "consideration for any construction, assembly, mining or like project undertaken by the recipient". Even though this exclusion clause does not make a categorical mention about 'installation, commissioning or erection' of plant and equipment, these expression, belonging to the same genus as the expression 'assembly' used in the exclusion clause and the exclusion clause definition being illustrative, rather than exhaustive, as evident from the expression 'or like project undertaken by the recipient, the installation, commissioning and erection of plant and equipment are also, in our considered view, covered by this exclusion clause. The common thread, and the highest common factor, in all the three activities set out in the exclusion clause, i.e. construction, assembly and mining, is that all these activities are carried out at the project site in India, and that factor is also present in installation, commissioning and erection. In any case, once we come to the conclusion, as seems to be free from any doubt or controversy, that income as a result of such activities, as installation, commissioning, erection or assembly of a plant, machinery or equipment, in Indian accrues or arises in India and is, therefore, taxable, if at all can be taxed, under section 5, there cannot be any occasion to invoke the deeming fictions under section 9, nor have the authorities below invoked this deeming fiction either.

31. Learned counsel's contention is that no part of the purchase consideration relates to the installation, commissioning, erection or assembly of the plant and equipment and that whenever such services are availed by the assessee from

vendors separate payments have been made in respect of the same. Learned Departmental Representative vehemently opposes this plea and contends that these additional payments for installation and commissioning services, or supervision thereof, are nothing more than additional remuneration to the technicians, or their reimbursement of expenditure, and that the actual consideration for rendition of these services is embedded in the invoice value of the related equipment, plant or machinery.

32. Given the scheme of the allocation of taxing rights under the respective tax treaties, however, in our humble understanding, this is a wholly academic question.

33. We have noted that so far as the transactions impugned in these appeals are concerned, these transactions pertain to the vendors fiscally domiciled in (1) Austria, (2) Belgium, (3) China, (4) Germany, (5) Switzerland, (6) United Kingdom, and (7) United States of America. With all these seven tax jurisdictions, India has entered into double taxation avoidance agreements, and, therefore, the provisions of the Indian Income Tax Act, so far as non-residents eligible to the benefits of these tax treaties are concerned, to use the phraseology employed under section 90(2) of the Act, "**the provisions of this** *(i.e. the Income Tax Act, 1961)* **Act apply only to the extent they are more beneficial to the assessee**". As a corollary thereto, when the assessee is not taxable under the provisions of the respective DTAA, there is no occasion to invoke the provisions of the Act. Let us, therefore, examine, in the light of the applicable DTAA provisions. the taxability of the income embedded in these transactions.

34. The recipients of these payments, as is the undisputed factual position, are engaged in the business of manufacturing and selling related equipment, plant or machinery. As to what should be the scope of taxation of such business income, as all the related DTAAs provide, that the profits non-resident vendor shall not be taxable in India, unless the non-resident vendor carries on business in India through a permanent establishment in India, and where the non-resident vendor carried on business through the permanent establishment, taxability of income shall be confined, except in the cases in which limited force of attraction principle

is specifically extended in article 7(1) i.e. Belgium, Germany and US, to the income as is attributable to that permanent establishment. This basic scheme of taxation of business profits of non-resident vendors is evident from the following related treaty provisions:

Article 7(1) of **India Austria Double Taxation Avoidance Agreement [251 ITR (Stat) 79]**– *hereinafter referred to as Indo Austrian tax treaty*

ARTICLE 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

Article 7(1) of **India Belgium Double Taxation Avoidance Agreement [228 ITR (Stat) 79]**– *hereinafter referred to as Indo Belgium tax treaty*

ARTICLE 7
BUSINESS PROFITS

1. *The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.*

Article 7(1) of **India China Double Taxation Avoidance Agreement [214 ITR (Stat) 160]**– *hereinafter referred to as Indo China tax treaty*

ARTICLE 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment.

Article 7(1) of **India Germany Double Taxation Avoidance Agreement [223 ITR (Stat) 130]**– *hereinafter referred to as Indo German tax treaty*

ARTICLE 7
Business profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as

aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as are attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

Article 7(1) of **India United Kingdom Double Taxation Avoidance Agreement [206 ITR (Stat) 235]**– *hereinafter referred to as Indo UK tax treaty*

ARTICLE 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment.

Article 7(1) of **India United USA Double Taxation Avoidance Agreement [187 ITR (Stat) 102]**– *hereinafter referred to as Indo US tax treaty*

ARTICLE 7
BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.

35. The taxation of business income in India in respect of non-resident vendors being situated in any of the seven jurisdictions above is thus wholly dependent on the existence of permanent establishment in India. Unless such vendors have a permanent establishment in India, there cannot be any occasion to bring any part of their income, in respect of the business of sale of equipment, plant or machinery in question, to tax in India. Of course, once it is held that they have a permanent establishment in India, the question of quantum of taxability has to be decided in the light of the specific scope of the provision of Article 7(1) above.

36. As to whether these non-resident vendors have a PE in India or not, it is not even the case of the revenue that any of these non-resident vendors had a place of business in India and as such a PE under the basic rule, i.e. Article 5(1).

While taking note of this fact, it is useful to bear in mind, as was held in the landmark Special Bench decision in **Motorola Inc's case** *(supra),* "***DTAA is only an alternate tax regime and not an exemption regime"*** and, therefore***, "the burden is first on the Revenue to show that the assessee has a taxable income under the DTAA, and then the burden is on the assessee to show that that its income is exempt under DTAA".*** There is not even whisper of a suggestion that the non-resident vendors had a place of business in India. We have carefully perused the material on record and the orders of the authorities below and we do not find that suggestion anywhere. The case of existence of the PE thus hinges on whether by the virtue of, what is normally termed as, installation PE as could come up by the nature of the activities leading to the income impugned before us. The related provisions in respect of all these jurisdictions above are as follows:

Indo Austria tax treaty

ARTICLE 5

Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

……

(i) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (for the same or connected project, site or activities) continue for a period of more than six months****.*

……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

Indo Belgium tax treaty

Article 5
Permanent Establishment

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

……

(j) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities , if any) continue for a period of more***

than six months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment.
……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

Indo China tax treaty

ARTICLE 5
Permanent Establishment

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

……
(j) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 188 days;***
……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

India Germany tax treaty

ARTICLE 5
Permanent Establishment

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:
……

(i) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months.***
……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

India UK tax treaty

ARTICLE 5
Permanent establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:
……

(j) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;***
……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

Indo US tax treaty

ARTICLE 5
Permanent Establishment

1. For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term 'permanent establishment' includes especially:
……..
(k) ***a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve month period;***
……

(Emphasis by underlining supplied by us;
portion not reproduced not relevant for our purposes)

37. The underlying principle in all the above definition, even as there is a variance on the threshold time limits, is that unless the installation or assembly project or supervisory activities in connection therewith cross the specified threshold time limit, the non-resident enterprise cannot be treated to have a permanent establishment in India. However, as an exception to this general principle in the above cases, in the case of Belgian and UK tax residents, even when threshold time limit is not crossed but where the charges payable for these services exceeds 10% of the sale value of the related machinery or equipment, the profits attributable to this activity can also be brought to tax. As a corollary to this legal position, even in the case of Belgian and UK tax residents, profit relatable to installation or assembly project or supervisory activities connected therewith, which do not cross threshold time limit of six months, cannot be

brought to tax unless it is demonstrated that the consideration for such services is more than 10% of the sale value. There is nothing on record to establish, or even suggest, that this condition is satisfied in the cases before us. It is well settled in law, as we have noted earlier in our discussions, that the onus is on the revenue authorities that the conditions for permanent establishment coming into existence are satisfied, and that onus is clearly not discharged. The assessee's contention is that no part of the income embedded in the impugned payments is in respect of the installation, assembly or commissioning activities of the plant, machinery and equipment purchased. There has to be something, apart from shallow prolixity, to even point in the direction that the consideration for installation or assembly project, or supervisory activities connected therewith, exceed 10% of the value of related plant, machinery or equipment.

40. These provisions with respect to permanent establishment on account on construction, installation and assembly activities, or supervisory activities connected therewith are broadly on the line of the model provisions in the 'UN Model Double Taxation Convention between the Developed and Developing Countries'. While elaborating upon this model provision and recognizing, while rejecting, the legitimate concerns about erosion of tax base by the developing countries, the UN Model Convention Commentary has observed as follows:

> **10. A few developing countries oppose the six-month (or 183 days) thresholds in subparagraphs *(a)* and *(b)* of paragraph 3 altogether. They have two main reasons: first, they maintain that construction, assembly and similar activities could, as a result of modern technology, be of very short duration and still result in a substantial profit for the enterprise; second, and more fundamentally, they simply believe that the period during which foreign personnel remain in the source country is irrelevant to their right to tax the income (as it is in the case of artistes and sportspersons under Article 17). Other developing countries oppose a time limit because it could be used by foreign enterprises to set up artificial arrangements to avoid taxation in their territory. <u>However, the purpose of bilateral treaties is to promote international trade, investment, and development, and the reason for the time limit (indeed for the permanent establishment threshold more generally) is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State.</u>**
>
> *[@ page 108; emphasis by underling supplied by us]*

41. The UN's 'Committee of experts on International Cooperation in Tax Matters', which reviews and updates the UN Model Convention Commentary, not

only has presence, but also very active and laudable contribution, from India. In this view of the matter, the views so expressed in the UN Model Convention Commentary, particularly in the absence of any specific reservations by India, can be reasonably construed to be acceptable to the Indian tax administration as well. It would, therefore, appear that it is a conscious decision of India, being a party to a double taxation avoidance agreement based on the UN Model Convention, that even though "**construction, assembly and similar activities could, as a result of modern technology,** *(may)* **be of very short duration and still result in a substantial profit for the enterprise**" and even though "**the period during which foreign personnel remain in the source country is** *(perhaps)* **irrelevant to their right to tax the income",** the right to tax will not vest in the source country unless time limit threshold is satisfied as **"the reason for the time limit (indeed for the permanent establishment threshold more generally) is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State".** In our considered view, therefore, it is plain on principle that as long as threshold time limit for PE is not satisfied, the consideration for such installation or assembly activities, or supervisory activities in connection therewith, cannot be brought to tax in the source country. During the course of hearing and at the instance of the bench, learned counsel for the assessee has filed details of the work carried on at the installation and assembly site in respect of all the transactions, as it did take place in the relevant financial period, and, as evident from even a cursory look at these details, in none of these cases the conditions for creation of PE are satisfied.

42. In view of the above discussions, even if a part of the income, embedded in the impugned payments made to non-resident vendors, can indeed be attributed to the installation, assembly or commissioning activities of the plant, machinery or equipment purchased, such an income, on the facts of this case, cannot be brought to tax as business income under article 7 read with article 5 of the respective DTAAs.

43. Let us now move on to examine the impact of taxability of impugned payments as fees for technical services. The relevant tax treaty provisions are as follows:

<u>Indo Austrian tax treaty</u>

ARTICLE 12
Royalties and Fees for Technical Services

1. Royalties and 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 State.

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

……

4. The term "fees for technical services" as used in this Article means payments of any amount to any person other than payments to an employee of a person making payments, in consideration for the services of a managerial, technical or consultancy nature; including the provision of services of technical or other personnel.

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 or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property 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 a resident of that 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 Contracting State a permanent establishment or a fixed base 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 State in which the permanent establishment or fixed base is situated.

7. Where, by reason of a special relationship 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 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 Convention.

Indo Belgian tax treaty

Article 12
Royalties and Fees for Technical Services

1. Royalties and 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 State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed 20 per cent of the gross amount of the royalties or fees for technical services.

3. (a) ……..

(b) the term "fees for technical services" as used in this Article means payments of any kind to any person, other than payments to an employee of the person making the payments and to any individual for independent personal services mentioned in Article 14, in consideration for services of a managerial, technical or consultancy nature, including the provision of services of technical or other personnel.

4. 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 or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which, or the contract under 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.

5. Royalties and fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that 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 Contracting State a permanent establishment or a fixed base in connection with which the liability to make the payments was incurred and the payments are borne by such permanent establishment or fixed base, then the royalties or fees for technical services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where, by reason of a special relationship 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, information or technical services 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 royalties or fees for technical services shall remain taxable according to the laws of each Contracting State.

Indo China tax treaty

ARTICLE 12
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 or fees for technical services.

3. ……..

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 paragraph 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 or fees for technical services arise, through a permanent establishment or Performs in that other contracting state independent Personal service from a fixed base situated therein or performs in that other contracting state independent personal service 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 Contracting State a permanent establishment or a fixed base 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 relationship 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.

<u>Indo German tax treaty</u>

ARTICLE 12

Royalties and Fees for Technical Services

1. Royalties and 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 State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that 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 or the fees for technical services.

3. ……

4. The term "fees for technical services" as used in this Article means payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel, but does not include payments for services mentioned in Article 15 of this 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 or fees for technical services arise, through a permanent establishment situated therein, or performs in that other 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 and fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a Land or a political subdivision, a local authority or a resident of that 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 Contracting State a permanent establishment or a fixed base 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 State in which the permanent establishment or fixed base is situated.

7. Where, by reason of special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of royalties or fees for technical services paid exceeds the amount which would have been paid 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.

Indo Swiss tax treaty

ARTICLE 12
Royalties and fees for included services

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

2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the

beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) in the case of royalties referred to in sub-paragraph (a) of paragraph 3 and fees for included services referred to in sub-paragraph (b) of paragraph 4 of this Article:

(i) during the first five taxable years for which this Agreement has effect,

(A) 15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company; and

(B) 20 per cent of the gross amount of the royalties or fees for included services in all other cases; and

(ii) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services; and

(b) in the case of royalties referred to in sub-paragraph (b) of paragraph 3 and fees for included services referred to in sub-paragraph (a) of paragraph 4 of this Article, 10 per cent of the gross amount of such royalties or fees for included services.

3. The term "royalties" as used in this Article means:

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematogrph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent trademark, design or model, plan, secret formula or process, or for information concerning industrial commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment.

4. For purposes of this Article the term "fees for included services" means:

(a) payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services are ancillary and subsidiary to the application or enjoyment of the right, for which a payment described in sub-paragraph (b) of paragraph 3 is received;

(b) payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:

(i) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in sub-paragraph (a) of paragraph 3 is received; or

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

5. Notwithstanding paragraph 4, "fees for included services" does not include amounts paid:

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property;

(b) for teaching in or by educational institutions;

(c) for services for the personal use of the individual or individuals making the payment; or

(d) to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services falling under Article 14.

6. The provisions of paragraphs l and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for included services arise, through a permanent establishment situated therein and the contract in respect of which the royalties or fees for included services are paid is effectively connected with such permanent establishment. In such case, the provisions of Article 7 shall apply.

7. Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the liability to pay the royalties or fees for included services was incurred, and such royalties or fees for included services are borne by such permanent establishment, then such royalties or fees for included services shall be deemed to arise in the State in which the permanent establishment is situated.

8. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for included services paid exceeds the amount which would have been paid 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.

Indo UK tax treaty

ARTICLE 13
Royalties and fees for technical services

1. Royalties and 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 State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties within paragraph 3 (a) of this Article, and fees for technical services within paragraph 4 (a) and (c) of this Article;

(i) during the first five years for which this Convention has effect;

(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and

(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services;

and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

(3) For the purposes of this Article, the term "royalties" means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

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 or consultancy services (including the provision of services of technical or other personnel) which :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this Article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this article is received; or

(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.

5. The definitions of fees for technical services in paragraph 4 of this article shall not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisions of paragraphs 1 and 2 of this Article 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 or fees for technical services arise through a permanent establishment situated therein, or performs in that other 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 provision of Article 7 (Business profits) or Article 15 (Independent personal services) of this convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political sub-division, a local authority or a resident of that 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 Contracting State a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borne by that permanent establishment or fixed base then the 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.

8. Where, owing to a special relationship 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 paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment.

<u>Indo US tax treaty</u>

ARTICLE 12
Royalties and fees for included services

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

2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties referred to in sub-paragraph (a) of paragraph 3 and fees for included services as defined in this Article (other than services described in sub-paragraph (b) of this paragraph):

(i) during the first five taxable years for which this Convention has effect,

(A) 15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company; and

(B) 20 per cent of the gross amount of the royalties or fees for included services in all other cases; and

(ii) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services; and

(b) in the case of royalties referred to in sub-paragraph (b) of paragraph 3 and fees for included services as defined in this Article that are ancillary and subsidiary to the enjoyment of the property for which payment is received under paragraph 3(b) of this Article, 10 per cent of the gross amount of the royalties or fees for included services.

3. The term 'royalties' as used in this Article means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and

(b) payment of any kind received as consideration for the use of, or the right to use, the industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 or Article 8.

4. For purposes of this Article, 'fees for included services' means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

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

5. Notwithstanding paragraph 4, 'fees for included services' does not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than a sale described in paragraph 3(a);

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the personal use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Article 15 (Independent personal services).

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties or fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business profits) or Article 15 (Independent personal services), as the case may be, shall apply.

7. (a) Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State. Where, however, the person paying the royalties or fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for included services was incurred, and such royalties or fees for included services are borne by such permanent establishment or fixed base, then such royalties or fees for included services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

(b) Where under sub-paragraph (a) royalties or fees for included services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for included services relate to services performed, in one of the Contracting States, the royalties or fees for included services shall be deemed to arise in that Contracting State.

8. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for included services paid exceeds the amount which would have been paid 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 the Convention.

44. One common factor in all the above treaty provisions is that the expression 'fees for technical services', which is also referred to as 'fees for included

services' in some the treaties i.e. Indo Swiss and Indo US tax treaties, describes these services in a rather general manner whereas the expression 'construction, installation or assembly project or supervisory activities in connection therewith' find a specific mention in the PE clauses in all the related treaties. Generally speaking, and *de hors* the restricted meanings assigned by 'make available' clause or exclusion clauses, installation or commission activities are a particular type of technical services. There is thus a general provision for rendering of technical services and a specific provision for rendering of technical services in the nature of construction, installation or project or supervisory services in connection therewith.

45. While on this issue, it is important to bear in mind the fact that when it comes to 'services PE', as in article 5(2)(l) of Indo US tax treaty or article 5(2)(k) of Indo UK tax treaty, any services which can be covered by the FTS or FIS clause in the respective tax treaty are specifically excluded as these clauses refer to "the furnishing of services, other than included services as defined in Article 12 (Royalties and fees for included services), within a Contracting State by an enterprise through employees or other personnel " and "the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise though employees or other personnel" respectively. There is no such exclusion clause in the PE article dealing with construction, installation and assembly activities, including supervision activities relating thereto. It is also not in dispute, as has been stand of the revenue all along, that the construction, installation and assembly activities are *de facto* in the nature of technical services. To that extent, and unlike in the case of the provisions relating to Service PE, there is indeed overlapping effect of Article 5 and Article 12 or Article 13, so far as such services are concerned. As to what should be done in such a situation, we find guidance from the observations of Hon'ble Supreme Court in the case of **Union of India vs. India Fisheries (P) Ltd. [57 ITR 331 (1965)]** "If there is an apparent conflict between two independent provisions of law, the special provision must prevail." This principle is described in Sampat Iyengar's Commentary on Law of Income-tax (9th Edn; Vol. 1, p. 48) as follows:

> **"The general maxim is *generalia specialibus non derogant,* that is, general things will not derogate from special things. The maxim is also otherwise expressed as *generalibus specialia derogant*. A special provision normally excludes the operation of a general provision. ... It can be resorted to for deciding the competing claims of two provisions in the same enactment, one specific and other general with some overlapping between the two. The requisite conditions to attract this principle are: Firstly, both the general enactment and the particular enactment must be simultaneously operative, the general enactment covering larger field and particular enactment covering a limited field out of a larger field covered by the general enactment and, secondly, there must be nothing contained in the general provisions indicating the legislative intent to overrule or set aside the particular provision."**

46. Similar views were also expressed in the case of **ITO vs. Titagarh Steels Ltd [79 ITD 532 (2001)]**, wherein one of us, while articulating the views of Kolkata C Bench, had observed as follows :

> **"It is fairly well-settled in law that general provisions do not override specific provisions, as aptly described by the maxim *'generalia specialibus non derogant.'* A special provision normally excludes the operation of a general provision and we are of the view that such a principle governs the instant case also. In the case of South India Corpn. (P) Ltd. vs. Secretary, Board of Revenue AIR 1964 SC 207, Hon'ble Supreme Court had an occasion to consider whether Art. 277 or Art. 372 of the Constitution of India should govern the particular situation involved therein. Their Lordships then pointed out that "a special provision should be given effect to the extent of its scope, leaving the general provision to control cases where specific provisions do not apply."**

47. The same principle must apply in the treaty situations as well. What is the point of having a PE threshold time limit for construction, installation and assembly projects if such activities, whether cross the threshold time limit or not, are taxable in the source state anyway. If we are to proceed on the basis that the provisions of PE clause as also FTS clause must apply on the same activity, and even when the project fails PE test, the taxability must be held as FTS at least, not only the PE provisions will be rendered meaningless, but for gross versus net basis of taxation, it will also be contrary to the spirit of the following observations in the UN Model Convention Commentary, as reproduced earlier in

this order in paragraph 40 above. As we have noted so earlier, it appears to be a conscious decision of India, being a party to a double taxation avoidance agreement based on the UN Model Convention, that even though "construction, assembly and similar activities could, as a result of modern technology, *(may)* be of very short duration and still result in a substantial profit for the enterprise" and even though "the period during which foreign personnel remain in the source country is *(perhaps)* irrelevant to their right to tax the income", the right to tax will not vest in the source country unless time limit threshold is satisfied as "the reason for the time limit (indeed for the permanent establishment threshold more generally) is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State". If we are to interpret the FTS and FIS clauses overlapping with PE clause in practice, and apply the FTS and FIS clauses when PE taxation cannot be invoked, the very purpose of PE provisions will stand defeated and it will be contrary to the UN Model Convention Commentary quoted earlier in this order, which, as a coordinate bench has held in the case of Graphite India Ltd Vs DCIT [6 ITD 384 (2002)], are in the nature of '*contemporanea expositio'*. While holding so, the coordinate bench, speaking though one of us (i.e. the Accountant Member), had observed as follows:

> **17. The aforesaid interpretation is clearly in harmony with the OECD and UN Model Conventions' official commentaries, as elaborated in paras. 9 and 10 above. As the provisions of art. 15 of Indo-US DTAA, and corresponding provisions in these model conventions, are identical in material respects i.e., are in *pari materia*, the UN and OECD Model Conventions, and Commentaries thereon, have key role in determining connotations of the expressions employed in art. 15. Hon'ble Andhra Pradesh High Court has, in the case CIT vs. Visakhapatnam Port Trust (1984) 38 CTR (AP) 1 : (1983) 144 ITR 146 (AP), referred to OECD commentaries on the technical expressions and the clauses in the model conventions, and referred to, with approval, Lord Radcliffe's observations in Ostime vs. Australian Mutual Provident Society (1960) AC 459, 480 : (1960) 39 ITR 210, 219 (HL), which have described the language employed in these documents as the "international tax language". In view of the observations of Hon'ble Andhra Pradesh High Court, in Visakhapatnam Port Trust's case (supra), these model conventions and commentaries thereon constitute international tax language and the meanings assigned by such literature to various technical terms should be given due weightage. In our considered view, the views expressed by these bodies, which have made immense contribution towards development of standardization of tax treaties between various counties, constitute '*contemporanea expositio'* inasmuch as the meanings indicated by various expressions in tax treaties can be inferred as the meanings normally understood**

in, to use the words employed by Lord Radcliffe, 'international tax language' developed by bodies like OECD and UN.

48. When we put it to the learned Departmental Representative as to what is the purpose of an installation PE clause in Article 5, if PE or no PE, the consideration for installation and assembly project, or supervisory activities in connection therewith, are to be taxed anyway as FTS or FIS, he pointed out that the assessee has on its own accepted the taxability under the FTS clause and withheld tax, on that basis, while making specific remittances for independent payments for the installation and commissioning charges. It could thus not be possible for the assessee to take an about turn now and claim that such payments are not taxable anyway. Learned counsel for the assessee, on the other hand, fairly submitted that the taxability of such payments as FTS or FIS was taken as granted, without appreciating this nuance of the matter, as coming to the light in the course of this hearing, so far as standalone payments for these services were concerned, but neither such a conduct on the part of the assessee can constitute estoppel against the correct legal position nor would it imply that the a part of sale consideration can be fictionally treated as towards such services and then treated as FTS or FIS while the scope of such payments, under the tax treaties, is confined to amounts actually paid as FTS or FIS. We are unable to see legally sustainable merits in the stand of the learned Departmental Representative. The taxability of an income is to be decided on the basis of the provisions of law and not conduct of the parties. Just because the assessee has accepted a taxability in respect of some other transaction, no matter howsoever related, the legal remedies available to the assessee cannot be negated. There cannot be, and there is no, estoppel against the law. In view of the above discussions, in our considered view, in a situation in which there are specific PE clauses in relation to a particular type of services, which are covered in the scope of services covered by the scope of the 'fees for technical services' or 'fees for included services', the taxability of consideration for such services must remain confined to taxability of profits under the relevant specific PE clause. In our humble understanding, the provisions for taxability as FTS or FIS will not come into play in such cases.

49. In additions to the reasons set out above, there are many more reasons why the impugned payments, even if partly attributable to the consideration for fees for technical services or fees for included services, cannot be brought to tax under FTS or FIS.

50. As is evident from a plain look at the above tax treaty provisions, so far as the tax treaties with UK and USA are concerned, the definition has a 'make available' clause which implies that unless the services are such which enables the person acquiring the services to apply the technology contained therein, without recourse to the service provider, these services will not be covered by the definition of the fees for technical services. In other services, it is condition precedent for the taxability of an income under the head 'fees for technical services' or 'fees for included services', under these tax treaties, that there should be a transfer of technology to the recipient of the service. This is what coordinate benches of this Tribunal have held, in a series of decisions including in the cases of **Raymond Ltd Vs DCIT [86 ITD 791 (2002)]**, **CESC Ltd Vs DCIT [87 ITD TM 653 (2003)]**, and this stand has also been confirmed by Hon'ble Delhi and Karnataka High Courts in the cases **DIT Vs Guy Carpenter & Co Ltd [346 ITR 504 Del (2012)]** and **CIT Vs De Beers India Pvt Ltd [346 ITR 467 Kar (2012)]**. By no stretch of logic, installation or assembly activities even involve transfer of technology in the sense that recipient of these services can perform such services on his own without recourse to the service provider, nor has it been the case of the authorities below. For this short reason alone, the installation, commissioning or assembly activities cannot constitute fees for technical services, or fees for included services- as these are termed in Indo US tax treaty.

51. The same is the position with regard to the Indo Belgium tax treaty by the virtue of following MFN (*most favoured nation*) clause vide protocol dated 26th April 1993 which provides as follows:

> **1. Ad Articles 5, 7 and 12**
>
> **If under any Convention or Agreement between India and a third State being a member of the OECD which enters into force after 1st January, 1990, India limits its taxation on royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in the present Agreement on the said items of income, the same rate or scope as provided for in that**

Convention or Agreement on the said items of income shall also apply under the present Agreement with effect from the date from which the present Agreement or the said Convention or Agreement is effective, whichever date is later.

52. The manner of implementation of a somewhat similar MFN clause in the treaty protocol came up for consideration before a coordinate bench of this Tribunal, in the case of **DCIT Vs ITC Limited [82 ITD 239 (2001)]**. It was held that the provisions of the related tax treaty, i.e. Indo French DTAA in that case, are, therefore, required to be read with the protocol clauses and are subject to the provisions contained in such protocol. It was also held that the benefit of lower rate of or restricted scope of 'fees for technical services' under the related tax treaty is not dependent on any further action by the respective Governments, unlike the situation envisaged in certain other treaties such as India Philippines tax treaty or Indo Swiss tax treaty, and the narrower scope of the FTS clause, as referred to in the protocol, is to be read into the tax treaty which is assured an MFN status as such. That was a case in which, by the virtue of MFN clause, narrower scope of FTS with respect to '*fees for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property*' came into play, while right now we are concerned with the connotations of 'make available' clause which restrict the scope of the FTS. The parameters so far as narrower scope of FTS is concerned are different but the principle and mechanism, on the basis of which MFN clause is given life and effect, remains the same. It is in this respect that we have taken note of the views of the coordinate bench. We are in considered agreement with the views so expressed by the coordinate bench, and, following the same approach, we hold that the provisions of the Indo US and Indo UK tax treaty, which came into force with effect from 1st April 1991 and 1st April 1995 respectively (i.e. after the cutoff date of 1st January 1990 set out in protocol to Indo Belgium tax treaty) and which restrict the taxability of only such fees for technical services as 'make available' the technical knowledge, experience, skill or know-how etc, will apply in respect of Belgian tax resident vendors as well.

53. In the light of the above discussions, and in view of narrower scope of FTS by the virtue of 'make available clause' in Indo UK tax treaty, which has come into effect much after the cut-off date set out in protocol to Indo Belgian tax treaty, the

taxability as fees for technical services does not come into play in the cases of Belgian vendors as well.

54. We have also further that, in terms of article 12(5)(a) of Indo Swiss tax treaty, the fees for technical services, which is termed as fees for included services in this treaty, does specifically exclude, "amounts paid for ... services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of a property", Elaborating upon the scope of this provision, which also finds place in Indo US tax treaty, a coordinate bench of this Tribunal, in the case of **Hindalco Industries Ltd Vs ACIT [94 ITD 242 (2005)]**, has observed as follows:

> **23. The easily discernible common thread in all the transactions visualized in art. 12(3)(a) is that all these transactions are such that when sale takes place by the resident of one Contracting State to the resident of the other Contracting State, consideration of sale is taxable under art. 12 in the source country as well. Article 12(3)(a) and (b) only define as to what constitutes 'royalties' and art. 12(2) provides that 'royalties' and 'fees for included services' arising in a Contracting State and paid to the resident of the other Contracting State may also be taxed in the Contracting State in which they arise, i.e., in the source country, though subject to certain restriction on the rate of tax. It is thus clear that when the principal sale itself is subjected to tax in the source country, the services which are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of a property, are also subjected to tax in the source country. The said principle is also implicit in art. 12(4)(a) which provides that consideration for rendering any technical or consultancy services, where such services are ancillary and subsidiary to the application or enjoyment of the right, property or information which is covered by the definition of 'royalty' in art. 12(3), is also includible in the 'fees for technical services' and accordingly liable to be taxed in the source country.**
>
> **24. The scheme of the tax treaty, so far as royalties and fees for technical services (termed as 'fees for included services' in the India US tax treaty) is clearly like this. When principal transaction itself is such that it involves taxability in the source country, the transactions subsidiary and integral to such a transaction also give rise to the taxability of subsidiary transact ions in the source country. On the other hand, when principal transaction is such that it does not generally give rise to taxability in the source country, the transaction subsidiary and integral to such a transaction also does not give rise to taxability in the source country. In other words, the subsidiary and integral transactions have to take colours from the principal transaction itself and are not to be viewed in isolation. That is the intent and purpose, in our understanding, of the provisions of art. 12(5)(a) ……..**

55. In view of these discussions, in our humble understanding, Installation, commissioning or assembly of a plant, machinery or equipment, or any supervision activity connected therewith, is ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of such a property i.e. plant,

equipment or machinery. Therefore, for this short reason, any consideration for installation, commissioning or assembly activities, or supervision services in respect thereof, of a property, which obviously includes a plant, equipment or machinery, cannot be included in fees for included services under the Indo Swiss tax treaty as well. Accordingly, even if there be any income embedded in the impugned payments, in respect of installation, commissioning or assembly activities, or supervisory activities connected therewith, the same cannot be brought to tax, in view of the provisions of Article 12(5)(a) of Indo Swiss tax treaty, in the hands of the Swiss vendors as well. As corresponding provisions also find place in Indo UK [Article 13(5)(a)] and Indo US [Article 12(5)(a)] tax treaties, for this reason as well and for the material facts being similar, the consideration for installation, commissioning or assembly activities, or supervision services in respect thereof, can also not be subjected to tax in India in the hands of the UK and US based vendors either.

56. As evident from a plain look at the language employed in the FTS and FIS clauses of related tax treaties the taxability as FTS or FIS arises at the point of time when the payment is "actually" made "for" technical services "arising in a Contracting State and paid to a resident of other Contracting State". The event triggering the taxability under the tax treaties is the payment and not accrual. In any event, it is also beyond dispute that the provisions of Section 195 come into play at the time of payment or credit, whichever is earlier, and not on the basis of accrual method of accounting- as has been so vigorously canvassed in the orders of the authorities below. Holding so, a co-ordinate bench of this Tribunal, in the case of **C J International Hotels Ltd Vs ITO [79 ITD 506 (2001)]** and speaking through one of us (i.e. the Accountant Member), has observed as follows:

> **We find that the lower authorities have proceeded on the fallacy that taxability in the hands of the foreign company and TDS liability of the tax deductor are not one and same thing. It is, however, well settled that tax deduction at source is only one mode of recovery of the taxes due on recipient of that income, but it cannot be equated with final determination of tax liability in the hands of the recipient of such income. No doubt, in case of non-resident assessee, it is open to the regular AO to treat person from or through whom such assessee is in receipt of any income, as an agent under s. 163(1)(c) of the Act and, accordingly, assess such person in respect of that income as a 'representative assessee', but the case before us does not relate to such assessment under Chapter XV and we are only in seisin of the issue regarding tax deduction at source liability of the tax deductor company. The only relevant question, therefore, is as to at what point of time tax**

deduction at source liability under s. 195 crystallises in the present case—at the time of payment of the franchise fees, at the time of crediting the same to the account of M/s Societe Des Hotels Meridien, or, as argued by the Revenue, at the time of the franchise fees accruing to the aforesaid company. The answer to this question is provided by the plain and unambiguous language of s. 195 itself which states that tax is to be deducted "at the time of credit of such income to the account of the payee or at the time of payment thereof.....whichever is earlier". In our considered view, it is not open to the Revenue, for the purpose of determining TDS liability of an assessee tax deductor, to tinker with, or in anyway reject, the method of accounting employed by such assessee tax deductor. The judicial precedents relied upon by the authorities below deal with the issue of taxability in the hands of the foreign company and therefore, in our considered view, these judicial precedents have no bearing on the determination about the point of time when TDS liability under s. 195 crystallises. It is also not in dispute that account of the payee was not credited at the time of accrual of income and the accounting was done on cash basis. On these facts, TDS liability of the assessee cannot be said to crystallize at the time of income actually accruing to the foreign company and Revenue's claim that taxability crystallizes at the time of income accruing to the foreign company is not even relevant for deciding that question. As Rowlatt, J. has said, Cape Brandy Syndicate vs. IRC 1 KB 64, "in a taxing statute, one has to look merely at what is clearly said; there is no room for any intendment...". Since s. 195 specifically provides for deduction of tax at source at the time of payment or crediting the payee's account, whichever is earlier, we are unable to approve the stand of the Revenue regarding deduction of tax at source on the basis of accrual of income. In this view of the matter, we are of the considered opinion that the TDS liability, under s. 195, arises only when the income is credited to the account of the payee or on actual payment of the same, whichever is earlier. We further hold that mere accrual of income in the hands of the foreign company cannot be a sufficient proximate reason for tax deductor's liability under s. 195 of the Act. In view of this legal position, as also bearing in mind the fact that the AO has raised the impugned demand under ss. 201(1) and 201(1A) on the basis of taking TDS liability at the point of accrual of income in the hands M/s Societe Des Hotels Meridien, we cancel the impugned orders, hold that these orders are indeed contrary to the scheme of the Act, and restore the matter to the file of the AO(TDS) for passing fresh orders, if necessary, in accordance with the law and after giving due opportunity of hearing to the assessee tax deductor.

57. Viewed thus, the FTS or FIS provisions cannot be invoked for taxing a non-resident on the basis of accrual of liability, whether credited or not, or on the notions of fiction of an element of FTS or FIS being embedded in the business receipts for sale of plant, equipment or machinery. The receipts in the hands of the vendors are in the nature of business income, and the deeming fiction, as sought to be canvassed by the revenue, has no application in the matter. The business income can be taxed under article 7 read with article 5, and, as we have seen earlier in this order, the conditions precedent for taxability under article 7 r.w.a. 5 are not fulfilled on the facts of this case. In many of the cases, as noted in the orders of the authorities below, the related installation and commissioning services, and supervision services in connection therewith, have been rendered

by the domestic entities and payments made to those entities have already been subjected to tax withholding under other provisions of chapter XVII D but, disregarding this reality, the CIT(A) has proceeded on the basis that "cost of services is also vested in the cost of material" whether such services are performed or not. When admittedly no such services were rendered, there not have been any occasion to bring fictional 'consideration' for those services to tax.

58. In view of the above discussions, in our considered view, under the scheme of allocation of taxing rights under the related tax treaties, India does not have the right to tax income, even if any, in respect of rendition of installation, commissioning or assembly services, embedded in the invoice value of the related equipment, plant or machinery. We, therefore, see no need to address ourselves to the question whether any part of the stated sale consideration for these equipment, plant or machinery can indeed be attributed to such an installation, commissioning or assembly activity. The question as to whether, under the contract, the assessee was separately compensated for the installation, commissioning or assembly activities, or supervisions activities relating thereto, or whether the consideration for such activities was embedded in the sale consideration itself, is, not really to be examined any further, as the scope of taxability under Section 5(2)(b), given the facts of this case, is wholly academic. These provisions could have been pressed into service when these could have been more beneficial to the assessee, but now that these payments have no tax implications at all in India under the scheme of the relevant tax treaties under section 90(2), there is no occasion for the assessee to look at the provisions of the Income Tax Act, 1961, for 'more beneficial' a treatment.

59. While concluding his submissions, learned Departmental Representative had filed a letter dated 25th September 2014 praying that as the DTAA aspects were not taken up at the stage of the Assessing Officer or the CIT(A), and as such the revenue authorities had no occasion to examine that aspect of the matter at all, the matter should at best be restored to the file of the AO for fresh examination in the right perspective. In particular, he submits that the assessee's contentions regarding the PE being not in existence cannot be verified in such a short period as given by us.

60. We see merits in learned Departmental Representative's plea to the extent that the facts stated by the assessee with regard to the PE of foreign vendors not being in existence may need to be verified, and particularly as the assessee did not make proper submissions, duly supported by the facts on this aspect of the matter, at the assessment or the appellate stage. In case the Assessing Officer can bring any material on record which can demonstrate that the vendors had a PE in India, and the income embedded in the impugned payments was indeed liable to be taxed in India, to that extent and in accordance with the provisions of law, the Assessing Officer will be at liberty to raise the fresh demand under section 201 r.w.s. 195. With this rider, we hold that the demands under section 201 r.w. 195, impugned in appeal before us, are unsustainable in law and we set aside the same.

61. In the result, the appeals are allowed. It is so pronounced today on 24th day of December, 2014.

Sd/xx
C M Garg
(Judicial Member)

Sd/xx
Pramod Kumar
(Accountant Member)

Dated: the 24th day of December 2014

Copies to:	*(1)*	*Appellant*	*(2)*	*Respondent*
	(3)	*Commissioner*	*(4)*	*CIT(A)*
	(5)	*Departmental Representative*		
	(6)	*Guard File*		

By order etc

Assistant Registrar
Income Tax Appellate Tribunal
Jabalpur bench, Jabalpur