IN THE HIGH COURT OF UTTARAKHAND AT NAINITAL

INCOME TAX APPEAL (ITA) 46 of 2007

1. The Commissioner of Income-tax, Dehradun.
2. Dy. Commissioner of Income-tax, Circle -1, Dehradun.....Petitioner(s)

Versus

Arthusa Offshore Company
C/o Arthur Andersen, CAs.
2nd Floor, The Capital Court,
LSC Phase III, Olof Palme Marg,
Munirka, New Delhi.....Respondent(s)

Mr. Arvind Vashisth.....Advocates for Petitioner(s)
Mr. Percy Pandiwalla and Mr. Chetan Joshi.....Advocates for Respondent(s)

Coram: Hon`ble P.C.Pant,J. & Hon`ble Dharam Veer

Dated: 31/03/2008

Judgment: This Appeal, preferred under Section 260-A of the Income Tax Act, 1961, is directed against the judgment and order dated 26th February 2006 / 7th April 2006, passed by the Income Tax Appellate Tribunal, Delhi Bench 4D4, New Delhi (hereinafter referred as ITAT), in Income Tax Appeal No. 1338 / Del / 2002, for the Assessment Year 1994-95, whereby the appeal of the Revenue, is dismissed.

2) Heard learned counsel for the parties.

3) The substantial question of law involved in this Appeal, is as under:

> Whether, Income Tax Appellate Tribunal has erred in law in holding that word “tax” does not include “surcharge” for the purposes of Clause (2) of Article 14 of the Double Taxation Avoidance Agreement with United States of America, and in upholding the decision of the Commissioner of Income-tax (Appeals), reducing the tax rate applicable to assessee NRC (respondent) at 60 per cent instead of 65 per cent applied by the Assessing Officer?

4) Brief facts of the case are that assessee (present respondent) is a foreign company, which is resident of United States of America. In the return of the Income-tax filed by the asessee NRC for the Assessment Year 1994-95, it offered tax at the rate of 60 per cent on its income as against the maximum rate of 65 per cent applicable to foreign companies. The basis for offering the tax rate at 60 per cent by the assessee NRC is that under Article 14(2) of Double Taxation Avoidance Agreement (hereinafter referred as DTAA) between the Government of India and Government of United States of America, a company which is resident of United States of America can be subjected to tax in India at a higher rate to

the one applicable to domestic companies but the difference in the tax rate cannot exceed 15 per cent. Admittedly, the rate of tax for the domestic companies for the year under consideration was 45 per cent (excluding surcharge), as such, the assessee NRC offered tax only at the rate of 60 per cent. However, the Assessing Officer did not accept the stand taken by the assessee NRC. The Assessing Officer was of the view that word 4tax4 used in Article 14(2) as defined in Article 2(1)(b) of the DTAA includes surcharge also, as such, the assessee NRC cannot escape liability by adding 15 per cent to the tax rate of 50% per cent applicable to domestic companies when DTAA signed. The Assessing Officer calculated the rate of tax taking into consideration the rate i.e. 50 per cent applicable to the domestic companies in the Assessment Year 1990-91 when the DTAA was signed between the two countries, and as such, added to it 15 per cent surcharge on the rate of tax (50%) applicable in that year which makes the rate of tax for domestic companies 50 % + (15% of 50%) = 50 + (15 X 50 / 100) = 57.50 per cent, and on that rate he added the 15 per cent tax applicable to the foreign companies and as such since the rate of tax comes out to be 72.5 per cent, the maximum limit of 65 per cent, as provided in DTAA, was applied. Aggrieved by said order dated 10.01.1996, passed by Additional Commissioner of Income-tax, Dehradun (Assessing Officer), an appeal was preferred by the assessee NRC under Section 143(3) of Income Tax Act, 1961 before the Commissioner of Income-tax (Appeals), Dehradun [hereinafter referred as CIT(A)]. After hearing the parties, the CIT(A) vide his order dated 07.01.2002, passed in Apeal No. 308 / DDN / 1995-96, allowed the appeal upholding the contention of the assessee NRC and held that the rate of tax applicable to the assessee NRC is 60 per cent and not 65 per cent imposed by the Assessing Officer. On this, Revenue preferred its appeal against said order of CIT(A) before the ITAT, New Delhi, which was registered as I.T.A. No. 1338 / Del / 2002, and disposed of vide impugned judgment and order dated 27th February 2006 / 7th April 2006, affirming the decision of CIT(A). Hence, this Appeal.

5) Admittedly, the respondent assessee is a foreign company, resident of United States of America. It is also not disputed between the parties that it is liable to pay the tax as per the terms and conditions, mentioned in the DTAA, agreed between the Government of India and Government of United States of America on September 12, 1989, which was notified on 20.12.1990. It is settled principle of law that the DTAA has overriding effect over the provisions of the Income Tax Act, wherever the same are inconsistent to it.

6) Before further discussion, it is pertinent to mention here the relevant Clauses of DTAA, which are to be interpreted for the purposes of coming to the conclusion at what rate of tax the respondent assessee is liable to pay the income tax for the Assessment Year 1994-95. Article 2 of DTAA reads as under:

> "1. The existing taxes to which this Convention shall apply are:
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> (a) in the United States:
> the federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes), and the excise taxes imposed on

insurance premiums paid to foreign insurers and with respect to private foundations (hereinafter referred to as "United States tax"); provided, however, the Convention shall apply to the excise taxes imposed on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to exemption from such taxes under this or any other Convention which applies to these taxes; and

(b) in India:

(i) the income-tax including any surcharge thereon, but excluding income-tax on undistributed income of companies, imposed under the Income-tax Act; and

(ii) the surtax.

(hereinafter referred to as "Indian tax")

Taxes referred to in (a) and (b) above shall not include any amount payable in respect of any default or omission in relation to the above taxes or which represent a penalty imposed relating to those taxes.

2. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes which have been made in their respective taxation laws and of any official published material concerning the application of the Convention."

Clause (2) of Article 14 of DTAA, reads as under:

"2. A company which is a resident of the United States may be subject to tax in India at a rate higher than that applicable to the domestic companies. The difference in the tax rate shall not, however, exceed the existing difference of 15 percentage points." (Emphasis supplied by us)

7) From the above Clause (2) of Article 14 of DTAA it is clear that assessee NRC is liable to pay tax in India at a rate not exceeding 15 percentage points to the rate of tax applicable to the domestic companies. Now, the question arises, whether, word "tax" used in Article 14 includes "surcharge", or not?

Clause 1 (b) of Article 2 of DTAA, quoted above, clearly provides that surcharge is also payable by the foreign companies under the Income Tax Act. Clause 2 of Article 2 further provides that the Agreement (Convention) would be applicable to substantially similar taxes in place of the "existing taxes". The expression "existing taxes" undoubtedly refers to the rate of tax applicable in the Assessment Year 1990-91, when the Agreement was executed between the two countries.

Clause 1(d) of Article 3 of the DTAA simply says that the term 4tax4 means Indian tax or United States tax, as the context requires.

8) Having read all the relevant Clauses of the DTAA for the purposes of coming to the conclusion at what rate of tax assessee NRC of United States of America is liable to pay the tax, we are of the view that for the Assessment Year 1994-95, respondent NRC is liable to pay tax at the rate of 45 per cent (applicable for domestic company) + surcharge + 15 per cent, but not exceeding 65 per cent.

9) Mr. Percy Pandiwalla, learned counsel for the respondent assessee, defending the impugned judgment passed by the ITAT and the one passed by CIT (A), argued that the DTAA intended to impose the restriction of 15 percentage points excluding the surcharge. In this connection, he further argued that 4surcharge4 and 4Income-tax4 are to different connotations. In support of his case, learned counsel for the respondent assessee, relied on the case of Bank of America Vs. Deputy Commissioner of Income Tax; (2001) 73 TTJ pg. 51. We have gone through said judgment delivered by ITAT, Mumbai. We are unable to take the view taken by ITAT, Mumbai in interpreting the word "tax". The entire discussion made by the ITAT in Bank of America case (supra) appears to have been based on the presumption that "surcharge" is not payable by foreign companies. However, Clause 1(b) of Article 2 of DTAA entered into between the Government of India and Government of United States of America, quoted above, clearly provides that surcharge is also payable by the foreign companies. If the interpretation taken by ITAT, Mumbai, which is followed by ITAT, Delhi and CIT(A) in the impugned orders is taken to be true, there would have been no need of mentioning of word "surcharge" in Clause 1(b) of Article 2, nor would have been any need to add the Clause 2 of Article 2, which says that the Convention shall apply also to any identical and substantially similar taxes, which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes.

10) Mr. Arvind Vashistha, learned Standing Counsel appearing on behalf of the appellants drew attention of this Court to the principle of law laid down in Commissioner of Income Tax, Kerala Vs. K. Srinivasan; 1972 ITR (Vol. 83) pg. 346; and submitted that "surcharge" is included within the meaning of "tax" as "surcharge" is nothing but "additional tax" imposed under the same Act. In reply to this on behalf of the respondent assessee our attention is drawn to Article 270 and Article 271 of the Constitution of India and it is argued that expression "surcharge" and "tax" are to different connotations and "surcharge" cannot be included in the "tax", and as such, 15 percentage points can be calculated only from the rate of tax of 45 per cent applicable to the domestic companies in the Assessment Year 1994-95. On going through Article 270 and Article 271 of the Constitution of India, we found that the two Articles provide that "surcharge" shall form part of the consolidated fund of India, while in the case of "tax", the Government of India can fix a percentage of tax which shall not form part of consolidated fund of India and will be required to be distributed among the States. The two Articles of the Constitution of India have no application for the purposes of calculating rate of tax payable by an assessee. Article 270 and Article 271 only clarify that how the taxes levied and recovered by the Government of India are to be distributed between the Union of India and its States. The two words may have different meanings for the purposes of forming part of consolidated fund of India or that of the States but

it does not reflect any light whether a foreign company which is liable to pay tax under DTAA, is liable to pay surcharge or not, or whether 15 percentage points are to be added on the rate of tax (inclusive of surcharge), or not? For that purpose the Clauses of DTAA are the final guidelines overriding even the provisions of Income Tax Act, wherever they are inconsistent.

11) Paragraph E of Part I of First Schedule of the Finance Act, 1994 provides the rate of income tax for the companies for the Assessment Year 1994-95. The relevant portion of paragraph E of First Schedule of Finance Act, 1994, is being reproduced below:

> "In the case of a company, -
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> **Rates of income-tax**
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> I. In the case of a domestic company, -
> (1) where the company is a company in which the public are substantially interested 45 per cent of the total income;
> (2) where the company is not a company is which the public are substantially interested 50 per cent of the total income.
>
> II. In the case of a company other than a domestic company, -
> (i) on so much of the total income as consists of -
> (a) royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31st day of March, 1961, but before the 1st day of April, 1976, or
> (b) fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29th day of February, 1964, but before the 1st day of April, 1976,
> and where such agreement has, in either case, been approved by the Central Government 50 per cent;
> (ii) on the balance, if any, of the total income 65 per cent.
>
> **Surcharge on income-tax**
>
> The amount of income-tax computed in accordance with the provisions of this Paragraph or Section 112 shall, in the case of every domestic company having a total income exceeding seventy five thousand rupees, be increased by a surcharge calculated at the rate of fifteen per cent of such income-tax."

12) In view of the rate of tax mentioned above in Paragraph E of Part I of First Schedule of the Finance Act, 1994, read with the relevant Clauses of DTAA, we are of the view that CIT (A) as well as ITAT, New Delhi has erred in law in holding that the assessee NRC (respondent) is not liable to pay tax beyond 60 percent. The substantial question of law stands answered, accordingly. Both the impugned orders are liable to be set aside. Therefore, the Appeal of the Revenue is allowed. Both the impugned orders i.e. order passed

by the CIT(A) on 07.01.2002, in Appeal No. 308 / DDN / 1995-96 and the order passed by the ITAT on 27.02.2007 / 07.04.2006, in I.T.A. No. 1338 / Del / 2002, are set aside. The order passed by the Assessing Officer holding that the respondent assessee is liable to pay tax at the rate of 65 per cent is upheld. No order as to costs.

(Dharam Veer, J.) (Prafulla C. Pant, J.)
Dt. March 31, 2008.