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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment Reserved on: 05.12.2023

% *Judgment Pronounced on: 16.02.2024*

\+ **ITA 180/2014**

THE COMMISSIONER OF INCOME TAX-II ..... Appellant

Through: Mr Ruchir Bhatia, Sr. Standing Counsel with Ms Deeksha Gupta, Adv.

versus

MITSUBISHI CORPORATION INDIA P. LTD. ..... Respondent

Through: Mr M.S. Syali, Sr. Advocate with Mr Mayank Nagi, Ms Husnal Syali Nagi, Mr Tarun Singh and Mr Sandeep Yadav, Advs.

CORAM:
HON'BLE MR. JUSTICE RAJIV SHAKDHER
[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.:

Preface

1. This appeal concerns Assessment Year (AY) 2006-07. *Via* the instant appeal, the appellant/revenue seeks to assail the order dated 23.08.2013 passed by the Income Tax Appellate Tribunal [in short, "Tribunal"].

1.1 The record shows that the instant appeal was admitted on 29.04.2014 when the coordinate bench framed the following questions of law:

> *"(i) Whether the ITAT fell into error in holding that Section 40(a)(i) of the Income Tax Act, 1961 cannot be applied in view of the provisions of the Double Tax Avoidance Agreement between the Indian* (sic) *and Japan and India and the US?*
>
> *(ii) Whether the ITAT fell in error in reversing the findings of the DRP with respect to the existence of the PEs in India?"*

2. Since there was a difference of opinion between the judges who comprised the division bench concerning the answers to the questions of law framed on 29.04.2014, the matter was referred to a third judge. In the first instance, the bench which rendered the decision consisted of Hon'ble Mr Justice S. Muralidhar (as he then was) and Hon'ble Ms Justice Prathiba M. Singh.

2.1 A perusal of the decision dated 17.11.2017 discloses that while Hon'ble Mr Justice S. Muralidhar answered both questions in favour of the respondent/assessee, Hon'ble Ms Justice Prathiba M. Singh took a converse view, i.e., answered the questions in favour of the appellant/revenue.

3. The record also discloses that *via* the order dated 27.04.2018, the division bench stated the points of law on which they had differed while rendering their respective decisions on 17.11.2017. The relevant part of the order dated 27.04.2018 is thus extracted hereafter:

> *"3. Each of us has, in our respective opinions, differed in the answers to the above two questions. The points of law of which we have differed and which would be required to be answered by Sanjiv Khanna, J. is whether questions (i) and (ii) above should be answered as decided by each of us in our respective opinions.*
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> *4. A further point of law on which we have differed, and which is required to be answered by Sanjiv Khanna, J. is whether question (ii) requires to be re-framed and answered as stated by Prathiba M. Singh, J. in para 64 of her opinion?"*

Background

4. To render a view on the aspects adverted to in the order dated 27.04.2018, it would be necessary to capture, broadly, the backdrop in which the instant appeal was instituted in this Court.

4.1 The respondent/assessee in the AY in issue entered into transactions with certain group companies, reference to whom is made hereafter. *Qua* the transactions executed between the respondent/assessee and its group companies, remittances were made. However, the respondent/assessee made remittances without deducting tax at source [in short, "TAS"]. The Assessing Officer (AO) took umbrage and disallowed the deductions claimed by the respondent/assessee. The AO ordered the disallowance under Section 40(a)(i) of the Income Tax Act, 1961 [in short, "the Act"].

S. No.	***Name of the Group Company***	***Country***	***Disallowance u/s 40(a)(i) - Rs.***
1	Mitsubishi Corporation [MC (Japan)]	Japan	5,01,55,844
2	MC Metal Services Asia [MC Metal (Thailand)]	Thailand	24,09,32,203
3	Metal One Asia P. Ltd. [Metal One (Singapore)]	Singapore	10,06,99,115
4	Metal One Corporation [Metal One (Japan)]	Japan	57,91,87,712
5	Mc.Tubular Inc. [Tubular (USA)]	USA	11,60,956
6	Petro Diamond Corporation [Petro (Japan)]	Japan	16,34,096
7	Miteni [Miteni (Japan)]	Japan	51,84,250

5. Thus, in effect, on account of disallowances made by the AO under Section 40(a)(i) of the Act, Rs.97,89,54,176/- was added to the income of the respondent/assessee. Addition was also made on account of an adjustment of Arm's Length Price (ALP) by the Transfer Pricing Officer (TPO), an aspect which, concededly, does not form the subject matter of the instant appeal. The record shows that the Tribunal remitted the case to the AO for reconsideration regarding the ALP issue.

5.1 The aforementioned amount was added to the respondent/assessee's income after its return of income (ROI) had gone through various twists and

turns. The record discloses that the AO passed a draft assessment order on 31.12.2009. Via the order dated 30.09.2010, the Dispute Resolution Panel (DRP) sustained the said addition, which resulted in the final assessment order dated 25.10.2010 being passed under Section 143(3)/144C of the Act.

6. At this stage, it would be relevant to note that Section 40 underwent amendments by virtue of the Finance Act (FA), 2004 and FA 2014. The amendment brought about by FA 2004 took effect from 01.04.2005, while the amendment triggered *via* FA 2014 took effect from 01.04.2015. Since the amendments brought about in Section 40(a)(i) of the Act are crucial to the conclusion, one may arrive at, for convenience, the original provision, along with amendments which were triggered w.e.f. 01.04.2005 and 01.04.2015 are captured below:

SECTION 40 AS APPLICABLE IN HERBALIFE FOR AY 2001-02	***SECTION 40 – WEF 01.04.2005***	***SECTION 40 – AS AMENDED ON 1ST APRIL, 2015***
AMOUNTS NOT DEDUCTIBLE	***AMOUNTS NOT DEDUCTIBLE***	***AMOUNTS NOT DEDUCTIBLE***
40. Notwithstanding anything to the contrary in Sections 30 to 38.	*40. Notwithstanding anything to the contrary in Sections 30 to 38.*	*40. Notwithstanding anything to the contrary in Sections 30 to 38.*
The following amounts shall not be deducted.	*The following amounts shall not be deducted.*	*The following amounts shall not be deducted.*
*In computing the income chargeable under the head "**Profits and gains of business or profession**"*	*In computing the income chargeable under the head "**Profits and gains of business or profession**"*	*In computing the income chargeable under the head "**Profits and gains of business or profession**"*
(a) In the case of any assessee- *(i) any interest (not being interest on a loan issued*	*(a) In the case of any assessee-* *(i) any interest (not being interest on a loan issued for public subscription*	*(a) In the case of any assessee-* *(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty,*

for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,- *(A) outside India; or* *(B) In India* *to a non-resident, not being a company or to a foreign company,* *On which tax has not been deducted or, after deduction, has not been paid before the expiry of the time prescribed under sub-section (1) of section 200 and in accordance with other provisions of Chapter XVIIB.* ***Provided** that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid:* *Explanation – For the purposes of this sub-clause-* *(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;*	*before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,-* *(A) outside India; or* *(B) In India* *to a non-resident, not being a company or to a foreign company,* *On which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200;* ***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year or, has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under sub-section (1) of section 200, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.* *Explanation – For the purposes of this sub-clause-* *(A) "royalty" shall have the same meaning as in*	*fees for technical services or other sum chargeable under this Act, which is payable,-* *(A) outside India; or* *(B) In India* *to a non-resident, not being a company or to a foreign company,* *On which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid, [on or before the due date specified in sub-section (1) of section 139]* ***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.* ***Provided further** that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purposes of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on that date of furnishing of return of income by the payee referred to in the said proviso.*

(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9; ***NEW INSERTIONS***	*Explanation 2 to clause (vi) of sub-section (1) of section 9;* *(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;* *(ia) any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work),* *On which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200:* ***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or, has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under sub-section (1) of section 200, such sum shall be allowed*	*Explanation – For the purposes of this sub-clause-* *(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;* *(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;* *(ia) thirty per cent of any sum payable to a resident, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, [has not been paid on or before the due date specified in sub-section (1) of section 139.* ***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or, has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, thirty per cent of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.* ***Provided further** that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1)*

	as a deduction in computing the income of the previous year in which such tax has been paid. ***Explanation-*** *For the purposes of this sub-clause,* *(i) "commission or brokerage" shall have the same meaning as in Clause (i) of the Explanation to section 194H;* *(ii) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;* *(iii) "professional services" shall have the same meaning as in Clause (a) of the Explanation to section 194J;* *(iv) "work" shall have the same meaning as in Explanation III to section 194C;*	*of section 201, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.* ***Explanation-*** *For the purposes of this sub-clause,* *(i) "commission or brokerage" shall have the same meaning as in Clause (i) of the Explanation to section 194H;* *(ii) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;* *(iii) "professional services" shall have the same meaning as in Clause (a) of the Explanation to section 194J;* *(iv) "work" shall have the same meaning as in Explanation III to section 194C;* *(v) "rent" shall have the same meaning as in Clause (i) to the Explanation to section 194-I;* *(vi) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;*

7. Furthermore, what is critical for arriving at a decision in the matter is the relevant provisions of the Double Taxation Avoidance Agreements (DTAAs) entered into by India with Japan and the USA. It is common ground that Articles 24(3) and 26(3) found in the India-Japan and India-USA

DTAAs are pari materia. Once again, for convenience, the relevant parts of the DTAAs are extracted hereafter:

> ***"JAPAN***
>
> *ARTICLE 24*
>
> ***NON-DISCRIMINATION***
>
> *1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other Contracting State* ***in the same circumstances*** *are or may be subjected. This provision shall, notwithstanding the provision of article 1, also apply to persons who are not residents of one or both of the Contracting States.*
>
> *xxx xxx xxx*
>
> *3.* ***Except*** *where the provisions of article 9, paragraph 8 of article 11, or paragraph 7 of article 12 apply, interest, royalties and* ***other disbursements*** *paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the* ***same conditions*** *as if they had been paid to a resident of the first mentioned Contracting State."*
>
> ***"USA***
>
> *ARTICLE 26*
>
> ***NON-DISCRIMINATION***
>
> *1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall apply to persons who are not residents of one or both of the Contracting States.*
>
> *xxx xxx xxx*
>
> *3.* ***Except*** *where the provisions of paragraph 1 of article 9 (Associated Enterprises), paragraph 7 of article 11 (Interest), or paragraph 8 of article 12 (Royalties and Fees for Included Services) apply, interest, royalties and* ***other disbursements*** *paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State."*
>
> [Emphasis is ours]

8. As evidenced by the narration of facts set forth hereinabove, question no. (i), as framed by the Court, concerns five (05) entities, i.e., MC (Japan), Metal One (Japan), Tubular (USA), Petro (Japan) and Metini (Japan).

8.1 Insofar as the aforementioned five (05) entities are concerned, the respondent/assessee seeks to assail the disallowance ordered by the AO on the ground that it violates the non-discrimination provision contained in Article 24(3)/26(3) of respective DTAAs executed by India with Japan and USA. Significantly, the challenge to the disallowance is not pivoted on the absence of a Permanent Establishment (PE) in India. However, except for MC Japan, *qua* the remaining four (04) entities, the stand of the respondent/assessee is that it has no PE in India.

8.2 Question no. (ii), thus, concerns MC Metal (Thailand) and Metal One (Singapore). Insofar as these entities are concerned, the respondent/assessee has assailed the disallowance on the ground that they do not have a PE or a Liaison Office (LO) in India, as alleged or at all. Since there is no non-discrimination or equal treatment provision in the DTAAs executed by India with Thailand and Singapore, the objection raised *vis-à-vis* the other five (05) entities is not put forth by the respondent/assessee to assail the disallowance *qua* MC Metal (Thailand) and Metal One (Singapore).

Submissions of Counsel:

9. It is against this backdrop that the counsel for the parties advanced submissions. On behalf of the appellant/revenue, Mr Ruchir Bhatia learned senior standing counsel, made arguments. Insofar as the respondent/assessee

is concerned, submissions were put forth by Mr M.S. Syali, learned Senior Advocate, instructed by Mr Mayank Nagi, Advocate.

10. Mr Bhatia's arguments can broadly be paraphrased as follows:

(i) During the assessment proceedings, the AO noticed that the survey conducted at the Delhi LO of MC (Japan) revealed that it constituted a PE of the respondent/assessee. The respondent/assessee has not disputed this position.

(ii) Furthermore, the AO held that since Metal One (Japan) had an LO in India, logically, it would follow that it has a PE in India. Insofar as the remaining entities were concerned, the AO took recourse to the business connection test and proceeded to disallow deductions against payments made to the said entities.

(iii) The finding returned by the AO that the LO of MC (Japan) constitutes a PE in India stands affirmed by the DRP and the Tribunal. The decision dated 17.11.2017 rendered by the division bench has not disturbed this finding. [See paragraphs 50 and 65 of the said judgment rendered by Justice Singh.]

(iv) As far as Metal One (Japan) is concerned, the Tribunal *via* its order dated 11.05.2012 (concerning AY 2008-09) held that it did not have a PE in India; an issue which is the subject matter of an appeal (ITA 113/2013) filed by the appellant/revenue in this Court.

(v) The aforesaid facts would demonstrate that all seven (07) entities to whom the respondent/assessee had made payments had business connection in India. Therefore, having regard to the plain language of Sub-Section (1)

of Section 195 of the Act, the respondent/assessee was obliged to deduct TAS, as the payments made constituted sums chargeable to tax under the Act.

(vi) Therefore, the AO rightly invoked the provisions of Section 40(a)(i) of the Act and disallowed the deduction claimed by the respondent/assessee *vis-à-vis* payments made "outside India", as TAS had not been deducted, although the said payments were chargeable to tax in India. Thus, the payments made to the aforementioned seven (07) entities cannot be claimed by the respondent/assessee as a deduction while computing income under the head "profits and gains of business or profession". Failure to comply with provisions of Section 195(1), correctly resulted in the disallowance made by the AO under Section 40(a)(i) of the Act. [See ***Transmission Corporation of AP Ltd. v. CIT***, (1999) 239 ITR 587 (SC)]

(vii) The provisions of Article 24(3)/26(3) would have no application, as one of the exceptions to the applicability of the said Article(s) is Article 9 contained in the respective DTAAs. Article 9 incorporated in the said DTAAs is applicable. The transactions were entered into between Associated Enterprises (AEs), and therefore, the profit shown against service income by the respondent/assessee was benchmarked by the TPO. The Tribunal remanded the said issue to the AO/TPO for selecting appropriate comparable.

(viii) Since Article 9 applies in the instant case, the reliance by Justice Muralidhar on the judgment rendered by another coordinate bench in the matter of ***CIT v. Herbal Life International (P.) Ltd.***, (2016) 388 ITR [hereafter referred to as "Herbal Life case"] was misplaced.

(ix) The discrimination noticed by the coordinate bench in the Herbal Life case was done away with by FA 2004. [See paragraphs 18, 46 and 53 of the division bench's judgment dated 17.11.2013 passed by Justice Singh].

(x) Although the amendment made *via* FA 2004 to Section 40(a)(i) of the Act was noticed in the Herbal Life case, the said judgment was based on the language of Section 40(a)(i) as it stood in AY 2001-02. After the insertion of Clause (ia) pursuant to the amendment made *via* FA 2004, the payments made to a resident towards interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services required deduction of TAS, failing which, the concerned assessee was denied deduction. Thus, the purported discrimination due to disallowance of deduction concerning payments made outside India or to non-resident *vis-à-vis* resident ceased, with effect from 01.04.2005.

(xi) The Explanation 2 appended to Section 195 of the Act, which was introduced *via* FA 2012 with retrospective effect, i.e., 01.04.1962, is not the sole basis on which Justice Singh has sustained the disallowance. The judgment rendered by Justice Singh notices the amendment made to Section 40(a) of the Act. [See paragraphs 46, 47, 48 and 55].

11. In sum, the argument was that the judgment rendered by Justice Singh should be sustained, including that part of the judgment whereby she reframed the second question. [See paragraph 64]

12. Mr Syali, on the other hand, made the following submissions:

(i) This Court should confine itself to aspects referred to in the order dated 27.04.2018. This Court need not delve into those issues *qua* which

findings have yet to be returned by the statutory authorities or into those aspects where no difference of opinion is articulated in the judgment under reference.

(ii) Question no. (i) pertained to the applicability of the non-discrimination Clause found in the above-referred DTAAs. The decision *qua* question no. (ii) thus pivots on the existence of PE.

(iii) The respondent/assessee has two separate sources of income, i.e., income from purchases and income earned through services rendered. Both sources are independent of each other. The deductions claimed by the respondent/assessee against payments made towards services rendered by it have not been disallowed under Section 40(a) of the Act. Thus, insofar as payments made for services are concerned, a transfer pricing adjustment was made, which was sustained by the DRP. The Tribunal, however, set aside the upward adjustment made by the TPO/DRP, a position that stands accepted by the TPO. Therefore, the two streams of payments made by the respondent/assessee cannot be clubbed for the purposes of Section 40(a) of the Act. The AO ordered disallowance for the purchases by invoking provisions of Section 40(a) of the Act. In contrast, payments received against services rendered were subjected to income adjustment.

(iv) The appellant/revenue did not advance any argument based on the provisions of Article 9 of the DTAAs entered into by India with Japan and the USA. A perusal of the division bench judgment dated 17.11.2017 would show that the difference of opinion of the learned judges did not emanate from the provisions of Article 9 of the concerned DTAA. The submission based on Article 9 was noticed and thereafter rejected by the coordinate

bench in the Herbal Life case. The argument advanced on behalf of the respondent/assessee concerning discrimination in treatment will not be impacted because the transactions were entered into between Associated Enterprises (AEs). The only impact of such dealing would be that the purchase price would have to be tested against transfer pricing principles. The tenability of the submission that unequal treatment is accorded concerning payments made outside India or to non-residents as against residents would remain open to examination. The AO, in fact, has adopted this approach by considering TP adjustments and disallowances made under Section 40 of the Act separately.

(v) The judgment rendered by Justice Singh is fraught with errors. Justice Singh failed to note that payments were made by the respondent/assessee related to purchases and not services. Contrary to the observations made by Justice Singh, payments made by the respondent/assessee were not towards "composite transactions."

(vi) Most of the issues raised in the appeal stand answered by the judgment rendered by the coordinate bench in the Herbal Life case. The decision rendered in the Herbal Life case has, apparently, been accepted by the appellant/revenue. It appears that the appellant/revenue has not preferred an SLP against the said judgment. Notably, the following aspects were dealt with in the Herbal Life case:

(a) A resident could claim the benefit of provisions contained in the DTAA.

(b) The argument based on Article 9 adverted to Article 24(3)/26(3) of the DTAAs entered by India with Japan and the USA was dealt with and rejected.

(c) The division bench noticed and dealt with the impact of the insertion of Clause (ia) of the Act to Section 40(a) of the Act. The respondent/assessee was an intervenor in that case, an aspect which emerges upon perusal of paragraphs 30 and 48 of the judgment.

(vii) The issue concerning chargeability to tax about the payments made requires scrutiny having regard to the provisions of the Act. Once chargeability is established, the provisions of the DTAAs have to be looked at only to soften the rigour of the concerned provision of the Act. There is no dispute regarding chargeability; what needs to be answered is whether its impact is mitigated having regard to the provisions of the DTAA.

(viii) The taxation of business profits under the DTAA is possible only if the concerned assessee has a PE in India [See Article 7]. The concept of business connection is alien to the matter in question. [See ***UAE Exchange Center Ltd. v. Union of India & Anr***, 313 ITR 94 (Delhi) and ***Danisco India Pvt. Ltd. v. Union Of India & Ors.***, 404 ITR 539 (Delhi)]

(ix) Section 195 is a machinery provision that effectuates the chargeability of income to tax as per Section 4 of the Act. Section 195 is not a standalone provision; it cannot apply if the charging provision has no applicability. [***Union of India v. Azadi Bachao Andolan & Anr***., 263 ITR 706 (SC)]

(x) The provisions of Section 195 follow once income comes within the sway of the provisions of Section 4/5/90 of the Act. The tax burden is on the

payee and not the payer; the only obligation cast on the payer is to deduct tax. Mere chargeability to tax under the Act only forecloses some issues. Justice Singh's judgment does not take into consideration the impact of the provisions of Section 90 and the concerned DTAAs.

(xi) Justice Singh's judgment treats the provisions of Section 195 as a charging provision and then proceeds to arrive at the following conclusions. (a) Since Section 195 is a self-contained provision the absence of PE would make no difference.

(b) For the deduction of TAS, business connection test would suffice. Whether or not the payment received by the payee was chargeable to tax would be ascertained at the assessment stage. The position adopted by Justice Singh is contrary to the judgment rendered by the Supreme Court in the ***G.E. India Technology Centre P. Ltd. v. CIT***, 327 ITR 456 (SC).

(xii) The correct and true interpretation of the provisions of Explanation 2 appended to Section 195 of the Act is ascertainable by referring to the Memorandum Explaining the Provision in the Finance Bill, 2012; Notes on Clause dated 16.03.2012 and the CBDT Circular dated 15.07.2005. Explanation 2, appended to Section 195 of the Act, governs the liability of the payee and not the payer.

(xiii) In any event, the provisions of Explanation 2 to Section 195 cannot alter the law. Unilateral amendment by the Legislature of the provisions of DTAAs executed between two nations is impermissible in law.

Analysis and reasons

13. Having heard learned counsel for the parties and perused the record, which includes the judgments dated 17.11.2017 rendered by the learned judges, what emerges is the following:

13.1 The AO had ordered disallowances *qua* payments made by the respondent/assessee concerning purchases from its seven (07) group companies. The disallowance of the expenditure incurred for purchases made was triggered as TAS had not been deducted by the respondent/assessee. The AO took recourse to the provisions of Section 40(a)(i) of the Act.

13.2 Insofar as the income received by the respondent/assessee against services rendered by it for acting as an intermediary between the ultimate customer and the group companies was concerned, that was subjected to transfer pricing adjustment. This aspect is not the subject matter of the instant appeal. The Tribunal has, in fact, remitted this issue to the TPO/AO for fresh consideration.

13.3 It was neither the stand of the appellant/revenue nor was any finding of fact arrived at by the AO that the transactions entered into between the respondent/assessee and its seven (07) group companies were "composite transactions". In other words, the suggestion that an element of taxable income was embedded in the transactions executed between the respondent/assessee and its seven (07) group companies does not emerge from the record. The AO ordered disallowance under Section 40(a)(i) of the Act concerning payments made by the respondent/assessee to its group companies on the ground that they were chargeable to tax in India. The

conclusion reached by the AO about the taxability of the payments made by the respondent/assessee in India was based on the rationale that since MC Japan had acquiesced to the jurisdiction of the appellant/revenue [as it had a LO located in India, which was treated as its PE], the business model of the remaining group companies being identical, they would stand on the same footing. In other words, the AO concluded that all seven (07) group companies had PE in India.

13.4 Thus, the AO, having regard to the provisions of Explanation 2 appended to Section 195 of the Act (which was inserted in the Act *via* FA 2012, *albeit* with effect from 01.04.1962) concluded that payments made by the respondent/assessee to its group companies were chargeable to tax in India and hence, the disallowance under Section 40(a)(i) of the Act could be ordered for failure to deduct TAS.

14. As noted hereinabove, the respondent/assessee insofar as the following entities are concerned, i.e., MC (Japan); Metal One Corporation (Japan); Tubular (USA); Petro (Japan) and Miteni (Japan), has assailed the disallowance ordered by the AO, not on the ground that the payments made are not chargeable to tax in India, but on the basis that equal treatment was not accorded, as envisaged in Articles 24(3) and 26(3) of DTAAs entered into by India with Japan and USA.

15. As indicated above, before 01.04.2005, payments specified in Clause (i) of Section 40(a) made outside India or to a non-resident could not be deducted while computing the income chargeable to tax under the head "profits and gains from business and profession" unless TAS was deducted or after the deduction the amount was made over, i.e., paid. *Inter alia*, the

payments specified in Clause (i) of Section 40(a) concern interest [not being interest on a loan issued for public subscription before the 1st day of April, 1938], royalty, fees for technical services or other sums chargeable under the Act.

15.1 The rigour of the said provision, as it obtained prior to 01.04.2005, did not apply to the aforementioned specified payments made to residents. FA 2004 brought about an amendment in Section 40(a), whereby the resident was also brought within its sway, *albeit* with respect to payments specified in Clause (ia). The payments adverted to in Clause (ia) were the following:

> "*any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work)"*

15.2 Thus, although parity had been brought about with regard to the power of the AO to deny deduction where TAS was not deducted against payments made outside India or to non-residents and residents, it was limited to certain payments. As is evident upon perusal of Clause (ia) of Section 40(a), it did not bring payments made towards purchases to resident-vendors within its net. Therefore, the respondent/assessee argued that even after the amendment in Section 40(a) w.e.f. 01.04.2005, unequal treatment, i.e., discrimination, obtained with regard to payments made against purchases to resident-vendors. The expenditure incurred on payments made to resident-vendors against purchases could thus, be taken into account while computing income chargeable under the head "profits and gains of business or profession". This disparity was removed by FA 2014, *albeit* w.e.f. from 01.04.2015, when the ambit of disallowance was enlarged by

bringing any sum payable to a resident within the four corners of Clause (ia) of Section 40(a).

15.3 Since the period in issue is AY 2006-07, the amendment brought about in Section 40(a) by virtue of FA 2014 would have no relevance. Therefore, in my opinion, the equal treatment or the non-discrimination Clause obtaining in Articles 24(3) and 26(3) of the India-Japan/India-USA DTAAs would apply with regard to the payment for purchases made by the respondent/assessee concerning the following five companies: MC (Japan); Metal One Corporation (Japan); Tubular (USA); Petro (Japan) and Miteni (Japan)

16. There can be no cavil with the proposition advanced on behalf of the respondent/assessee that since the provision of Article 24(3)/26(3) of the India-Japan and India-USA DTAAs respectively are more beneficial, it is entitled to rely upon the same, in support of its stand that the disallowance had been rightly deleted by the Tribunal. Section 90(2) of the Act makes it abundantly clear that, "Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India…for granting relief of tax, or....avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee." [See ***Union of India v. Azadi Bachao Andolan***]

17. The argument advanced on behalf of the appellant/revenue that since provisions of Article 9 of the respective DTAAs apply, the equal treatment/non-discrimination clause incorporated in Article 24(3)/26(3)

would have no application to my mind, is untenable for the following reason:

17.1 Article 9 captures transactions that an assessee may enter with an AE, which may result in a transfer pricing adjustment. In the instant case, the transfer pricing adjustment impacted the payments received by the respondent/assessee against services rendered by it to its group companies. This aspect was concededly not the subject matter of the disallowance ordered under Section 40(a) of the Act. The disallowance under the said provision was confined to payments made by the respondent/assessee against purchases required to conform to the equal treatment clause or the non-discrimination Clause contained in Article 24(3)/26(3). Perhaps for this reason, the AO did not take recourse to the provisions of Article 9 of the respective DTAAs.

18. As regards the transactions entered into by the respondent/assessee with the remaining two entities, i.e., MC Metal (Thailand) and Metal One (Singapore), the respondent/assessee does not press the argument of equal treatment as the DTAAs entered into by India with Thailand and Singapore do not contain an equal treatment/non-discrimination clause.

18.1 In this behalf, the respondent/assessee has contended and, in my view correctly, that since the two companies referred to above, i.e., MC Metal Thailand and Metal One Singapore, do not have a PE in India, the payments made to them are not chargeable to tax in India. Articles 7 of the India-Thailand and India-Singapore DTAAs, respectively, provide complete clarity in that behalf. The AO, *via* convoluted logic, has concluded that since MC (Japan) had a LO in India, on account of the similarity of business

models, it ought to be concluded that these two companies, amongst other companies, also had PE in India. On the other hand, the Tribunal has returned a finding that MC Metal Thailand and Metal One Singapore do not have a PE in India. The following paragraph from the Tribunal's order, being relevant, is extracted hereafter:

> "*9.7 In the above decision the Tribunal has concluded that Metal One Corporation does not have a PE in India. The Assessing Officer on the analogy that the functions of Metal One Asia Pte. Ltd. Thailand are similar to that of Metal One Corporation, drew an inference that Metal One Asia Pt. Ltd. have a PE in India. Similar inference has been drawn in the case of MC. Tubular Inc. USA, Petro Diamond Corp. Japan and Miteni Japan. As the ITAT had, in the case of Metal One Corporation held that the entity does not have a PE in India, on the facts and circumstances of the case, the ratio applies to all other entities other than Mitsubishi Corporation, Japan. We are informed that, for none of the entities, other than Metal One Corporation, Japan the Revenue authorities have passed any order holding that those entities have a PE in India. We find that the AO drew an inference that these entities have a PE in India while examining the provisions of S.195 and S.40(a)(ia) in the case of the assessee but, the department has not passed any order holding that these entities have a PE in India. Thus the income of these entities are not taxed in India.* ***Under these circumstances we have to necessarily hold that the payments made for purchases from these entities are not taxable in India as these entities have not held as having a PE in India and hence the provisions of S.195 are not attracted and consequently the disallowances made u/s 40(a)(ia) of the Act are bad in law. In the result this ground of the assessee is allowed."***
>
> [Emphasis is ours]

19. Given this position, as correctly argued on behalf of the respondent/assessee, it was not obliged to deduct TAS from payments made to MC Metal (Thailand) and Metal One (Singapore). Chargeability to tax is the paramount condition for triggering the obligation to deduct TAS. The plain language of sub-section (1) of Section 195 brings this aspect of the matter to the fore. The said section reads as follows:

> ***"195.*** *(1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to*

in section 194LB or section 194LC) [or section 194LD] or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :

***Provided** that in the case of interest payable by the Government or a public sector bank within the meaning of Clause (23D) of section 10 or a public financial institution within the meaning of that Clause, deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode :*

***Provided further** that no such deduction shall be made in respect of any dividends referred to in section 115-O.*

Explanation 1.—For the purposes of this section, where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

Explanation 2.—For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has—

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India."

19.1 This is also the dicta of the judgment rendered by the Supreme Court in ***GE India Technology,*** as is evident from a perusal of the following extract:

"7. Under Section 195 (1), the tax has to be deducted at source from interest (other than interest on securities) or any other sum (not being salaries) chargeable under the Income-tax Act in the case of non residents only and not in the case of residents. Failure to deduct the tax under this section may disentitle the payer to any allowance apart from prosecution under section 276B. Thus, Section 195 imposes a statutory obligation on any person responsible for paying to a non resident, any interest (not being interest on securities) or any other sum (not being dividend) chargeable under the provisions of the Income-tax Act, to deduct Income-tax; at the rates in force

unless he is able to pay income-tax thereon as an agent. ***The most important expression in Section 195(1) consists of the words "chargeable under the provisions of the Act". A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Income-tax Act.*** *For instance, where there is no obligation on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the Income-tax Act. It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to 'the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, "chargeable under the provisions of the Act". It is for this reason that vide Circular No. 728 dated 30-10-1995 that the CBDT has clarified that the tax deductor can take into consideration the effect of DTAA in respect of payment of royalties and technical fees while deducting TAS. It may also be noted that Section 195(1) is in identical terms with Section 18(3B) of the 1922 Act The application of Section 195 (2) presupposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure as to what should be the portion so taxable or is not sure as to the amount of tax to be deducted. In such a situation, he is required to make an application to the ITO (TDS) for determining the amount. It is only when these conditions are satisfied and an application is made to the ITO (TDS) that the question of making an order under Section 195 (2) will arise.* ***While deciding the scope of Section 195(2) it is important to note that the tax which is required to be deducted at source is deductible only out of the chargeable sum. This is the underlying principle of Section 195…***

8. If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words "chargeable under the provisions of the Act" in section 195(1). *The said expression in section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not as assessable, there is no question of TAS being deducted.*

9. One more aspect needs to be highlighted. Section 195 falls in Chapter XVII which deals with collection and recovery. Chapter XVII-B deals with deduction at source by the payer. On analysis of various provisions of Chapter XVII one

finds use of different expressions, however, the expression "sum chargeable under the provisions of the Act" is used only in Section 195. Therefore, section 195 has to be read in conformity with the charging provisions, i.e., sections 4, 5 and 9. This reasoning flows from the words "sum chargeable under the provisions of the Act" in section 195(1). The fact that the revenue has not obtained any information per se cannot be a ground to construe section 195 widely so as to require deduction of TAS even in a case where an amount paid is not chargeable to tax in India at all. ***We cannot read section 195, as suggested by the Department, namely, that the moment there is remittance the obligation to deduct TAS arises. If we were to accept such a contention it would mean that on mere payment income would be said to arise or accrue in India. Therefore, as stated earlier, if, the Contention of the Department was accepted it would must obliteration of the expression "sum chargeable under the provisions of the Act" from section 195(1) Hence, the provisions relating to TDS applies only to those sums which are chargeable to tax under the Income-tax Act. If the contention of the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the moneys deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the income- tax Act by which a payer can obtain refund. Section 237 read with section 199 implies that only the recipient of the sum, i.e., the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum chargeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act to be omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when the income has no territorial nexus with India or is not chargeable in India, the Government would nonetheless collect tax*** *As stated hereinabove, Section 195(1) uses the expression "sum chargeable under the provisions of the Act." We need to give weightage to those words. Further****, section 195 uses the word 'payer' and not the word "assessee". The payer is not an assessee****. The payer becomes an assessee-in-default only when he fails to fulfil the statutory obligation under Section 195(1). If the payment does not contain the element of income the payer cannot be made liable. He cannot be declared to be an assessee-in-default. The abovementioned contention of the Department is based on an apprehension which is ill founded. The payer is also an assessee under the ordinary provisions of the Income tax Act. When the payer remits an amount to a non-resident out of India he claims deduction or allowances under the Income-tax Act for the said sum as an "expenditure". Under section 40(a) inserted vide Finance Act, 1988 with effect from 1-4-1989, payment in respect of royalty, fees for technical services or other sums chargeable under the Income-tax Act would*

not get the benefit of deduction if the assessee fails to deduct TAS in respect of payments outside India which are chargeable under the Income-tax Act. This provision ensures effective compliance of section 195 of the Income-tax Act relating to tax deduction at source in respect of payments outside India in respect of royalties, fees or other sums chargeable under the Income-tax Act. In a given case where the payer is an assessee he will definitely claim deduction under the Income-tax Act for such remittance and on inquiry if the Assessing Officer finds that the sums remitted outside India comes within the definition of royalty or fees for technical service or other sums chargeable under the Income-tax Act then it would be open to the Assessing Officer to disallow such claim for deduction."

[Emphasis is ours]

19.2. The reliance on the judgment rendered by the Supreme Court in ***Transmission Corporation of AP Ltd. v. CIT*** is misplaced, as that was a case involving a composite transaction where the trading receipt was embedded with a component of income. This is evident upon perusing the following extracts from ***G.E. India Technology***, whereby the said aspect has been discussed:

"Applicability of the judgment in the case of Transmission Corporation (supra)

10. In Transmission Corpn. of AP Ltd.'s 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 exigible 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 Corpn. of AP Ltd.'s case (supra) it was held that TAS 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 TAS 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 TAS 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 TAS 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. 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 Corpn. of AP Ltd.'s 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 TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of 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 IT Act, i.e., chargeable under sections 4, 5 and 9 of the IT Act."***

[Emphasis is ours]

20. This brings me to the other aspect of the matter: whether the second question could have been reformulated. The observations of J Singh in this behalf are as follows:

> *"64. Question 2, however, is modified to read as under:*
>
> *Whether the ITAT was in error in reversing the findings of the DRP with respect to the existence of PEs as well as a business connection in India?*
>
> *65. The AO had clearly come to the conclusion that the non-resident entities had a PE as well as a business connection in India. This Court holds that MC admittedly has a PE. The other entities also do have a business connection in India. The question is thus, answered in the affirmative i.e. in favour of the Revenue and against the Assessee."*

21. In my view, the learned Judge could not have reformulated the question after the pronouncement of the judgment. As indicated above, the

respondent/assessee could have taken recourse to the DTAAs *qua* the reformulated question since the provisions contained therein were more beneficial. [See Section 90(2) of the Act.] Therefore, the business connection test had no relevance once it was established that MC Metal (Thailand) and Metal One (Singapore) did not have a PE in India.

22. In my opinion, all three questions, as outlined in the order dated 29.04.17 read with the order dated 17.11.2017, have to be answered in favour of the assessee and against the revenue.

(RAJIV SHAKDHER)
JUDGE

FEBRUARY 16, 2024/aj