

CASE LAW**ITAT Pakistan:**

ITA No. 774 & 805/LB/2011

Foreign:Rolls Royce Singapore Pvt. Ltd.
v.
Assistant Director of Income TaxUttam Bir Singh Bedi v.
Union of IndiaITA No. 3796/Del/2006
Assessment Year: 2002-03,
ITA No. 4154/Del/2006
Assessment Year: 2002-03,
ITA No. 142/Del/2007
Assessment Year: 2003-04,
ITA No. 480/Del/2007
Assessment Year: 2003-04,
ITA No. 5122/Del/2010
Assessment Year: 2006-07Aditya Birla Nuvo Limited,
(Formerly known as Indian Rayon
& Industries Limited) v.
The Deputy Director of Income-
tax, (International Taxation)Income Tax Appeal Nos. 1331,
1332, 1333, 1334, 1335 & 1336
(Del) of 2008.Assessment Years: 1999–2000,
2000–01, 2001–02, 2002–03,
2003–04 & 2004–05,
1392 (Del) of 2005.Assessment Years : 1996–97 and
1393, 1394 & 1395 (Del) of 2005.
Assessment Years: 1999-2000,
2000-01 & 2001-02Ram Jethmalani & Ors. v.
Union of India & Ors.

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Published by Dr. Ikramul Haq,
printed at Meraj Jamshaid Butt
Printers, Rattigan Road, Lahore

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ARTICLES

2011: Year of conflicts

STATUTES

Sales Tax General Order No. 30 of 2011, dated December 21, 2011.

Sales Tax General Order No. 31 of 2011, dated December 21, 2011.

SECP Circular No. 17 of 2011, dated December 23, 2011.

S.R.O. 1121(I)/2011, dated December 28, 2011.

No. SRB-3-4/17/2011, dated December 29, 2011.

S.R.O. 1125(I)/2011, dated December 31, 2011.

MISCELLANEOUSWITHHOLDING TAX STATEMENTS U/S 165 OF INCOME TAX
ORDINANCE 2001 (Data Validation Checks)**TAX NEWS**

Political apathy hampers WB tax programme

National Tax or CNIC numbers:
SRO 821(I)/2011 creates fear among traders

Over Rs13bn liabilities: Textile millers move court against govt

National Audit Plan: targets given to RTOs and LTUs halved

FBR decides to establish ATT Directorate General

FBR to give tax relief to PIA

SECP approves electronic reporting of trades in TFCs

Intellectual Property: 'Legislation process in final stages

Number of audit cases finalised by FBR nosedive: World Bank

1.6 million NTN holder non-filers to face legal action: FBR

MoC may notify changes in import/export policy orders

Land, police the most corrupt departments: survey

Against FBR representations:

President upheld over 80 percent of FTO decisions

Tax collection from builder: TI Pakistan questions FBR's lack of action

Annual report-2010: FTO raises issue of 'misuse of appeals' by FBR

Improving revenue collection:

Pakistan, WB negotiating second reform programme

Tax treaties to be revisited

SECP allows relief to MTS market

Small clubs exempted from ST on services

FBR extends office timings

Owner of goods transport: applicability of tax questioned

Khyber Pakhtunkhwa refers motor registration scam to NAB

Taxpayers protest over audit notices without scrutiny

SECP makes amendments to solvency

FBR strives to facilitate businessmen

'Govt's inaction on GST ruins tractor industry'

WB for reduction in FBR workforce

Causing delay in production

Cash and reconciliation reporting systems:

FBR chief denies allegations of figures fudging

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2011: Year of conflicts

by

Huzaima Bukhari & Dr. Ikramul Haq

2011 is about to end leaving behind many sordid memories, troubles and challenges—imperialist highhandedness evoking Occupying Wall Street Movement, political upheavals, armed conflicts, economic collapses and slowdowns, rising poverty and unemployment, social distresses and above all, rapidly growing menace of militancy coupled with religious extremism. At the close of 2011, the world's most worrisome melting pot remains the tribal areas of Pakistan and Afghanistan. The US Af-Pak strategy after receiving setbacks culminated in the statement by Vice President Joe Biden that “[the] Taliban are not enemies of USA”. This is, in fact, an admission by US of failure of its military operations in Afghanistan, leaving no option but enter into “political negotiations” with the groups once condemned as “terrorists”.

Ensuing events in the wake of NATO attack on Salalah check post, especially Pakistan's boycott of Bonn Conference and severing of supplies to ISAF troops stationed in Afghanistan forced Biden to tell *Newsweek* that “it is good enough for the US if Afghanistan stops being a haven for people who do damage and have as a target the United States of America and its allies”. He further said that “the U.S. is supportive of a reconciliation process between the Afghan government and the Taliban even if it is questionable whether reconciliation is possible”. Republican presidential candidate Mitt Romney reacted strongly saying that Biden's remarks—as as well as President Obama's belief that the Taliban “are not the enemy”—are “bizarre”, factually wrong and “an outrageous affront to our troops carrying out the fight in Afghanistan”.

It is a fact that since 9/11 many opportunities surfaced for “reconciliation”, but each time a hidden hand, using the ugly weapon of “terrorism”, damaged any peace effort. The hidden hand is keeping the armed conflicts alive to control Eurasia. New military bases in Afghanistan encircling Iran in the long run would be used for any possible military confrontation with China or Russia. Projecting them as enemies but covertly supporting and funding religious fanaticism is the secret weapon of CIA. It is painful that leadership of Afghanistan, India and Pakistan has miserably failed to counter operations of CIA that successfully disrupted any peace process in the region.

The root-cause of trouble in this region is “occupation” of Afghanistan. The occupant forces have incited “resistance”, which is unquestionably justified. Unfortunately, the hidden hand has successfully maligned the legitimate Afghan resistance by pushing their terrorist friends within their ranks and files. These terrorists, operating on behalf of CIA, are part of the New Great Game, unleashed by imperialist and neo-imperialist forces for their economic and military interests in the wake of 9/11.

2011

Tax Review

The creation of *Jihadis* (holy warriors) in the wake of Talibanization of Afghanistan was at the behest of forces that had keen interest in defeating the erstwhile communist USSR to control world trade and politics. Afghanistan and Pakistan became victims of shortsightedness of policies they pursued both at the time of Soviet occupation and in the aftermath of 9/11 by becoming US allies in the so-called 'wars against communism and terrorism'. Even the democratic (sic) government of India and oil-rich Muslim states did not protest when the US started killing innocent civilians in Afghanistan in December 2001 by indiscriminate bombings under the pretext of annihilating Al-Qaeda operatives.

In Bonn peace talks of 2001, a grave mistake was committed, by keeping out the Taliban. Leaderships of both India and Pakistan failed to take any lead in aiming for political settlement in the neighbouring Afghanistan. They did not ask UN mediators to marginalize Al-Qaeda by persuading moderate Taliban leaders to participate in both the peace process and future political setup. Ouster of Taliban from peace talks and brutal killing of innocent civilians in several villages in Tora Bora and near Gardez in December 2001 by US, sowed permanent seeds of hatred and revenge—this was the beginning of an unabated cross-border wave of terrorism which has now turned into an insurmountable tsunami threatening the peace and tranquility of the entire region.

Not only is Afghanistan far from becoming a stable and peaceful state in the near future, two nuclear states—Pakistan and India—are also poised in a perpetual conflict situation. Being captives in the hands of military establishments, since Mumbai carnage in 2008, there is no meaningful progress to peace talks. War-mongers on both sides persistently create paranoia of hate to halt peace process and enhanced trade between the two neighbouring countries. Media in India and Pakistan make things worse by over-publicizing, publishing and broadcasting irresponsible statements by imprudent politicians. The electronic media vividly projects war games and possible scenarios of mass destruction in the event of nuclear attacks. This shows deep penetration of war psychosis—a lamentable mindset. A few raise voices of sanity and peace across the borders, but they are weak and ineffective before the hawkish elements—supporters and sympathizers of military establishments having control over state apparatus and popular media.

Forces of terror and obscurantism are re-employed in the New Great Game—they were created by CIA to dismember USSR but dumped in 1989 when Russian troops packed their bags and went home. Once the Central Asian countries became independent from the erstwhile USSR in 1991, USA concentrated its attention in the region on Soviet nuclear leftovers, the decommissioning of which it hailed as a great success. When the Taliban took over in 1996, the Americans did not seem overly concerned that the bearded rulers and their Al-Qaeda friends were supporting radical Islamic groups in Central Asia. Was CIA totally

oblivious of Taliban-Al Qaeda nexus and their nefarious activities until 9/11? Why did the US government fail to counter their activities when they openly extended their actions into Africa and elsewhere? What lessons did the US learn when its embassies were bombed in Africa by Al Qaeda? What measures were taken to stop them when an Indian plane was hijacked in December 1999 from Katmandu and taken to Kandahar? How did the hijackers, acting for slain Osama Bin Laden, manage to get freed, militants like Maulana Azhar and Ahmed Omar Sheikh from Indian jails? For eight long years, why did the US allow Musharraf to cheat everybody and keep on supporting the militants?

The above questions and their answers can unveil the truth behind the tragic happening of 9/11 in New York and operation of May 2, 2011 in Abbottabad. George Bush and Dick Cheney made plans for invasion of Afghanistan and Iraq much before 9/11. They supported Musharraf *et al* for implementation of their agenda of militarization of the region. It is a fact that even Barak Obama, before occupying the Oval Office, was talking of controlling Afghanistan through increased military presence. What is the significance of Afghanistan in the New Great Game? The answer is simple. The hidden agenda of US and its allies in Afghanistan and elsewhere is to control oil and gas reserves, promote drug trade, religious fundamentalism and mass acceptance of their policies of fascism for self-interests. Till today, India, Afghanistan and Pakistan have failed to realise that they are being sucked into a deadly trap by these forces.

CIA, through hired militants is waging continuous proxy wars in this region. It is funding and arming religious fanatics. Under this game plan of CIA, Kabul gives free hand to agents of India's Research and Analysis Wing (RAW) on Pakistan's western borders. It is an open secret that CIA operatives with the help of RAW and Afghan secret agency have been funding the insurgency in Balochistan, carrying out suicide bombings and attacking Pakistani military installations. At the same time, many CIA agents are promoting a number of militant groups in Pakistan to create problems in Afghanistan, India, China and Iran.

The linkage behind troubles in all the countries of this region is the same—Central Intelligence Agency that has become a protector of corporate interests of USA and the West as documented in detail by L. Fletcher Prouty in his remarkable book, *The Secret Team*. Sadly, the Afghan, Indian and Pakistani governments have conveniently been playing in the hands of their common enemy, yet ironically relying on US support. For this occasion, Mir Taqi Mir, the great Urdu poet, very aptly said, *Mir kai sada hain bemar huai jis kay sabab, usi attar kai londay se dawa latain hain* (What a simple soul is Mir that he seeks prescription from protégé of the person who is cause of his ailment).

One wonders how rulers are ignoring the obvious tentacles of the dirty game plan of the neo-colonial forces in this region. The main aim behind this bizarre scheme, prepared by neo-colonialists, is to push the armed forces of Pakistan against the wall using India as conduit, obtain the

control of nuclear arsenals and use bogey of “Islamic terrorism” for the containment of China. George W. Bush, before leaving the Oval ensured that the new man taking his place should have no option but to remain engaged in wars in various parts of the world. Ruthless bombing on innocent civilians, armed conflicts in the Middle East and Africa testify to these nefarious designs.

One hopes that one day Afghan, Indian, Pakistani leadership and other nations of the world will understand this great conspiracy against humanity. It is high time Soviet Union, China, Iran, Afghanistan, India and Pakistan convene summit for uniting against the forces of neo-colonialism and foil their ‘New Great Game’ plan. They must understand that “cross-border terrorism” is the main weapon in the New Great Game waged by US and its allies to achieve common goal of attaining monopoly over energy resources, ensuring military presence around Iran, China, India and Soviet Union and take control of nuclear weapons possessed by Pakistan.

American Late Neo-colonialism, as explained by Dr. Sachithanandam Sathananthan in his *Great Game Continues*, is using terrorism as political cover for intervening and, where necessary, invading resource-rich and strategic countries to overthrow nationalist leaders, install puppet regimes and salvage the countries’ wealth. And of course, the US is by far the most detestable terrorist force. The reality of “war on terror” is that religious fanatics and Late Neo-colonialists appear to be enemies, but in fact they are ‘friends-in-arms’—their hidden agenda is to snatch away from the world its peace and tranquility. The greatest challenge before forces of peace in 2012 would be how to put up a united stand for defeating monopolies, stemming the rising tide of terrorism, communalism, religious bigotry and economic injustice caused by capitalism, which is vigorously protected and controlled by Late Neo-colonialist forces.

Political apathy hampers WB tax programme

Lack of political commitment proved to be one of the major factors affecting implementation on the World Bank (WB) funded Tax Administration Reform Project (TARP) which is going to expire on December 31, 2011; WB observed in its recent report. Federal Board of Revenue (FBR) Chairman Salman Siddique while talking to Profit; on a question of implementation status on TARP programme said, "It is true that FBR could not implement the TARP programme fully due to various reasons but I can definitely say that, TARP programme is implemented 53 per cent on the IT side and 83 per cent on the infrastructure side."

Former Chairman FBR and member Tax Advisory Committee Federal Tax Ombudsman Pakistan Abdullah Yousaf, on a question about reasons that lead to partial implementation on TARP programme, said maximum systemisation of TARP programme needed full commitment at the top level and support from FBR team that was unfortunately not there when needed.

He said overall, problems that have negatively affected TARP implementation are: lack of effective political commitment, insufficient tax policy reforms to expand tax bases and simplify the tax system, lack of follow-up on the measures agreed to be implemented, lack of co-ordination among different areas, lack of management conviction to implement key measures, high turnover of top managers, lack of accountability, leadership and ownership on the project; weak implementation capacity and a rigid and inappropriate legal framework.

Abdullah Yousaf further said there are three stakeholders to the tax system, government, taxpayer and tax collector. There should be a win-win situation for all three. He said the tax payee should be given the due facilitation that FBR owes to him while salaries of tax employees especially tax collectors should also be raised to ensure more efficiency and transparency into the tax machinery.

Chairman Tax Committee Islamabad Chamber of Commerce and Industry (ICCI) and Tax Lawyer Mian Ramzan said ineffective co-ordination among the operations (now Inland Revenue - IR), Enforcement, Audit Wings, PRAL and RTOs/LTUs seriously undermined the effective implementation of instructions from HQ to field formations resulting in ineffective operations and non-achievement of TARP objectives.

He said TARP project mainly helped FBR in constructing buildings, purchasing cars and computers, but the objective of

automation for broadening the tax base did not materialise, so to say TARP as successful project do not seem feasible. WB report said high turnover of top authorities severely affected the project. A situation of permanent instability has also been aggravated by vested interests both within FBR and the business community, undermining support of the project and its ability to fully meet the development objectives.

The main tax policy envisaged in TARP did not lead to the introduction of a modern VAT, combined with an effective excise tax system. Also, removal of exemptions and zero rates in sales tax were below expectations. Zero rates for non-exporters and special regimes (for example, retailers) remain intact. WB observed that lack of leadership and accountability was also a critical feature of TARP implementation.

TARP was cut down its size to over \$78 million from first allocated amount of \$123 million. TARP has been implemented under three ministers of finance, four chairmen of FBR and a number of FBR Board members. TARP that would expire on December 31 has remained a problematic project for the WB during the last few years as this project was initially conceived and signed during the tenure of Musharraf-Aziz regime, but failed to utilise its allocated amount of \$123 million till December 2009. During the PPP regime, World Bank Executive Board granted extension of two years till December 2011 and cut down its size to over \$78 million, including the grant amount of DFID. FBR authorities would also be reviewing the decision to make a formal request to WB for a new programme in a visit of WB Team into Pakistan in January 2012. – *Courtesy Pakistan Today.*

National Tax or CNIC numbers: SRO 821(I)/2011 creates fear among traders

With the imposition of mandatory requirement by the Federal Board of Revenue (FBR) to issue invoices containing National Tax or CNIC numbers of unregistered traders are now becoming more fearful of the situation.

The FBR has made it mandatory for all industrial sectors except sugar sector to issue invoice carrying CNIC numbers or NTN's of their unregistered buyers, which would definitely cause the businesses to shrink, said Zeeshan-ur-Rehman, ACA, from Shekha & Mufti, Chartered Accountants. He said that under SRO 821(I)/2011, the board has made it mandatory for all registered

manufacturers, importers and exporters selling taxable or dutiable goods to unregistered persons to mention their CNIC/NTN in the invoices from January, 2012.

He expressed fear that this mandatory requirement would restrain non-compliant taxpayers from reporting sales made to unregistered without disclosing buyers' NTN/CNIC.

However, few beneficial rulings were also issued by FBR in this respect, overlapping with each other, and creating confusion among the business circles, he added.

Zeeshan said that all industrial sectors have expressed resentment over the said decision, terming it as impractical and unrealistic approach as unregistered buyers either refuse to share their NTN/CNIC or switch to some other unregistered seller, which would cause severe financial shocks to the already depressed business community.

Following the requests made by the business fraternity, the FBR has only excluded the sugar sector from the jurisdiction of the said SRO but this exemption remains applicable till the discussion between the FBR and Pakistan Sugar Mills Association (PSMA) reaches any conclusion, he said.

Similarly, upon agitation by other quarters, the FBR later relaxed the implementation of SRO 821(I)/2011 across the board till 31 December 2011, he said. Therefore, the business fraternity is required to exercise the requirements of said SRO from January 2012, he added.

Moreover, he said, these rulings are in field and appear to be overlapping vis.a.vis implementation of SRO 821(I)/2011 upon sugar sector as on one hand, the FBR had made it mandatory for all taxpayers to observe compliance with the requirement of NTN/CNIC. However, on the other hand, the sugar-specific ruling has not been rescinded by FBR.

"If the sugar sector will continue to enjoy immunity from disclosing their buyers' NTN/CNIC, while all other business segments will be bound by the requirements of SRO 821(I)/2011," he said.

Keeping all these ambiguities in view, he urged the authority concerned to withdraw the sugar specific ruling or else clarify the matter to avert potential problems in future. – *Courtesy Business Recorder.*

Over Rs13bn liabilities: Textile millers move court against govt

Textile millers have moved court against the government for what they say outstanding liabilities amounting to over Rs13 billion, it is reliably learnt.

Due to financial constraints, textile sector's pending liabilities against the government under different schemes announced in the Textile Policy 2009-14 have swelled to over Rs 13 billion, informed sources told Business Recorder on Monday. This includes Rs 10 billion as Drawbacks on Local Taxes and Levies (DLTL) announced in the Textile Policy.

Sources revealed that Cresox Company Limited has filed a petition in Sindh High Court against the government seeking immediate release of pending liabilities.

According to sources a sum of Rs7.5 billion were allocated in the 2011-12 budget. The Ministry of Textile has sought Rs 3 billion from the Ministry of Finance to pay the outstanding liabilities but only Rs 1 billion could be released so far. Efforts are under way to seek additional funds to pay the pending liabilities of textile sector to provide it relief.

The government had announced different schemes as well as drawbacks on taxes for textile sector in the Textile Policy. The pre-policy 60 percent Research and Development (R&D) pending dues that the Policy committed have not yet been cleared.

The ongoing financial crisis as well as the cumbersome registration process for obtaining dues accounts for only 10 percent of companies qualifying for R&D, textile exporters added.

Official sources revealed that to meet stakeholders' pending liabilities, more than Rs 17.25 billion have been disbursed to the industry under various schemes in last two years and further requests have been sent to the Ministry of Finance to allocate more funds to support the industry by settling remaining claims. – *Courtesy Business Recorder.*

National Audit Plan: targets given to RTOs and LTUs halved

The Federal Board of Revenue has made a reduction of 50 percent in the targets assigned to the Large Taxpayer Units and Regional Tax Offices for carrying out income tax and sales tax audit of

corporate sector, Association of Persons (AOPs), business individuals and withholding agents for Tax Year 2010 under the National Annual Audit Plan 2011-12.

Sources told *Business Recorder* here on Monday that the FBR has made 50 percent reduction in selection of total number of cases for audit due to inability of the FBR Taxpayer Audit Wing to meet the assigned targets under the 'National Audit Plan 2011-12'.

The FBR will issue instructions to the field formations here on Tuesday (Dec 27) for 50 percent reduction in the number of cases for income tax and sales tax audit for Tax Year 2010.

In this connection, the FBR has revised the methodology for selection of cases for audit under the Tax Year 2010.

According to the revised policy under the 'National Audit Plan 2011-12', sources said that directions to be issued to field formations to limit the selection of cases for audit for the Tax Year 2010 to 50 percent.

The remaining 50 percent cases should be selected directly by FBR through computer ballot on the basis of approved risk criteria before January 1, 2012.

In order to implement this decision, a team of officers (Tax Audit Task force) shall work under Member (Taxpayer Audit), who will identify the risk parameters, select cases for audit and monitor their progress.

The selection of cases by this team shall be completed by December 31, 2011 and rolled out wef January 1, 2012.

Sources said that as per 'National Audit Plan 2011-2012', the targets for audit coverage as against the number of income tax returns received for the Tax Year 2010 and corresponding tax periods of sales tax and federal excise were fixed for the LTUs/RTOs on August 30, 2011.

The LTUs were assigned to select 30 percent of the taxpayers including withholding agents (Tax Year 2010) for audit, RTOs seven percent companies cases including withholding agents and RTOs were assigned target to pick 5 percent non-company cases including AOPs and 'business individuals' and withholding agents.

The LTUs/RTOs have also been empowered to select 20 percent of the total cases selected for audit on the basis of local knowledge.

Following 50 percent reduction in selection of cases for income tax and sales tax audit for Tax Year 2010, the LTUs/RTOs would

correspondently reduce the percentage of cases to be selected for audit under the new development.

Under the 'National Annual Audit Plan 2011-12', sources said the cases for audits shall mainly be selected by the Commissioners based on the risk factors developed by FBR.

However, he may also select cases for audit on the basis of his local knowledge.

The number of such cases must not exceed 20 percent of the total cases selected for audit.

Keeping in view new development here on Monday, the 50 percent reduction would also affect cases where Commissioners can exercise their discretionary powers, sources added. – *Courtesy Business Recorder*.

FBR decides to establish ATT Directorate General

In a major move to prevent 'ISAF/NATO containers scam' in future, the Federal Board of Revenue (FBR) has decided to establish a Directorate General of Afghan Transit Trade to regulate and exclusively handle all issues relating Afghan Pakistan Transit Trade Agreement (APTTA).

Sources told *Business Recorder* here on Monday that the main purpose of the creation of a separate Directorate General of Afghan Transit Trade is to monitor the movement of transit trade consignment to check scams like 'ISAF/NATO containers in future.

The directorate would be headed by a senior customs official who would be responsible to supervise its functioning.

The directorate would be established at Karachi and its key function would be to exclusively regulate and monitor the Afghan transit trade consignments under the APTTA.

The cases of missing containers scam would be effectively checked with the help of Directorate General of Afghan Transit Trade.

Directorate General of Afghan Transit Trade would be a separate department with the mandate to totally focus on operations of the Afghan transit trade and monitor consignments to ensure rules and regulations have been duly followed by the importers.

With this major initiative to improve customs operations at Pak-Afghan borders, it is expected that the implementation of a

separate directorate would be successful in checking missing containers during their transportation to Afghanistan.

Directorate General of Afghan Transit Trade would also be given the assignment to ensure that any kind of fraud could not be committed by unscrupulous elements.

This would be done by proper checking of documents during clearance of Afghan cargo at Pakistani ports.

Sources said that the FBR has also decided for not giving any other assignment to the Directorate General of Afghan Transit Trade except monitoring of transit trade.

The Terms of the Reference and powers and jurisdiction of the new directorate would be notified after approval of the directorate at the highest level.

In the absence of an exclusive directorate to monitor the Afghan transit trade consignments, misuse of the transit trade facility has been witnessed with violations of rules and regulations.

The directorate would also place effective checks to ensure that the destined cargo has reached Afghanistan without opening the containers during transportation.

This would only be possible in the presence of an exclusive department like Directorate General of Afghan Transit Trade to deal with all matters of the APTTA in future, sources added. – *Courtesy Business Recorder.*

FBR to give tax relief to PIA

The Federal Board of Revenue (FBR) has decided to give a major tax concession, under Income Tax Ordinance 2001, to Pakistan International Airlines (PIA) to help it come out of the current financial crisis.

Sources told *Business Recorder* here on Sunday that the FBR has now accepted a major demand of the national flag carrier to give 50 percent reduction in the minimum tax under Section 113 of the Income Tax Ordinance, 2001.

The FBR has agreed to reduce minimum tax rate from 1 percent to 0.5 percent under Section 113 of the Ordinance, 2001 for PIA.

According to sources, the minimum tax has been collected irrespective of profit or loss under the relevant provisions of the Income Tax Ordinance 2001.

The national flag carrier had given a presentation to the FBR for reduction in the minimum tax.

In order to facilitate the airline in its operations, it would be appropriate to provide some tax relief without creating any distortion in the tax system.

The FBR will also play its due role in improving the financial condition of the airline by providing some tax relief to it.

Earlier, a draft reply was prepared by the FBR in which it was regretted that the tax reduction could not be given to the airline.

Recently, the tax authorities thoroughly analysed the case of the national flag carrier and finally decided to reduce the minimum tax from 1 percent to 0.5 percent under Section 113 of the Ordinance, 2001.

Any draft has no legal grounds and it could not be considered as an authentic document of the FBR.

The decision has been approved by the tax authorities and would be notified in due course of time, sources added.

Sources dispelled the impression that the FBR had rejected the proposal of the PIA for reduction in tax rate.

Contrary to this, the representation of the airline had been sympathetically considered by the tax authorities and duly approved.

It had been reported that the financial losses of the airline had increased.

The reduction in the tax rate would facilitate the airline to give some financial help in current circumstances.

However, this reduction in minimum tax would not create any discriminatory treatment for other airlines as only PIA had approached the FBR for such tax concession, sources added. – *Courtesy Business Recorder.*

SECP approves electronic reporting of trades in TFCs

The Securities and Exchange Commission of Pakistan (SECP) have approved amendments to the regulations of the National Clearing Company of Pakistan Limited (NCCPL), providing for electronic reporting of trades executed in unlisted term finance certificates (TFCs), a statement said on Tuesday.

“The NCCPL reporting platform will be operational next month and all financial institutions, mutual funds, brokers and other corporate bodies will be able to report their trades through this functionality,” it said.

Unlisted TFCs represent a major portion of the corporate debt market in the country, hence, development of a centralised platform, providing access to real-time trading information in these securities, is vital, it said.

This will not only provide market participants with transparent and accurate trading information, but will also assist in price discovery process. The trades reported through this platform will also be disseminated to the stock exchanges and displayed on their websites to provide the debt market participants with a holistic view of the local corporate debt market and its trading activities, the statement said.

Efforts are also underway for introducing clearing and settlement of these unlisted TFCs through the NCCPL, which will facilitate investors in settling their transactions and providing the debt market segment with necessary infrastructural support, it said.

The SECP has advised NCCPL to disseminate the concept paper on the reporting platform to all its clearing members and conduct training sessions and workshops to create awareness among the market participants.

In order to ensure completeness of trading data being reported, amendments will also be made to the regulations of the Central Depository Company, whereby, movements of TFCs in the CDC on account of trading activity will only be allowed if these trades are reported through NCCPL platform, it said.

Recently, the SECP had introduced significant improvements to the Bonds Automated Trading System of the stock exchanges with an aim at providing the market with a modern and flexible trading system for listed debt securities. – *Courtesy The News.*

Intellectual Property: ‘Legislation process in final stages’

Intellectual Property Organisation (IPO-Pakistan) Chairman Hameed Ullah Jan Afridi said that after upgrading infrastructure and strengthening of the intellectual property (IP) regime, the legislation process of IP is in its final stages.

Addressing a meeting of American Business Council (ABC) and Overseas Chamber of Commerce and Industry (OCCI) on Tuesday, Afridi further said that with the cooperation of World Intellectual Property Organisation (WIPO), training courses of IP professionals and representatives of stakeholders are progressing effectively.

He also said that appropriate measures had been adopted to upgrade the facilities in the offices of Intellectual Property Registries and an automation project in this regard is also being implemented.

Highlighting the role of corporate sector in promotion of intellectual property, Afridi said that enforcement mechanism has been upgraded by seeking close cooperation of the members of enforcement agencies and areas of mutual cooperation would be explored between IPO and trade organizations.

It was pointed out in the meeting that vigorous media campaign has been started for elimination of counterfeiting and piracy, besides creating awareness regarding punitive actions against violation of IP rights.

IPO Director General Sajjad Ahmad Bhutta stressed the need of collaborated activities for capacity building of Intellectual Property Organisation officials as well as the members of enforcement agencies.

He said that a lot of work is required to be done to get excellence in the field of intellectual property and stringent efforts were being made to provide training opportunities to all the concerned officials in their relevant specialties.

American Business Council Vice President Saad Amanullah Khan and OICCI President Naved Khan pointed out the difficulties being faced due to piracy and counterfeiting of the registered brands and said that they are determined to cooperate for every activity to check intellectual property rights infringement. – *Courtesy The News.*

Number of audit cases finalised by FBR nosedive: World Bank

The World Bank has noted with concern that the total number of audit cases finalised by the Federal Board of Revenue has nosedived from 77,000 in 2009-10 to 61,500 in 2010-11, reflecting decrease in audit of 15,500 registered persons.

Sources told *Business Recorder* here on Tuesday that the WB report on the overall performance of Tax Administration Reform Project (TARP) revealed that the performance of the audit authorities deteriorated during 2010-11 as compared to 2009-10 as both number of audit conducted and amount recovered showed downward trend.

According to a WB report, audit performance has decreased considerably from 2009-10 to 2010-11.

The number of audits finalised fell from 77,000 in 2009-10 to 61,500 in 2010-11.

The recovery from audit assessments fell from Rs 85,107 million in 2009-10 to Rs 20,554 million in 20 10-11 (it fell from 54.57 percent on detection to 20.97 percent).

The recovery as a percent of net FBR collection came down from 6.66 percent to 1.32 percent.

This may indicate that FBR auditors are over assessing taxpayers in their audit.

This conclusion is also endorsed by the fact that most appeals were granted to taxpayers even at the FBR appeals judgement level, the report said.

The results of audit in 2010-11 (as of March 31, 2011) showed that the audit finalised against the taxpayers stood at 61,556; detections of Rs 98,024 million and recovery through audit was Rs 20,554 million during the period under review.

The report further said that FBR has implemented several measures under TARP to reduce evasion and increase compliance.

The first and most important thing was the introduction of a modern self-assessment system for both direct and indirect taxes.

This system is now operating smoothly in Pakistan.

Tax audits have been re-activated and they are now determined by an annual audit plan.

The selection of taxpayers for audit is based on a risk management system, and a tax audit management system (TAMS) has been implemented to assist with case allocation to auditors and follow up on audit work.

It also produces management information on audit.

The system is now being reviewed for further improvement.

The FBR massively crosschecks information to detect tax evasion.

In particular, the FBR cross-checked information from taxpayers' invoices filed/attached to tax returns and import/export information from Customs Department.

Nevertheless, lower than expected collection level is also the result of FBR management's lack of success in delivering decisive change as originally envisioned by the TARP.

As reported to FBR management throughout Bank's Aid Memoirs and Mission Reports during the past few years, recurrent critical factors affecting the satisfactory implementation of TARP are, among others, the following: i) unstable tenure at top and mid-management levels; ii) weak management and implementation of the reform action plan; iii) insufficient reform actions to streamline the audit function; iv) the absence of an institutionalised M&E system; and v) underutilisation of newly deployed IT-systems at field formations, the WB report added. – *Courtesy Business Recorder*.

1.6 million NTN holder non-filers to face legal action: FBR

The Federal Board of Revenue has decided to take a legal action against the non-filers of income tax returns particularly nearly 1.6 million National Tax Number (NTN) holders for the Tax Year 2011 from January 2012.

In this regard, the FBR has issued instructions to the Chief Commissioners of all Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) to start issuing legal notices under section 114 of the Income Tax Ordinance 2001 from first week of January 2012 and enforce filing of returns from all the NTN holders.

It is learnt that the last date for filing of returns by business individuals, salaried persons and association of persons (AOPs) has already expired on November 30, 2011 and the filing date for companies will expire on December 31, 2011.

Out of 3.2 million NTN holders, around 50 percent are non-filers of returns and action would also be taken against these non-filers NTN holders.

Thus, nearly 1.6 million NTN holders have failed to file their returns for the Tax Year 2011, sources added.

According to the FBR's instructions issued to all Chief Commissioners of LTUs and RTOs here on Tuesday, the master

index of National Tax Numbers (NTN) is growing day by day and now its size has reached to 3.2 million.

All the taxpayers who have obtained NTN are required to file the income tax returns u/s 114(1)(vii) of the Income Tax Ordinance 2001, but it is noticed with grave concern that a large majority of the NTN holders do not file the return of income.

This reflects adversely on the performance of field formations.

Urgent steps are required to be taken to bridge the gap between filers and NTN holders.

In order to ensure compliance by the non-filers it is imperative to identify the non-filers.

This can be achieved only when the returns filed manually are entered in the system.

The FBR further stated that in order to compile the inventory of all the returns received for Tax Year 2011 and pending their data entry in Integrated Tax Management System (ITMS) it has been decided that CNIC, NTN, income declared, tax payable and tax paid with return will be entered to computer by December 31, 2011 using Excel Sheet.

This Excel Sheet consolidated for each return received manually by the RTO (up to December 25, 2011) should reach the Chief (IR Operations) via e-mail on close of December 31, 2011.

The stock position communicated to the board in this manner will only be accepted in the monthly progress report (MPR) of the RTO, FBR's instructions maintained.

These stock lists will be consolidated in national inventory of returns and the same will be used in determining the non-filers.

The information of non-filers would be available in the ITMS for further follow-up and enforcement of returns from non-filers, FBR said.

The FBR's instructions added that the notices under section 114 for the tax year 2011 shall be issued in all cases in the first week of January 2012 and certificate to this effect furnished to the Board by January 10, 2012.

Proper service of notices has to be ensured and the notice servers and inspectors should be used for this purpose. – *Courtesy Business Recorder.*

MoC may notify changes in import/export policy orders

The Commerce Ministry is likely to notify amendments in 'Import and Export Policy Orders' in a couple of days, to include export of liquor, sources told.

The Economic Coordination Committee of the Cabinet, in November 2011 had approved Trade Policy 2012, but the Ministry had failed to get Law Ministry's vetting of the SROs to be issued regarding amendments.

According to sources, positive list of importable items from India is also being expanded, further, by adding 17 new items to the list to be imported from India through land route.

The list is as follows: (i) Empty aluminium alloy milk cans; (ii) accessories for leather bags and footwear; (iii) jigs and dies for vehicles; (iv) other polymers of ethylene in primary form; (v) Lufenuron (chemical name - dichloro-4-hexafluoro-propoxy phenyl/urea); (vi) cotton linters; (vii) fungicides for leather industry; (viii) other chemicals (ucer G-50) for leather industry; (ix) textile spinning machines; (x) cone/bobbin winding machines; (xi) reeling machines; (xii) power looms; (xiii) sewing, darning or embroidery needles; (xiv) fly ash for cement industry only; (xv) thermoplastic rubber sole; (xvi) traction motors and their spares; and (xvii) printed books of all kinds.

Import of polypropylene, polyethylene and pure terephthalic acid (PTA), frozen vegetables and newsprint is being allowed through land route.

Regulatory changes in the Import Policy Order and Export Policy Order are as follows:

- 1 Import of only raw materials is allowed from India under temporary importation scheme for manufacture of export items.

On the other hand, temporary importation scheme notified vide FBR SRO 492(1)/2009 also allows import of "accessories" for export-oriented textile/leather sectors like button, zipper, hangers, etc (S.No 6 refers).

The word "raw materials" in Appendix-G, therefore, creates restriction.

Therefore, the facility is being extended to include above-mentioned "accessories" to facilitate exporters for temporary import cum re-export of these items.

- 2 Export of all sorts of sugar is banned. There is demand for export of high value organic brown sugar. It is typically less processed and often comes in the form of raw sugar. Its export will not in any way affect the local market. The Ministry of Industries supported the proposal, but to the extent of 2 percent of annual production of sugar. Therefore, the Commerce Ministry has proposed to allow export of organic brown sugar to encourage its production.
- 3 Units registered under DTRE are unable to import input items (restricted items importable after fulfilling certain conditions) whereas other importers can do so after fulfilling the conditions. This facility is being extended to normal importers to DTRE users as well with the same conditions.
- 4 At present, import of auto scrap is banned. There are reports that under the garb of steel scrap, auto scrap is being imported. The present description ie “auto scrap” appearing in the list of second hand/used condition banned for import will be amended to read as “auto parts (including serviceable auto parts imported as steel scrap)” to check import of used auto parts under the garb of steel scrap.
- 5 The changes brought in the Import Policy Order from time to time have prospective effect. There are numerous judgments of the superior courts whereby it has been propounded that the amended IPO cannot be applied on such imports where goods were shipped prior to the amendment in IPO. The import policy however, does not mention the same. Resultantly, disputes arise. In order to avoid such disputes and to have transparency, the Commerce Ministry will bring changes/amendments to the IPO from time to time that will not be applicable on such imports where B/L and L/C has been issued/established prior to the date of amending notification.
- 6 Import of second-hand/used ambulances is allowed when donated by any organisation/individual to a charitable or non-profit organisation trust or hospital, provided they fulfill certifiable standards and have minimum 10 years useful life.

However, now a condition “disposal before 10 years from the date of import will be subject to payment of duty/taxes

as payable at the time of import” may be added to the para to avoid misuse of the ambulances as commercial vehicles after import.

- 7 Battery manufacturers in the country import waste exhausted batteries of automobiles to retrieve lead, which forms 55 percent of a battery. This lead is re-used in the manufacturing of batteries after re-melting process. Its disposal needs treatment to safeguard the biotech environment.

The Commerce Ministry has decided to allow import of such scrap only in favour of industrial consumer only for their own use subject to the condition that importer shall furnish to customs authorities (i) a certificate from Environmental Authority (CADD) that he has adequate manufacturing facility capable of handling hazardous wastes in accordance with the provision of Basel Convention; and (ii) permission/authorisation specifying quantitative entitlement for the import of waste & scrap of electric accumulators issued CADD.

- 8 Current Trade Policy provides that import of automotive engine oils of quality level (API) SC/CC and automotive gear oils of (API) GL-4 and above shall be imported by commercial importers, lubricants blending companies, lube/oil marketing companies and refineries. Ogra, being regulatory authority, had proposed that import of such lubricants should only be allowed to importers having valid registration with the Authority under the rules. It has proposed that IPO may be amended accordingly and procedure prescribed.

The Commerce Ministry has also decided to impose complete ban on re-export of imported pulses. – *Courtesy Business Recorder.*

Land, police the most corrupt departments: survey

The National Corruption Perception Survey 2011 indicates that the land and property and police are the two most corrupt departments, and education and military, which has been included in NCPS for the first time, are the two least corrupt departments in Pakistan.

The most alarming is the increase in corruption ranks of income tax customs and tendering and contracting, which are ranked at

3rd, 7th and 6th most corrupt in 2011, whereas they were 8th, 9th and 10th in NCPS 2010.

Judiciary/court's rank has slipped from 6th most corrupt department to 4th most corrupt department in NCPS 2011.

This year the survey has been conducted by Gallup Pakistan.

Sohail Muzaffar, Chairman TI Pakistan said that corruption has reached unprecedented level in Pakistan.

He said lack of accountability, as being witnessed due to delay in punitive action by state organs against corrupt elements in corruption cases like Pakistan Steel, NICL, Punjab Bank, Rental Power Plants.

Hajj 2010, KESC, PIA, Railways and Wapda, is harming the country most.

Judiciary is being confronted by deliberate defiance in implementing Supreme Court orders and unwilling attitude of prosecution agencies.

He said that when out of 40, 26 vacancies of Judges are vacant in Sindh High Court how can the efficient justice be provided and delay in punishing corrupt persons by judiciary is one of the causes of lower ranking of Judiciary.

Lack of political will to combat corruption could be seen from efforts of government to avoid transparency in procurements, as PPRI4 is being made dysfunctional by not appointing a Managing Director since October 2011.

This year, NCPS 2011 has shown that tendering and contracting, which was the least corrupt in 2010 has jumped by 4 places to become the sixth most corrupt.

Syed Adil Gilani, Adviser Transparency International Pakistan said the Sindh government in June 2011 issued a notification exempting Sindh Bank from application of Public Procurement Rules 2010 Pakistan filed a constitutional petition in Sindh High Court against this notification and in on 15th December 2011, the Chief Justice in CP 2135 after reading that the Chief Secretary Sindh has cancelled the exemption notification disposed: of the petition as stating that the purpose of the petition has been achieved Similar to this, the federal government has also issued a notification in July 2011 with approval of ECC, amending Rule 5 of the PPRA rules 2004.

This would amount to exempting contracts based on 39 MoUs signed by President and Prime Ministers with private parties from complying to Public Procurement Rules 2004 and competitive bidding.

These also include tenders for the 150 Railways Engines from USA and 75 Railway Engines from China, purchase of all PIA Aircraft, 7000MW Binji Dam, 1100MW Kohala Dam.

TI Pakistan has filed a constitutional petition against this amendment against GoP in the Sindh High Court. – *Courtesy Business Recorder*.

Against FBR representations: President upheld over 80 percent of FTO decisions

President has upheld over 80 percent of the Federal Tax Ombudsman (FTO) decisions against the representations filed by the Federal Board of Revenue during 2010, reflecting authenticity and professionalism in the findings/decisions of the FTO Office.

The annual report-2010 of the FTO office issued here on Wednesday revealed that the weak mechanism of in-house accountability of tax officials encourages recurrence of the same kind of maladministration and needs to be tackled by the Federal Board of Revenue (FBR).

As per report, a total of 212 (14.75 percent) FTO decisions were challenged before the President - 18 (1.25 percent) by taxpayers and 194 (13.5 percent) by the FBR.

Further, in about 80 percent of total representations, President upheld the FTO's decision.

According to the report, the FBR and taxpayers have the option under the law to either apply to the FTO for review of a decision or challenge it before the President of Pakistan, through a process called representation.

Out of 1,437 decided cases, the FBR and taxpayers went into review and representations in a total of 296 (20.60 percent) cases.

Thus, the FBR and taxpayers accepted nearly 80 percent of the FTO decisions, indicating a high level of trust in this institution by both the parties, the report said.

Out of 1,437 FTO decisions during 2010, the aggrieved parties moved the FTO for review in 84 cases (5.85 percent).

A total of 212 (14.75 percent) FTO decisions were challenged before the President - 18 (1.25 percent) by taxpayers and 194 (13.5 percent) by the FBR.

Further, in about 80 percent of total representations, President upheld the FTO's decision.

The report further said while investigating the complaints, FTO Office diagnosed systemic issues which taxpayers are repeatedly facing at the hands of tax functionaries.

During the investigation into complaints, the FTO office came across cases in which tax departments dodged the taxpayers for years.

There were instances showing tax officials did not even implement the decisions given in favour of taxpayers by the Appellate Tribunals or the higher judiciary.

The extent of maladministration can be judged by the fact that senior tax officials at times blatantly misstate facts during certain hearings before the FTO and make forged entries in the documents to hide their maladministration.

It has been observed that weak mechanism of in-house accountability of tax officials encourages recurrence of the same kind of maladministration and needs to be tackled by the FBR.

In 2010, the FTO office recommended several measures to the FBR to rectify systemic problems and the FBR positively responded to them.

In this regard, Chairman FBR issued a Standing Order directing immediate issuance of acknowledgement of communication made by taxpayers by letter, SMS or e-mail to improve public confidence in tax departments.

Another major development is introduction of Expeditious Refund System (ERS) under which Sales tax refund is being processed through electronic verification system.

Under this system, refund applications are promptly acknowledged through the electronic system, eliminating the need for physical interaction of taxpayers with tax officials.

Besides, the system electronically indicates discrepancies about input-output and verifies sale-purchase data, which allows ample time to the applications to remove the discrepancies, the report said.

Some other FTO recommendations to the FBR over systemic issues included evolving a workable strategy to address delay in processing of refund claims; issuing interpretations and clarification over impugned SROs; sorting out taxation issue in tax-exempt jurisdictions on permanent basis; and amending relevant rules for examination of imported goods by the Customs in the presence of importers or their representatives, the FTO report added. – *Courtesy Business Recorder*.

Tax collection from builder: TI Pakistan questions FBR's lack of action

Transparency International Pakistan has questioned the Federal Board of Revenue (FBR) as to why the tax department is reluctant to collect due taxes on the declared assets of one of the prominent builders in construction industry under the relevant provisions of the Income Tax Ordinance 2001.

Sources told here on Wednesday that the FBR has already turned down a request of Transparency International Pakistan to share asset declaration and tax deduction information of Malik Riaz, of Bahria Town, Rawalpindi, under the provisions of section 216 of the Income Tax Ordinance 2001.

Under section 216, all particulars contained in any statement made, return furnished, or accounts and documents produced; any evidence given, or affidavit or deposition made, in the course of any proceedings; any record of any assessment proceedings or any proceeding relating to the recovery of a demand shall be confidential and no public servant may disclose any such particulars.

In a letter written to FBR Chairman Salman Siddique, Adil Gilani Advisor Transparency International Pakistan has said that TI-Pakistan requested the Chairman of Federal Board of Revenue vide its letter of September 4, 2010 to provide the information with regard to payment of government revenue on Rs 225 billion assets admitted to be owned by the said builder in his interview on CNN on August 31, 2010.

The Transparency International Pakistan had requested the FBR to provide it information on total value of assets of the builder as assessed by FBR in accordance with Income Tax Ordinance 2001, and tax collected.

In case the assets of Rs 225 billion have not been declared to FBR in his tax returns of 2009-10, FBR has to take action according to law (to recover the government revenue and penalty if any for evasion of taxes), Transparency International Pakistan letter said.

The FBR did not respond to TI Pakistan's request for eight months, and therefore on April 29, 2011, TI-Pakistan sent a complaint to Federal Tax Ombudsman against FBR, requesting action under the FTO law, Transparency International Pakistan said.

Consequently a reply from FBR was received on June 17, 2011 vide letter No C.No 7(20)S.Asst/2010, quoting TI Pakistan's letter dated April 29, 2010, which is as under:

"This is to inform you that the information sought cannot be provided in view of section 216 of the Income Tax Ordinance, 2011." TI-Pakistan does not understand why the FBR is reluctant to perform its mandatory duty, and avoiding to collect the due taxes on the declared assets of the said builder.

TI-Pakistan in its complaint dated 4/9/2010 raised two issues.

First one was replied by FBR that under section 216 the tax figures of individuals cannot be provided.

However, the second request of TI Pakistan has not been responded to that in case these assets of Rs 225 billion have not been declared to FBR in builder's tax returns of 2009-10, FBR to take action according to law, which means that FBR should recover the outstanding tax and penalty on wilful concealment, TI letter further said.

TI-Pakistan further stated that Pakistan is suffering because of evasion of government revenue by taxpayers, and also due to lack of application of rules, especially by FBR, and TI Pakistan again requests the Chairman FBR to apply the law and recover the outstanding dues if any from the defaulter.

"We again request you to kindly confirm whether Rs 225 billion internationally declared to be owned by the said builder are included in the tax returns of 2009-10 and FBR has collected the due taxes", the letter of Adil, Advisor, TI-Pakistan to FBR Chairman, added. – *Courtesy Business Recorder.*

Annual report-2010: FTO raises issue of 'misuse of appeals' by FBR

The Federal Board of Revenue has wrongly assumed that mere filing of representations/appeals before the President against the orders of the Federal Tax Ombudsman (FTO) would automatically tantamount to grant of 'stay' for putting in abeyance the implementation of the FTO orders against the tax officials involved in cases of gross maladministration.

This issue of misuse of the representations/appeals by the FBR has been raised by the FTO in its annual report-2010 released here on Wednesday.

The FTO report has clearly said that only filing of an appeal and representation against the FTO decisions would not operate as 'stay' unless an order is specifically obtained in each case.

The report highlighted that the FBR officials invariably raise jurisdiction-related objections when taxpayers file complaints with the FTO.

After the FTO findings are delivered, a certain number of cases involving gross maladministration, especially those where responsibility of staff is required to be fixed are represented before the Hon'ble President of Pakistan.

In this way, tax officials take undue advantage of the automatic stay granted through these representations, as a notification of the law and Justice Division allowed suspension of the FTO recommendations during the pendency of the appeal.

However, according to the law, mere filing of an appeal and representation against the FTO decisions would not operate as stay unless an order is specifically obtained in each individual case.

On January 26, 2005, a reference was made to the president of Pakistan by the then FTO, former Justice Munir A Sheikh.

It appears that this reference did not attract the attention of the President's Secretariat.

The issue of automatic stay in the cases of Representations constitutes a critical challenge to the Revenue Division as well as the FTO Office because it's misuse deny the relief given by the FTO Office to aggrieved taxpayers and allows the guilty tax officials go scot-free, the FTO added. – *Courtesy Business Recorder.*

Improving revenue collection: Pakistan, WB negotiating second reform programme

Pakistan and the World Bank have been negotiating a \$300 million (Rs 27 billion) loan for a second round of tax reforms as the first programme is going to expire on December 31st on 'moderately satisfactory' note.

The negotiations for the second programme are at a preliminary stage. Both sides have been focused on determining how the programme may be designed to efficiently broaden Pakistan's tax base and raise revenues. The country currently has one of the lowest tax-to-GDP ratios in the region, said officials in the economic affairs division of the finance ministry.

According to the World Bank report, Pakistan's ratio of tax collection as percentage of total size of the economy plunged to 8.6% during the fiscal year that ended June 30, 2011, lower even than the 9.4% recorded in fiscal year 2010. As a result of such low tax collection rates, the government relies heavily on international lenders, the domestic banking sector and even just simply printing the money.

Federal Board of Revenue Chairman Salman Siddique confirmed that the government was negotiating with the Washington-based lender but added that the cost of the loan had yet to be determined. The programme is expected to last at least three years.

In 2004, the World Bank approved the first Tax Administration Reforms Project (TARP), worth about \$126 million, aimed at improving the effectiveness of Pakistan's tax collection authorities. The project never stayed on course and the government had to seek a two-year extension in December 2009, which expires at the end of this month.

Despite the extension, the government has not been able to achieve many of the programme's objectives. In its latest implementation and status report, the World Bank said "TARP implementation lags behind the intended achievements against the project objective of improving effectiveness of the tax administration." The project was awarded a 'moderately satisfactory' rating.

Of the \$126 million allocated for the project, the World Bank ended up cancelling about \$49.2 million entirely and did not disburse another \$17.5 million owing to delays in TARP's implementation.

Only about \$59 million was disbursed, 53% lower than the original amount. There have been reports that the FBR misused TARP funds to procure furniture and cars for its officials.

Siddique explained that while TARP did not meet its targets in technological improvements, it did meet its infrastructure development targets.

In its report, the World Bank said FBR headquarters lacks an adequate coordination mechanism to oversee the operations of its field offices.

Nonetheless, there were at least some minor improvements in the government's tax collection efforts. The total number of active tax payers increased by 6.2% to 3.2 million during fiscal year 2011. The number of people filing income tax returns jumped 27%, while the ratio of people filing electronic sales tax returns increased 6%.

The fiscal impact of all of these efforts, however, was all but obliterated by the devastating floods that have hit the country during the summer of 2010 and 2011. For fiscal year 2011, the government was not able to meet its downward-revised target of Rs1,588 billion.

As a result, the government resorted to borrowing from the commercial banking system, all but completely crowding out the private sector's ability to borrow money. According to the State Bank of Pakistan's annual report, government borrowing increased by 76% in fiscal 2011, compared to only a 4% increase in private sector borrowing. – *Courtesy The Express Tribune.*

Tax treaties to be revisited

The government is considering approaching foreign banks for exchange of information of Pakistani taxpayers having wealth in their accounts and illegally remitted from the country, official sources said on Wednesday.

“A large number of Pakistanis in the last few years invested or remitted their capital to offshore banks, but the wealth is not on tax records,” said a senior official of the Federal Board Revenue (FBR) on the condition of anonymity.

The official said that the government will revisit tax treaties with those countries where provision of exchange of information is provided. The government is desperate to increase the tax-to-GDP

ratio by enhancing tax filers and increasing revenue collection, the official said.

According to the latest World Bank report, Pakistan is among the countries having the lowest tax-to-GDP ratio. To broaden the tax base, the FBR had started collecting accountholders data from the banks, operating in Pakistan, including the branches of foreign banks.

“The exercise revealed a number of accountholders shifted their money in offshore banks,” the official said. “It is a difficult task for the tax authorities to obtain details from foreign banks where provision of exchange of information is not available under a treaty with a country,” the official added.

The exchange of information between the two countries provided that contracting states can exchange such information as is necessary for carrying out the provisions of a convention or for the prevention of fraud or for the administration of statutory provisions in relation to the taxes, which are the subject of the convention.

Another tax official at a local tax department said that the provision of exchange of information is available in most of those treaties, which were signed under OECD model. The treaties under OECD model are signed after introduction of the World Trade Organization (WTO).

“However, treaties, which are signed under the UN model may not have such provision,” the official added. The government for the current fiscal year has set a target of Rs1,952 billion, which appears to be too short when considering ballooning fiscal deficit in a scenario when the installment of repayments against the International Monetary Fund (IMF) loan is scheduled for February 2012.

“To avoid introducing additional tax measures, especially when the government is under severe criticism of different issues, the authorities are endeavouring to boost the revenue collection,” an expert said.

The FBR had already started broadening the tax base campaign for the purpose it is sending another 300,000 rich persons who are not in the tax net. Besides, the FBR is in talks with the power utilities for providing details of industrial connection holders.

The FBR had recently directed the tax officials to obtain complete information of every transaction of interest payment and cash

withdrawal made through financial institutions to identify people who are not in the tax net. – *Courtesy The News.*

SECP allows relief to MTS market

As part of the Securities and Exchange Commission of Pakistan's (SECP) continuous efforts to develop the capital market in the country and to support liquidity for encouraging trading activity and engendering investor confidence, amendments have been made to the Securities (Leveraged Markets and Pledging) Rules, 2011, a statement said on Wednesday.

The amended rules now empower the regulator to prescribe lenient cash margin requirements and allow individual investors to participate as financiers in the Margin Trading System (MTS).

The rules, which were promulgated by the Federal Government earlier in February, prescribe a broad regulatory framework for Margin Financing, Margin Trading, and Securities Lending and Borrowing.

The purpose of introducing these leverage products has been to help boost trading activity in the market and to cater to the financing needs of the capital market while providing retail investors with an easy access to financing against shares.

The amended rules relax the earlier mandatory condition of depositing at least 25% equity participation in the form of 'cash only' by the financees in MTS.

The SECP will now prescribe reduced minimum cash margin requirement while allowing a certain portion of the equity participation to be acceptable in shares of selected companies with necessary haircut for improved risk management.

Also, the restriction of only corporate bodies to act as financiers in the MTS has been waived and individuals meeting minimum eligibility requirements will be allowed to participate as financiers.

The amendments also remove the mandatory condition of prescribing minimum liquidity requirement for selecting securities eligible for Margin Financing (MF). This will encourage more securities to be available for funding under MF and generate more trading activity.

While considering the prevailing market conditions and liquidity needs, the SECP has endeavoured to strike a balance between effective risk management and the relief needed by the market. It

is expected that the inclusion of individual financiers will help to increase and make available financing much needed by the market.

This while improving the liquidity will generate enhanced trading volumes that will boost investor confidence. The relaxations in the rules will therefore serve as a much needed relief package to the capital market which is presently suffering from acute decline in the trading turnovers. – *Courtesy The News.*

Small clubs exempted from ST on services

The small clubs charging not more than Rs.30,000 as membership fee and not more than Rs.100 as monthly subscription have been exempted from sales tax on services, said a notification issued by the Sindh Revenue Board (SRB) here on Thursday.

With this notification, the small clubs in districts and towns would fall outside the scope of taxation.

The said notification stated that in exercise of the powers conferred by sub-section (1) of section 10 of the Sindh Sales Tax on Services Act, 2011, (Sindh Act No.

XII of 2011), the Sindh Revenue Board is pleased to direct that the following amendment shall be made in its notification No.SRB.Leg(1)/2011, namely:

In the aforesaid notification, in the table, before the entry S.No.lin the column (1) and the entries relating thereto in columns (2) and (3), the following new entry shall be inserted, namely:"1A.

(i) Services and ancillary services provided or 9801.4000 rendered by Clubs whose initiation fee for members does not exceed thirty thousand rupees and whose monthly fee/subscription for the members also does not exceed one hundred rupees; and

(ii) charges received by Clubs from its members as refundable security deposits and voluntary contributions received by Clubs from its members for the welfare (e.g. eid gifts) for the Club staff or for payment to the registered non-profit organisations, as defined and for the purposes mentioned in under section 2(3 6) of Income Tax Ordinance, 2011. – *Courtesy Business Recorder.*

FBR extends office timings

In a bid to facilitate the taxpayers, Federal Board of Revenue has decided to extend the office timings of all the Large Taxpayer Units (LTUs), Regional Tax Offices (RTOs) and Tax Facilitation Centres on 30th and 31st December 2011, beyond office hours up to 10:00 pm for receiving of returns and payment of taxes from the corporate sector, which are due on 31st December 2011.

All authorised branches of State Bank of Pakistan and National Bank of Pakistan will also remain open beyond their normal working hours till 10:00 pm on 30th and 31st December, 2011 to collect tax revenue. – *Courtesy Business Recorder.*

Owner of goods transport: applicability of tax questioned

There is a legal ambiguity in the Income Tax Ordinance 2001 on the chargeability of tax from owner of goods transport vehicle due to conflicting provisions of the said Ordinance.

It is learnt here on Thursday that Waheed Shahzad Butt a leading Lahore-based lawyer has written a letter to the FBR Member Inland Revenue to clarify applicability of tax on the owner of goods transport vehicle.

Legal expert has also sought clarification whether owner of goods transport vehicle is entitled to exemption from provision of section 153(1)(b) of the Income Tax Ordinance, 2001 if income tax has already been paid u/s 234(1) of the Ordinance by the said transporter? The FBR has received a presentation on the controversy amongst provision of Section 234(1) and Section 153(1)(b) of the Income Tax Ordinance, 2001 from the tax expert.

The legal expert has pointed out that under provisions of section 234(1) of the Income Tax Ordinance, 2001, wherein tax collected from owner of goods transport vehicle has been classified as "Final Tax" on income of such person from plying, or hiring out of such vehicle then further deduction of income tax u/s 153(1)(b) of the Ordinance is unfair and contrary to the law.

According to the tax expert, the Board's attention has been invited towards provisions of section 234(5) of the Income Tax Ordinance, 2001, wherein tax collected from owner of goods transport vehicle has been classified as 'Final Tax' on income of such person from plying, or hiring out of such vehicle.

The relevant portion of said provision of law is reproduced:

Section 234(5) of the Income Tax Ordinance 2001 says:- Where tax is collected from any person being the owner of goods transport vehicle, the tax so collected shall be the final tax on the income of such person from plying, or hiring out, of such vehicle.

Whereas provisions of section 153(1)(b) of the Income Tax Ordinance, 2001 creates an obligation at the part of Payer to deduct advance income tax at the time of making payment.

Transport services are liable to withholding tax @ 2 percent under Division III Part III of the First Schedule to the Income Tax Ordinance, 2001, he said.

In light of above provisions of the Income Tax Ordinance, 2001, it is humbly requested to kindly clarify the following propositions: Firstly, whether owner of goods transport vehicle is entitled to exemption from provision of section 153 (1)(b) if income tax has already been paid u/s 234(1) of the Income Tax Ordinance, 2001?

Secondly, what is status of income tax deducted u/s 153(1)(b) shall be treated as final income tax liability u/s 234(5)?, Waheed added.

A clarification has been sought from the Board to clarify the issue to remove ambiguity from the law, sources said. – *Courtesy Business Recorder.*

Khyber Pakhtunkhwa refers motor registration scam to NAB

The Department of Excise and Taxation, Khyber Pakhtunkhwa referred the motor vehicle registration scam to National Accountability Bureau (NAB) investigation and announced to go for contingency plan to start the suspended vehicles' registration process in the province.

This was disclosed by Khyber Pakhtunkhwa Minister for Excise and Taxation, Liaquat Shabab while addressing a press conference here in the Media Centre of the Directorate of Information on Thursday.

He was flanked by Secretary Excise and Taxation, Akbar Khan, Director General, Syed Nazar Hussein Shah and other senior officials of the department.

The provincial government of Khyber Pakhtunkhwa in 2005 signed an agreement with German firm Eha Hoffmaan GMBH for

the computerisation of the motor vehicles registration, publication of registration books and provision of number plates.

Furthermore, the imparting of the computerisation training of the staff of the department was also the responsibility of the firm.

The firm was working on the basis of BOT (build operate and transfer) and the dead of the completion was the end of the year 2010.

The project was given extension on technical basis to install the plant for the preparation of the number plates, printing of registration book and the transfer of the old data into the new computerised system.

The department in the meanwhile carried out two inquiries regarding irregularities in the motor registration and number plates and both held the firm responsible for it.

The first inquiry was conducted after the seizure of a vehicle carrying registration No Peshawar BB-2262, whose owners were possessing fake documents, which were prepared by the official firm.

The department conducted inquiry into the matter and on April 12, 2011 constituted a committee in this regard, which completed its finding May 5, 2011.

Similarly, in the meanwhile, the department seized another vehicle possessing the registration book and number plate issued by the firm and the department go for conducting another inquiry on June 2, 2011 and submitted its report on August 10, 2011.

The department also conducted a huge inquiry on the reports published in media regarding the revelations of a car-lifters don and two more in which experts from other departments were also included.

The inquiry committee started its proceeding on July 16, 2011 and compiled a report comprising of 350 pages, which exonerated the departments and the foreign firm responsible for illegal registration of about 2000 non-duty paid, theft and vehicles leased out by different commercial banks.

The department, in light of the said inquiry sought legal opinion from the department of law regarding the referring of the matter to the National Accountability Bureau, which have already initiated probe into the matter on the basis of the information published in different newspapers.

Defending the decision of referring the case to NAB, he said that the national anti-graft agency possessing better software and equipment for conducting inquiry into the matter.

Further measures, he said will be taken after the publication of the inquiry report of NAB.

He said that due to these inquiries and other crises the process of the issuance of registration book and number plates remained suspended since September 2010 in the province.

Due to the suspension of the process not only the people were suffering, but the province was also facing financial losses and the people moving to other provinces for the registration of vehicles.

For the resolution of the problem, he said the provincial government planned a contingency plan and following the procedure and system of motor registration in Punjab.

The registration books will be published in Pakistan Printing Press while the number plates will be prepared by the department of Science and Technology.

The responsibility of the provincial government, he said would be only the forwarding of the demand to the central database, which will be under the supervision of the department of science and technology.

The plan, he said would be launched within two or three weeks to minimise the grievances of the people.

To a question, he said that due to business in the inquiries, the department was not coming before the press and on its completion they are facing the media.

He said that district excise and taxation officers were used to seek the required registration books and number plates and the firm would have to import it from Germany.

He said that due to the renaming of the province, the firm was paid Rs 23 million as compensation for the already manufactured number plates.

He said that any one involved in the scam would be taken to task.

However, he said that the contract of the firm is still in tact as the allegations have not proved. – *Courtesy Business Recorder.*

Taxpayers protest over audit notices without scrutiny

Taxpayers have protested over issuance of notices for audit of cases for the tax year 2011 without conducting preliminary scrutiny.

On behalf of the taxpayers, the Karachi Tax Bar Association (KTBA) informed the Federal Board of Revenue (FBR) that the tax officials are issuing notices for audit for the tax year 2011 without any desk audit.

“The audit parameters should be defined before initiating the proceedings for the year to avoid complicity, litigation and make the audit meaningful,” according to a KTBA communication sent to the FBR.

The association pinpointed that the tax officials are also issuing notices for monitoring of withholding tax in respect of the tax year 2011 for private limited companies where the return has not yet been filed.

“The monitoring of withholding tax should start after filing of the tax return and monitoring proceeding should start from the first week of February 2012,” the KTBA suggested.

The association said that if the audit is completed in one case, than the same should not be selected for monitoring of withholding tax, as the verification of withholding is one of the elements of audit.

“Directives in this regard should be issued to minimise the additional burden of compliance on the taxpayers,” the association recommended.

Regarding the services sector, the revenue body notified that the services in case of corporate sector are adjustable and fall under the normal tax regime, but the tax authorities are interpreting the retrospective of the notification, the association said.

“The FBR should issue clarification in this regard, which will minimise discretionary powers of the tax officers,” it added.

The communication also said that the return of income in case of a company does not cater and adjustment of Workers Welfare Fund (WWF) from the current year’s fund. – *Courtesy The News.*

SECP makes amendments to solvency

The Securities and Exchange Commission of Pakistan (SECP) has made amendments to the “solvency regime” for the insurance

companies and approved “Fit and Proper Criteria” for chief executives, directors, chief operating officers, principal officers and department head for running the insurance companies, as to enhance the integrity, transparency and smooth functioning of the sector and improve the capacity of the companies for withstanding unforeseen default.

“Under the new criteria, we have defined criteria for all the chief executives, directors, chief operating officers, principal officers and department heads that what will be the minimum education, experience, their financial soundness, integrity and there should be also no conflict of interest of such person with the business of insurer.” said Muhammad Ali, Chairman of the SECP, while talking to a select group of reporters on Thursday.

The Policy Board of the SECP has approved the solvency requirements for insurance companies, which would improve the liquidity position of the insurance companies and eventually protect the interest of the policyholders.

Solvency is the ability of a business to have enough assets to over its liabilities, and the amendments call for insurance companies to manage their assets with different priority.

The changes in the solvency regime calls for non-life insurance companies to increase the value of their admissible assets from Rs50 million by December to Rs100 million by December 2012, Rs125 million by December 2013 and by the end of 2014 the net admissible assets should be Rs150 million.

Under the current rules, the life insurance companies need to have admissible assets of Rs75 million, however, after the amendments the companies need to have admissible assets of Rs105 million by the end of 2012, it has to be Rs135 million by December 2013 and Rs165 million by the end of 2014.

It was also informed that the insurance sector would significantly improve after the conventional insurance companies are allowed to open Takaful windows, this permission is expected in six-eight weeks.

“The management of the money will be changed and the admissible assets have to be more than the inadmissible assets so that the insurance companies have the capacity to pay the policyholders in case of emergency,” the chairman said.

He said that the insurance companies would be required to invest, reorganise and even make partnerships, but that is needed to cater

to the growth of the sector and ensure protection of the policyholders' claims.

Ali said, "As the policyholders come to know more about the financial strength of insurance companies their trust in insurance sector would increase. With higher capacity the companies would be looking for opportunities to expand businesses."

Another official of the commission said that currently there are 48 active insurance companies in the country, which includes seven life insurance companies, 35 non-life, three Takaful companies, two family Takafuls and one re-insurance company.

Currently, the total insurance base in the country is of Rs107 billion, but the non-life segment was dominating at Rs59 billion.

However, the SECP officials acknowledged that the insurance sector has not witnessed growth, keeping in view potentials in the country, the official said.

Responding to a question about the issues faced by the insurance sector with reference to the NICL scandal, the SECP chairman said that after the implementation of Fit and Proper criteria for the CEOs, and other officials of the insurance companies, only professional people with relevant experience will be allowed to hold important positions in the insurance sector.

"Under the Fit and Proper criteria the permission of the SECP is required prior to the appointment of senior management in the insurance sector, and we are confident that this will be implemented in the public sector insurance companies also," the SECP chairman said.

It has been felt that in order to prepare the insurance industry to meet the challenges of globalisation and also to avoid maladministration, the insurance companies must be run by competent persons with adequate know-how of insurance business.
– *Courtesy The News.*

FBR strives to facilitate businessmen

Chief Commissioner, Inland Revenue, Fiza Muzaffar, said that the Federal Board of Revenue (FBR) understands that enhanced revenue collection lies in the promotion and growth of businesses, therefore, all efforts are being done to facilitate the business community. Addressing the members of Lahore Chamber of Commerce and Industry (LCCI), she said that to expedite the

redressal of complaints of the business community, she would be available to all the complaints from 11 am to 12 pm daily. Muzaffar said that all the suggestions and the reservations of the business community have been forwarded to the FBR. She said that “both the FBR and the private sector are the wheels of same vehicle, therefore, they should act in unison in the larger interests of the economy”. – *Courtesy The News*.

‘Govt’s inaction on GST ruins tractor industry’

The government’s indecision to implement 16 percent general sales tax (GST) has not only ruined the tractor industry, but also have fatal repercussions on the agricultural economy and engineering industry, a statement said on Thursday.

Auto Parts Manufacturers and Exporters Association Chairman Tahir Javed Malik said that delay in a clear cut decision on this issue of national importance has caused closure of 400 tractor part manufacturers.

Approximately 80,000 tractors were produced in the country last year, averaging 6,000-7,000 tractors per month, but at present, this has nosedived to 500 tractors per month, he said. The government on the pretext of bringing agricultural income under the tax net and increase the tax-to-GDP ratio is trying to impose 16 percent GST on tractors, he said, adding that in India general sales tax on tractors is four-five percent.

Europe levies a tax of eight percent and in other countries around the world, the rate of tax on agricultural inputs is generally lower or these inputs are subsidised, he said. He demanded the prime minister, federal minister for industries and the Economic Coordination Committee (ECC) of the Cabinet to immediately convene a meeting to decide about imposition of general sales tax on tractors. – *Courtesy The News*.

WB for reduction in FBR workforce

The World Bank has proposed to the Federal Board of Revenue to rationalise the number of staff and employees to improve efficiency of the tax administration under reforms.

Sources told here on Friday that the WB mission has submitted a report to the FBR on the ‘lessons learned from the Tax Administration Reform Project of the FBR’.

According to the report, major increase in tax administration effectiveness requires steady fundamental organisational change. The Tarp anticipated a gradual evolution of the FBR from a tax-based to a function-based organisation. Efficiency increases were to come from rationalisation of the number of staff and reallocation of staff to activities that were to be computer assisted.

The degree of resistance to change within the organisation and especially to changes in traditional activities (ie Customs officers worked on Sales Tax and Excise Taxes only with Income Tax officer working exclusively on direct taxes) was not anticipated in the project design. The introduction of a change to physically locate customs staff working on sales tax close to staff working on Income Tax without changing any reporting structures was supposed to ease the transition of the organisation (this was known as co-location of staff) - this didn't happen; rather, it appears to have set the organisation up for increased entrenchment to maintain the traditional *modus operandi*.

The report further said that a fundamental change in the way business is conducted within the organisation, especially when it affects field workers and the way they do their job has the potential to be extremely disruptive. A plan that ensures all the staff are at least well informed and understand what changes are being made and addresses the concerns of rank and seniority must be in place in the early stages of the program. Ongoing monitoring to ensure buy-in or to find a way to address perceived or actual inequalities in the transition needs to be actively undertaken. Corrective actions need senior management participation and a contingency plan should be in place if resistance to the change is indicated.

It further said that the FBR should link performance to compensations and merit to promotions: In the TARP plan, it was recognised that the staff compensation levels were substantially below that of the private sector. The modernisation of FBR that was being envisioned through TARP would require more "knowledge workers" to make much more use of computerised systems. There was also an implicit recognition that when staff compensation was significantly below market values, there was an increased risk that staff would look for other means to augment their income.

Special funding was found to offer additional compensation to FBR staff, but this funding was applied across the board. The additional

compensation was offered irrespective of the staff's performance and their acquisition of new skills. This sent a misleading message to the staff, although the majority of the increased compensation was offered to the officer cadre.

In addition, this reinforced the old message that rewards (compensation and promotions) were not merit and performance based, but rather were an entitlement. Rather, the intended message was that if you adopt the new modernised way of doing work you will be rewarded, the WB report added. – *Courtesy Business Recorder.*

causing delay in production

Dual tax rates at import stage for manufacturers and other importers are hindering the import process, causing delay in production activity.

In a letter issued by Karachi Tax Bar Association (KTBA) to the chairman of Federal Board of Revenue (FBR) and Member Inland Revenue, FBR, has highlighted that the taxpayers are facing serious hardship in import process as the rate prescribed in the Income Tax Ordinance 2001 for manufacturers at import stage was 3 percent of the import value and other importer are liable for 5 percent withholding tax of the import value.

Therefore, the customs authorities are asking for reduced rate certificate from the manufacturers.

The Bar in its letter demanded to issue reduced rate certificate for manufacturers at import stage to facilitate the trade at maximum.

It further said the clarification issued by the collector Model Collectorate of Custom (MCC) Appraisement as per the decision SL.No 150/2011-CA dated 12.12.2011 forced the manufacturers to produce reduced rate certificate from the respect commissioner (I.R).

This procedure is not only creating hurdles in import process but also causing delay in production activities, the Bar maintained.

Keeping all these obstacles in view, the bar suggested to the board that the status of the taxpayer would be verified from the Sales Tax Registration Certificate and in case of multiple business activities; the customs officer should have access to the FBR web-portal to verify the status from the profile of the taxpayer, which

would definitely help FBR to deduct exact tax as per the status of the taxpayer. – *Courtesy Business Recorder*.

Cash and reconciliation reporting systems: FBR chief denies allegations of figures fudging

Federal Board of Revenue Chairman Salman Siddiq on Friday categorically denied allegations of figures fudging and explained the authenticity of the foolproof 'Cash Reporting System' and 'Reconciliation Reporting System' having minimum margin of adjustment in reporting of revenue collection figures of the FBR.

Sharing revenue collection and reporting mechanism with media here on Friday, FBR Chairman said that after learning lessons from gross reporting of tax collection figures in June last, now the government has made the system foolproof.

Since July this year the government has introduced online cash reporting system which is linked with State Bank of Pakistan and National Bank of Pakistan systems that leaves no room for doctoring the figures.

The FBR Chairman along with team of tax managers including Shahid Hussain Asad FBR Member Inland Revenue and Imtiaz Ahmad General Manger Pakistan Revenue Automation Limited (Pral) made a practical demonstration of the 'Cash Reporting System' and 'Reconciliation Reporting System', reflecting error-free online reporting system of revenue collection.

With several examples, tax managers showed that how the new electronic system cannot commit any mistake except minor adjustment during reconciliation of figures with the AGPR.

Salman Siddiq patiently heard the questions of media on reporting of figures and responded with evidence and supportive documents and gave live demonstration of all stages of revenue reporting till finalisation of figures after reconciliation process.

The FBR Chairman said that the provisional figures are reconciled with accounting system with a lag of one month.

Except minor accounting adjustments of less than a billion rupees the cash reporting system figures and accounting system figures match up to 98-99 per cent.

On November 30, the FBR had reported Rs 131 billion monthly collection on the basis of cash reporting system while the

reconciled figure was Rs 131.8 billion, Rs 831 million higher than provisional reporting.

The FBR provisionally announced figures of 'Cash Reporting System' and later the figures have been duly reconciled with the system of the Accountant General of Pakistan, State Bank of Pakistan and National Bank of Pakistan.

There is a very slight possibility of variation in the provisional revenue reported through the 'Cash Reporting System' and reconciled with the 'Reconciliation Reporting System'.

In the presence of authentic revenue reporting system, there is no possibility of any major variation in provisional revenue collection and final figures of the FBR.

With the help of the 'Cash Reporting System', the FBR has made a foolproof system which has made figure fudging almost next to impossible.

"With the passage of time the element of discrepancy in figures would be totally eliminated and there would be no difference in the reported and reconciled figures," he showed full confidence in the new system and announced that with the current system of Cash Based Reporting we are aware of the revenue collected on day to day and hour to hour basis.

For example, the revenue collection reported through the 'Cash Reporting System' stood at Rs 640 billion during July-November (2011-12) and final figure after reconciliation with the AGPR stood at Rs 639.035 billion during this period.

Thus, there is a very low margin of variation in the revenue reported through the 'Cash Reporting System' and later reconciled with the 'Reconciliation Reporting System'.

Similarly, during October 2011, the revenue reported through the 'Cash Reporting System' stood at Rs 128 billion and after reconciliation the revenue stood at Rs 126.408 billion this month.

In November, the 'Cash Reporting System' has reported Rs 131 billion whereas reconciled figure stood at Rs 131.8 billion.

Thus, there could be slight upward or downward adjustments during reconciliation of revenue collection, but this adjustment could not be very much higher.

To further clarify the issue tax authorities explained that usually the revenue collected on last day of the month by NBP is reflected in the new Cash Based Reporting system in the same month.

But this collection is deposited in the State Bank of Pakistan on the next working day, which falls in the next month, therefore in terms of reconciled reporting this amount is reflected in the next month.

This process of adjustments continues till closing of June, ie, up to end of the financial year.

Hence at the end of the financial year, any collection of previous year reported by NBP to SBP after close of the financial year is treated as spill over and accounted for the next financial year.

So far, provisional revenue collection of December 2011 stood at Rs 173 billion against Rs 161 billion in the corresponding period of last fiscal.

It is expected that the revenue collection in December 2011 would reach Rs 198 billion to Rs 200 billion during this period.

Salman Siddiq explained that the 'Cash Reporting System' works on daily basis which is based on the cash deposited in banks.

The 'Cash Reporting System' is basically provisional reporting of cash on net basis.

The banking sectors transactions of SBP and NBP of all domestic taxes have been captured under the 'Cash Reporting System'.

Now, it is a live electronic system, which has been reporting provisional figures on net basis.

Through Collection Automation Project (CAP-I) and CAP-II, the system has been improved to ensure revenue reporting through the electronic system.

Salman Siddiq further highlighted that the second system is the Electronic System which collects import related data of customs duty, sales tax, Federal Excise Duty (FED) and withholding tax through three sources of One Customs Clearance System, Pakistan Automated Customs Computerised System (PaCCS) and Web-Based one Customs System (WeBoc).

The revenue collection at the import stages through the electronic system has been made part of the 'Cash Reporting System'.

After one month lag, the FBR's Directorate of Research and Statistics reconcile revenue collection data with the AGPR, SBP and NBP and verify adjustments.

The process of reconciliation included that the monthly Civil Accounts by AGPR has been done by 15th to 18 of the next month.

The reconciliation of the FBR and the AGPR begins on 20th of the next month and it takes 10 working days.

The AGPR report the reconciled figures to the Finance Division as well as the FBR.

The FBR figures are being verified by the AGPR, which is a second check on the FBR revenue collection system.

As AGPR processes are not standardised with the FBR, the AGP has its own timeframe for reconciliation of revenue collection.

Responding to a query, the FBR Chairman said the board will start desk-audit of all the corporate return after expiry of the date of the filing of returns by the corporate sector on December 31, 2011.

In the Large Taxpayer Units (LTUs), the desk-audit of all the corporate returns has been carried out and in case of Regional Tax Offices (RTOs), the desk audit of 5-10 percent of the individuals and the Association of Persons (AOPs) would be conducted.

Under the Centralised Audit System, the audit is being conducted on the basis of risk based parameters under the Universal Self Assessment Scheme (USAS).

When asked about the new amnesty scheme for the sales tax defaulters or claimants of illegal input tax adjustments, Salman Siddiq said that one way is to legally pursue these cases in courts to recover the illegal adjustments claimed by the registered persons.

The second option is to put the method to recover defaulted amount more quickly without fighting in the courts.

However, the FBR has not finalised any amnesty scheme for the tax defaulters.

To a question on the number of total number of active companies, tax authorities stated that 22,500 active companies have filed their returns last year and these companies could be declared as active companies.

When asked about withdrawal of Annex-D from the new income tax return, official said that the FBR has not withdrawn the Annex-D as only minor amendments have been made in the relevant Annex on the recommendations of the business and trade.

The details of the personal expenditure has to be given by the taxpayers align with the wealth reconciliation statements.

Against the demand of the business community to abolish the Annex-D of the return, only few changes have been made.

Responding to another question, he said that the proposal of Gross Assets Tax was considered during last fiscal, but it was not implemented due to Constitutional issues.

Under the Universal Self Assessment Scheme (USAS), the existing tax system is based on income and not asset based taxation.

The concept of the Gross Assets Tax could not be materialised involving different factors including existing taxation system.

When asked about collection of income tax surcharge, Salman Siddiq said that the tax machinery has allowed the companies to pay the outstanding flood surcharge through adjustments.

After last year's devastating floods the government had imposed flood surcharge at a rate of 15 per cent of the payable income tax.

The big companies firms had disputed the levy by raising legal objections which resulted in delay of payments and the FBR was estimating to get another Rs 20 billion on this account.

The FBR has already collected Rs 11 billion from salaried class and small businesses.

Responding to a query on Value Added Tax (VAT), he added that the broad-based integrated VAT could not be implemented as services is a provincial subject.

The law is still lying with the Parliament and withdrawal of zero-ratings and exemptions in last March have started showing good results. – *Courtesy Business Recorder.*

C.No.4(10)ST-L&P/2011

Islamabad, the 21st December, 2011**SALES TAX GENERAL ORDER NO. 30/2011**

Subject: **Amendment in STGO 07/2007 Dated 13-09-2007 Facility of Zero-Rating on Supply of Electricity.**

In exercise of powers conferred by clause (d) of section 4 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to make the following further amendments in its Sales Tax General Order No. 07 of 2007 dated 13th September, 2007, namely:—

In the aforesaid General Order,

- (a) In the preamble, in condition (c) the words, comma, full stop, figure and brackets “S.R.O. 509(I)/2007, dated the 9th June, 2007” shall be substituted by “S.R.O. 1058(I)/2011, dated the 23rd November, 2011”.
- (b) In the table, serial number 702 in column (1) and entries relating thereto in columns (2), (3) and (4) shall be **omitted**;
- (c) in the table, after serial number 1291 in column (1) and the entries relating thereto in columns (2), (3) and (4), the following new serial numbers and the entries relating thereto shall be **added**, namely:—

S. #	Name of Unit	Registration No.	Consumer No.
1292	M/S Al-Furqan Industries	1700355907911	2706458196173
1293	M/S Faisal Spinning Mills Limited	1206520501128	24372250000111R
1294	M/S H. K. Textile	1100520513955	2605668635012
1295	M/S M. J. Textile	1700290549919	2506468279248
1296	M/S Mirtex International Company	1100590735337	2700565813721 2700565813737
1297	M/S Poly Tex International	1200550800282	AP079363
1298	M/S Shahzadi Industries	1100581000355	2507765643297 2507765647538 2507765641610
1299	M/S Shaman Textile	1100520510073	BL002752
1300	M/S Zaib Textile Industries	1700052122219	BL003687

(Fahad Ali Chaudhary)
Second Secretary (ST-L&P)

C.No.4(4)ST-L&P/2011

Islamabad, the 21st December, 2011**SALES TAX GENERAL ORDER NO. 31/2011**

Subject: **Amendment in STGO 11/2007 Dated 13-09-2007 – Allowing Facility of Zero-Rating on Supply of Electricity.**

In exercise of powers conferred by clause (d) of section 4 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to make the following further amendments in its Sales Tax General Order No. 11 of 2007 dated 13th September, 2007, namely:–

In the aforesaid General Order,

- (a) In the preamble, in condition (c) the words, comma, full stop, figure and brackets “S.R.O. 509(I)/2007, dated the 9th June, 2007” shall be substituted by “S.R.O. 1058(I)/2011, dated the 23rd November, 2011”.
- (b) in the table, after serial number 561 in column (1) and the entries relating thereto in columns (2), (3) and (4), the following new serial numbers and the entries relating thereto shall be **added**, namely:–

S. #	Name of Unit	Registration No.	Consumer No.
562	M/S Cruse Enterprises	0905420339164	27247220740014U
563	M/S Libermann International	0905420506628	24124150859300U
564	M/S Mehrish Industries	0905999970628	27124112035900U
565	M/S Shafy Sport Wear	0905620009028	24124720481601U
566	M/S Sports De Adnan Pealo Mahar	0905420312828	122240008500R
567	M/S Sunflex Industries	0990999926319	27124141705301U

(Fahad Ali Chaudhary)
Second Secretary (ST-L&P)

Islamabad, the 23rd December, 2011

SECP CIRCULAR NO. 17/2011

Subject: **Annual Supervision Fee for the Year 2012.**

Attention is drawn towards the ‘Conditions Imposed on Registered Insurers’ vide Sub-section (3) of Section 1 of the Insurance Ordinance – 2000, which states that:

- (3) *An insurer registered under this Ordinance shall pay to the Commission, on or before the fifteenth day of January in every calendar year, an annual supervision fee of the greatest of:*
- (a) *Rs.100,000; and*
- (c) *Such amount as may be prescribed.*

2. The amount against Sub-section (c) above was prescribed through the insertion of Rule-7-A in the Securities & Exchange Commission [Insurance] Rules – 2002 vide SRO Notification 1123(I)/2009 dated December 18, 2009, whereby the Annual Supervision Fee would be:

Every insurer registered under the Ordinance shall pay to the Commission, on or before the fifteenth day of January in every calendar year, an annual supervision fee:

(b) *At the expiry of one year, at the rate of Rs.2.00 per thousand of gross direct premium written in Pakistan during the calendar year, subject to maximum of rupees fifty million.*

3. Pursuant to the insertion of Rule 7A, the rate prescribed for the payment of annual supervision fee for the year 2012 will be, *the greatest of Rs.100,00 or Rs.2.00 per thousand of the gross direct premium written in Pakistan during the year 2010, subject to a maximum of Rupees Fifty Million.*

4. Accordingly, you are advised to deposit the Annual Supervision Fee in the Commission's Bank Account against **Code No. 30-05** in the authorized branch of MCB Bank Limited and the original challan thereof, along with the figures of direct gross written premiums reconciled from the Audited Annual-accounts-2010, should be furnished to the Insurance Division, Karachi, on or before **15th January 2012**, positively.

S.R.O. 1121(I)/2011, Islamabad, the 28th December, 2011.– In exercise of the powers conferred by section 19 of the Customs Act, 1969 (IV of 1969), the Federal Government is pleased to direct that the following further amendment shall be made in its Notification No. S.R.O 565(I)/2006, dated the 5th June, 2006, namely:–

In the aforesaid Notification, in the Table, in column (1) against S. No. 6, in column (3), after entry (6), the following new entry and the corresponding entry thereto in column (4) shall be added, namely:–

“(7) Aluminium Foil 7607.1990”.

No. SRB-3-4/17/2011, Islamabad, the 29th December, 2011.– In exercise of the powers conferred by sub-section (1) of section 10 of the Sindh Sales Tax on Services Act, 2011 (Sindh Act No.XII of 2011), the Sindh Revenue Board is pleased to direct that the following amendment shall be made in its notification No.SRB.Leg(1)/2011 dated the 1st July, 2011, namely:–

In the aforesaid notification, in the table, before the entry S.No. 1 in the column (1) and the entries relating thereto in columns (2) and (3), the following new entry shall be inserted, namely:–

- “1A. (i) Services and ancillary services provided or rendered by Clubs whose initiation fee for new members does not exceed thirty thousand rupees and whose monthly fee/subscription for the members also does not exceed one hundred rupees; and 9801.4000 and 9801.6000”.
- (ii) charges received by Clubs from its members as refundable security deposits and voluntary contributions received by Clubs from its members for the welfare (e.g. eid gifts) for the Club staff or for payment to the registered non-profit organizations, as defined and for the purposes mentioned in under section 2(36) of Income Tax Ordinance, 2011.

S.R.O. 1125(I)/2011, Islamabad, the 31st December, 2011.– In exercise of the powers conferred by clause (c) of section 4 read with clause (b) of sub-section (2) and sub-section (6) of section 3, clause (b) of sub-section (1) of section 8 and section 71 of the Sales Tax Act, 1990, and in supersession of its Notification No. S.R.O. 1058(I)/2011, dated the 23rd November, 2011, the Federal Government is pleased to notify the goods specified in column (2) of the Table below under the PCT heading numbers mentioned in column (3) of the said Table, including the goods or class of goods mentioned in the conditions stated in this notification, to be the goods on which sales tax shall, subject to the said conditions be charged at zero-rate or, as the case may be, at the rate of five per cent, wherever applicable, to the extent and in the manner as specified in the aforesaid conditions, namely:–

TABLE

S.No.	Description of goods	PCT heading No.
(1)	(2)	(3)
01.	Leather and articles thereof including artificial leather Footwear	41.01 to 41.15, 64.03, 64.04, 6405.1000, 6405.2000 and other respective headings
02.	Textile and articles thereof excluding monofilament, sun shading, nylon fishing net, other fishing net, rope of polyethylene and rope of nylon, tyre cord fabric	Chapter 50 to Chapter 63 and other respective headings excluding 5407.2000, 5608.1100, 5608.1900, 5608.9000.
03.	Carpets	57.01 to 57.05
04.	Maize (corn) starch	1108.1200

05.	Mucilages and thickness, whether or not modified, derived from locust beans locust bean seeds or guar seeds	1302.3210, 1302.3290, 1302.3900
06.	Sports goods	9504.2000, 9506 and other respective headings
07.	Surgical goods	Respective headings
08.	Emery powder/grains	2513.2010
09.	Magnesium oxide	2519.9010
10.	Coning oil	2710.1991
11.	Spin finish Oil	2710.1998
12.	Antimony oxide	2825.8000
13.	Sodium bromate	2829.9000
14.	Sodium sulphide and sodium hydrogen sulphide	2830.1010, 2830.1090
15.	Sodium dithionite	2831.1010
16.	Sodium sulphite and sodium hydrosulphide	2832.1010, 2832.1090
17.	Phosphinates (hypophosphites) and phosphonates (phosphates)	2835.1000
18.	Sodium dichromate	2841.3000
19.	Hydrogen per oxide	2847.0000
20.	p-Xylene	2902.4300
21.	Trichloroethylene	2903.2200
22.	Ethylene Glycol (MEG)	2905.3100
23.	Di-ethylene glycol	2909.4100
24.	Ethyl glycol	2909.4490
25.	Tri-ethylene Glycol	2909.4990
26.	Glutar aldehyde	2912.1900
27.	Formic acid	2915.1100
28.	Sodium formate	2915.1210
29.	Acetic acid	2915.2100
30.	Sodium acetate	2915.2930
31.	Acrylic acid and its salts	2916.1100
32.	Esters of Methacrylic acid	2916.1400
33.	Oxalic acid	2917.1110
34.	Pure terephthalic acid (PTA)	2917.3610
35.	Glycolic acid and their esters	2918.1800
36.	Other phosphoric esters and their salts	2919.9090
37.	Dyes intermediates	2921.0000 2922.0000 2923.0000 2924.0000 2927.0000 2933.0000 2934.0000

38.	DMF (Dimethyl Formamide)	2924.1990
39.	Acrylonitrile	2926.1000
40.	Other organic derivatives of hydrazine or of hydroxylamine	2928.0090
41.	Tanning extracts of vegetable origin; tannins and their salts, ethers, esters and other derivatives	3201.1000 3201.2000 3201.9020 3201.9090
42.	Synthetic organic tanning substances, inorganic tanning substances, tanning perpetrations, whether or not containing natural tanning substances; enzymatic preparations for pre-tanning	3202.1000 3202.9010 3202.9090
43.	Disperse dyes and preparations based thereon.	3204.1100
44.	Acid dyes and preparations based thereon	3204.1200
45.	Basic dyes and preparations based thereon	3204.1300
46.	Direct dyes and preparations based thereon	3204.1400
47.	Indigo Blue	3204.1510
48.	Vat dyes and preparations based thereon	3204.1590
49.	Reactive dyes and preparations based thereon	3204.1600
50.	Pigments and preparations based thereon	3204.1700
51.	Dyes, sulphur	3204.1910
52.	Dyes, synthetic	3204.1990
53.	Synthetic organic products of a kind used as fluorescent brightening agents.	3204.2000
54.	Other synthetic organic colouring matter	3204.9000
55.	Pigments and preparations based on titanium dioxide.	3206.1900
56.	Other colouring matter and other preparations	3206.4900
57.	Granules, flakes, powder of glass (others)	3207.4090
58.	Prepared water pigments of a kind used for finishing Leather	3210.0020
59.	Cationic surface active agents	3402.1210 3402.1220 3402.1290
60.	Non-ionic surface active agents	3402.1300
61.	Surface active preparations and cleaning preparations excluding detergents	3402.9000
62.	Preparations for the treatment of textile material, leather, fur skins or other material	3403.1110 3403.1120 3403.1990 3403.9110 3403.9190
63.	Spin finish oil	3403.9131
64.	Artificial waxes and prepared waxes	3404.9010
65.	Other artificial waxes	3404.9090
66.	Electro polishing chemicals	3824.9060
67.	Other glues (printing gum)	3505.2090

68.	Shoe adhesives	3506.9110
69.	Hot melt adhesive	3506.9110 3506.9190
70.	Enzymes	3507.9000
71.	Photographic film, with silver halide emulsion (for textile use) 3702.4300 3702.4400	
72.	Sensitizing emulsions (for textile use)	3707.1000
73.	Fungicides for leather industry	3808.9220
74.	Preparation of a kind used in textile or like industry	3809.9110 3809.9190
75.	Preparation of a kind used in leather or like industries	3809.9300
76.	Compound plasticizers for rubber or plastics	3812.2000
77.	Antimony triacetate	3815.1910
78.	Palladium catalyst	3815.9000
79.	Electrolyte salt	3824.9060
80.	Polymers of vinyl acetate (in aqueous dispersion)	3905.1200
81.	Vinyl acetate copolymers: in aqueous dispersion	3905.2100
82.	Polymers of vinyl alcohol	3905.3000
83.	Other vinyl polymers	3905.9990
84.	Other acrylic polymers	3906.9030
85.	Acrylic polymers in primary forms	3906.9090
86.	Polyethylene terephthalate-Yarn grade, and its waste	3907.6010
87.	Nylon Chips (PA6)	3908.1000
88.	Polyurethanes	3909.5000
89.	Silicones in primary form	3910.0000
90.	Cellulose nitrates nonplasticised	3912.2010
91.	Other cellulose nitrates	3912.2090
92.	Carboxymethyl cellulose and its salts	3912.3100
93.	Alginic acids, its salts and esters	3913.1000
94.	Nylon tubes	3917.3910
95.	Artificial leather	3921.1300
96.	Synthetic leather grip	3926.9099
97.	Natural rubber latex	4001.1000
98.	Technical specialized natural rubber	4001.2200
99.	Rubber latex	4002.1100
100.	Synthetic rubber SBR 1502 latex	4002.1900
101.	Butadiene rubber	4002.2000
102.	Thermo-plastic rubber (T.P.R.)	4002.9900
103.	Vulcanized rubber thread and cord	4007.0010 4007.0090
104.	Leather shearing-finish leather with wool	4302.1910

105.	Articles of apparel and clothing accessories of fur skin	4303.9000
106.	Artificial fur and articles thereof	4304.0000
107.	English willow cleft (wood)	4404.1000
108.	Cork Granules	4501.9000
109.	Cork sheet	4504.1010
110.	Satin Finishing Wheels	6804.2100
111.	Carbon Fiber	6815.1000
112.	Glass fiber sleeves	7019.9010
113.	Forging of surgical and dental instruments	7326.1920
114.	Nickel rotary printing screens	7508.9010
115.	Hooks for footwear	8308.1010
116.	Eyes and eyelets for footwear	8308.1020
117.	Tubular or bifurcated rivets	8308.2000
118.	Strings	8308.9090
119.	Bladders and covers of inflatable balls	9506.9919
120.	Press-fasteners, snap fasteners and press studs	9606.1000
121.	Buttons of plastics not covered with textile material	9606.2100
122.	Buttons of base metal not covered with textile materials	9606.2200
123.	Studs	9606.2910
124.	Buttons	9606.2920
125.	Slide fasteners	9607.1100 9607.1900
126.	Wood-pulp (dissolving grade)	4702.0000 if imported by manufacturers of viscose staple fibre for use in the manufacturing of viscose staple fibre.
127.	Cotton linter	1404.2000
128.	Sequins	3926.9099

Conditions

- (i) The benefit of this notification shall be available to every such person doing business in textile (including jute), carpets, leather, sports and surgical goods sectors, who is registered as:-
- (a) manufacturer;
 - (b) importer;
 - (c) exporter; and
 - (d) wholesaler;

- (ii) on import by registered manufacturers of five zero-rated sectors mentioned in condition (i) above, sales tax shall be charged at the rate of zero per cent on goods useable as industrial inputs;
- (iii) the goods imported by, or supplies made to manufacturers, other than manufacturers mentioned in condition (i) above, shall be charged, sales tax at the rate of five per cent;
- (iv) the commercial importers, on import of goods useable as industrial inputs, shall be charged sales tax at the rate of two per cent alongwith one per cent value addition tax at the import stage, which will be accountable against their subsequent liabilities arising against supply of these goods to the zero-rated sector at the rate of zero per cent or to non zero-rated sectors or unregistered persons at the rate of five per cent as the case may be. The balance amount shall be paid with the monthly sales tax return or in case of excess payment shall be carried forward to the next tax period;
- (v) the import of finished goods ready for use by the general public, shall be charged to tax at the rate of five per cent and value addition tax at the rate of one per cent;
- (vi) supplies of finished products of the sectors specified in condition (i) shall, if sold to the retailers (both registered and unregistered) or end consumers shall be charged to sales tax at the rate of five per cent *ad val*;
- (vii) supplies of goods, usable as industrial inputs, to registered persons of five zero-rated sectors up to wholesale stage shall be charged to tax at the rate of zero per cent;
- (viii) the registered persons who are solely or otherwise engaged in the retail business of these goods or products shall pay sales tax at the rate of five per cent *ad val* on their retail sales and shall be entitled to input tax adjustment. They shall not be required to pay any other sales tax leviable on their such retail transactions, however, such retailers shall be liable to pay turnover tax as prescribed under Chapter III of the Sales Tax Special Procedure Rules, 2007, and the goods supplied at the rate of five per cent shall not constitute part of turnover on which the aforesaid turnover tax is to be paid;
- (ix) the registered manufacturers who process goods owned by unregistered persons shall charge sales tax at the rate of five per cent on the processing charges received by them, provided that no such tax shall be charged from the registered principals;
- (x) a registered person who has consumed any other inputs acquired on payment of sales tax, whether covered under this notification or not, shall be entitled to input tax adjustment or, as the case may be, refund in respect of the supplies made by

him either at the rate of zero per cent or five per cent or sixteen per cent *ad val* as the case may be;

- (xi) the registered manufacturers shall be entitled to adjustment of input tax paid on machinery, parts, spares and lubricants acquired by them for their own use;
- (xii) supply of electricity and gas to the registered manufacturers or exporters of five zero-rated sectors mentioned in condition (i), shall be charged sales tax at the rate of zero per cent in the manner specified by the Board;
- (xiii) the benefit of this notification shall be available to such registered persons who appear on active taxpayers list (ATL) on the website of Federal Board of Revenue; and
- (xiv) this notification shall apply from:
 - (a) ginning onwards in case of textile sector;
 - (b) production of PTA or MEG for synthetic sector;
 - (c) regular manufacturing in case of carpets and jute products;
 - (d) tannery in case of leather sector; and
 - (e) organized manufacturing in case of surgical and sports goods

2. This notification shall take effect on and from the 1st day of January, 2012.

**WITHHOLDING TAX STATEMENTS
U/S 165 OF INCOME TAX ORDINANCE 2001
(Data Validation Checks)**

As the withholding tax statements can be prepared and submitted in any of the following modes:

- a. Online Data Entry
- b. Excel Based File attachment
- c. Mixture of Online and Excel based

In case of online data entry, the checks and performed in live mode and associated messages are displayed accordingly. However, for preparing data of withholding tax statements in Excel format, the data should be provided in accordance with the instructions given below:

Sr.	Column Name	Data Validation Checks/ Instructions
1	Taxpayer-ID Type	Should be one of N, C, F, D, A, T, R or P N=> NTN, C=> CNIC, F=FTN, D=CDC No., A=Bank Account No. T= Telephone or Mobile No. R= Reference No. P=> Passport No.
2.	Taxpayer's NTN/FTN	If Taxpayer-ID Type = "N" or "F" then Taxpayer's NTN/FTN should be a valid 9-Digit NTN/FTN with leading zeros and check digit (e.g 0132145-3)
3.	Taxpayer's CNIC	If Taxpayer-ID Type = "C", then Taxpayer's CNIC must be a valid CNIC with dashes, e.g 42301-2509891-5.
4.	Passport Number	If Taxpayer-ID Type = "P", then passport number should be provided comprising minimum of 8-characters and maximum of 30. Passport No. is allowed only for non-resident individuals.
5.	Taxpayer's Name	Must be provided
6.	Taxpayer's Address	Must be provided
7.	Payment Nature	Must be provided and should be among the Payment Natures defined in the Payment Nature Table available in the Excel Sheet Template).
8.	Payment Section Code	Payment Section Code must be provided and it should be among the Payment Section Code Table (the code table is available in the Excel Sheet Template).
9.	Payment Date	Payment Date must be provided in the format of YYYYMMDD.
10.	Payment Amount	Amount Paid should must be provided (rounded in Pak Rupees, no decimal values are allowed)
11.	Tax Rate	Tax rate should be according to the rates given in the Payment Section Code Table. For deduction u/s 149 on salary payments, the rate should be worked out as (Rate = Tax-Amount/Payment Amount) which can and even can be zero if the payment amount is zero or otherwise.

Misc. 6

Miscellaneous Section

12.	Tax Amount	If, Tax Deducted is Y, then this field must be > Zero Else If Tax Deducted is N, then it can be Zero as well If Tax Deducted is A (Adjustment), then it can be Negative
13.	Is Tax Deducted	It must be one of "Y", "N" or "A" If Tax is deducted, then fill "Y", If Tax is not deducted then fill "N", If Tax is Adjusted, then fill "A".
14.	Tax Deposited Amount	a) If tax deducted is "Y" then it should be Zero or a positive value b) If tax deducted is "N" then it should be Zero or left blank c) If tax deducted is "A" then it should be a negative value provided with "-" sign.
15.	Deposit Date	If Tax Deposit Amount is greater than zero , then it must be provided in the format of YYYYMMDD (with Number Format).
16.	CPR Number	If Tax Deposit Amount is greater than zero , then CPR Number must be provided.
17.	Provision of Law	If Tax Deducted = "N" , then provide either Provision of Law or Exemption Certificate Number.
18.	Exemption Certificate No	If Tax Deducted = "N" , then this field must be provided accordingly.
19.	Certificate Date	If Tax Deducted = "N" , then this date must be provided in YYYYMMDD format (with Number Format)
20.	Certificate Authority	If Tax Deducted = "N" , then it must be provided.

Following identification types are allowed at the time of e-filing of withholding tax statements:

Sr.	Section	Contents	Identification Types
1	148 149 153 154 155 156 156A 156B 231A 231AA 231B 233 233A 234 236A	Import of goods Payment of salary Payment for goods, services and execution of contracts Payment of export realization Payment of rent of property Payment of prizes or winnings Payment of commission/ discount on petroleum products Payment of withdrawal from pension fund Payment of cash against withdrawal from bank Issuance of banking instruments Registration of motor vehicles Payment of brokerage or commission Dealings with stock exchanges Receipt of motor vehicle tax (token tax) Receipt of proceeds of auction	N=NTN, F=FTN, C=CNIC

Miscellaneous Section

Misc. 7

2	150	Payment of Dividend	N=NTN, F=FTN, C=CNIC, D=CDC No., A=Bank Account No.
3	151	Payment of profit on debt	N=NTN, F=FTN, C=CNIC, A=Bank Account No.
4	152	Payment to Non-Residents (Having PE in Pakistan) Payment to Non-Residents (Not having PE in Pakistan)	N=NTN N=NTN, P=Passport Number, T= Telephone No. of non- resident person
5	153A	Payment to Non-Resident Media Persons	N=NTN, P=Passport Number
6	234A	Receipt of natural gas consumption bills	N=NTN, F=FTN, C=CNIC, R=Reference No. of gas connection
7	235	Receipt of electricity consumption bills	N=NTN, F=FTN, C=CNIC, R=Reference No. of electricity connection
8	236	Receipt of telephone usage bills	N=NTN, F=FTN, C=CNIC, T=Telephone/Mobile Phone No.
9	236B	Issuance of domestic air travel ticket	N=NTN, C=CNIC, T=Phone No. or Mobile Phone No.

2011 PTR 222 [Trib.]

APPELLATE TRIBUNAL INLAND REVENUE

**Syed Nadeem Saqlain, Chairman and
Tabbana Sajjad Naseer, Accountant Member**

EDITOR'S NOTE

From tax year 2009 onwards, the income tax law provides for scheduler assessment in the case of scheduled banks. Vital questions of interpretation with respect to assessment on the basis of the Seventh Schedule read with section 100A of the Income Tax Ordinance, 2001 have been answered in this judgement by the Tribunal for this first time that will have bearing on all the cases of banks.

FACTS/HELD

1. The bank filed return for tax year 2009 and audit proceedings under section 177(1) of the Income Tax Ordinance 2001, as amended by the Finance (Amendment) Ordinance dated 28th October, 2009, were initiated.
2. The bank, in response to notice issued under section 177 took legal objection that from tax year 2009 onwards, the banks were to be taxed under section 100A read with the provisions of Seventh Schedule to the Ordinance, and audit should be within the four corners of the said Schedule.
3. The Deputy Commissioner Inland Revenue rejected appellant's legal objection and after confronting certain additions passed the order under section 121 read with section 177(10). The order was passed ignoring the replies of the appellant-Bank on the points specifically confronted and documents furnished.
4. The bank agitated the order before the Commissioner of Appeals who confirmed the action under section 121 and most of the additions. The Commissioner of Appeals allowed relief under Rule 1(c) of the Seventh Schedule and disapproved

apportionment of administrative expenses vis-à-vis capital gains and dividends. The Department filed appeal against these findings of the Commissioner of Appeals.

5. In appeal before the Tribunal, the bank contested order under section 121 as well as additions made beyond the scope of Seventh Schedule. The Department defended the orders passed by the Deputy Commissioner and Commissioner of Appeals. The Tribunal held as under:
 - a. Order under section 121 was untenable as the bank did not commit any default and provided both documents and replies on the specific points.
 - b. Section 100A read with the Seventh Schedule with effect from tax year 2009 overrides all other provisions relating to computation of income in the case of banking companies as defined in section 2(7) of the Income Tax Ordinance, 2001. As regards Rule 9 of the Seventh Schedule it is applicable only in respect of provisions not specifically mentioned in the Seventh Schedule. Rule 9 cannot be interpreted to override other provisions of the Seventh Schedule or bring to operation any provision of the Income Tax Ordinance that is in conflict with the Schedule itself. The Commissioner has to accept the net profit of the banks before tax as per audited accounts and can make only permissible additions and adjustments mentioned in Rule 1(a) to (h) and elsewhere in the Seventh Schedule. The Seventh Schedule, to the extent of computation of income, is a self-contained law as special provision always overrides general provisions on the same subject matter.
 - c. Additions made on account of diminution in value of investment, provisions for other assets, compensated absence, contribution for gratuity fund, apportionment of expenses allegedly related to capital gains and dividend income stand deleted being violative of specific provisions of the Seventh Schedule.
 - d. Relief given under Rule 1(c) of the Seventh Schedule and deletion of apportionment of administrative expenses against capital gains and dividends confirmed.

Appeal of bank accepted and that of department rejected

ITA No. 774 & 805/LB/2011**Heard on: 19th December, 2011.****Decided on: 19th December, 2011.****Present at hearing: Dr. Ikramul Haq, Mr. Mansoor Beg, Advocate, for Appellant. Raja Sikandar Khan, LA, for Respondent.**

ORDER*Syed Nadeem Saqlain, Chairman*

This is the case of a scheduled bank, engaged in banking business. Brief facts of the case are that the appellant-Bank filed return for tax year 2009 under section 114 of Income Tax Ordinance, 2001 [“the Ordinance”] which was treated as assessment order under section 120(1) of the Ordinance. Later on, audit proceedings under section 177(1) of the Ordinance, as amended by the Finance (Amendment) Ordinance dated 28th October, 2009, were initiated. The appellant, in response to notice issued under section 177 dated 29.01.2010 took legal objection that from tax year 2009 onwards, the banks were to be taxed under section 100A read with the provisions of Seventh Schedule to the Ordinance, which did not permit audit of many items mentioned in the notice. The Deputy Commissioner Inland Revenue rejected appellant’s legal objection and after confronting certain additions passed the order under section 121 read with section 177(10). The order was passed ignoring the replies of the appellant-Bank on the points specifically confronted. The appellant-Bank contested proceedings initiated under section 177 and order passed under section 121 on both legal and factual grounds before Commissioner Inland Revenue (Appeals), Zone-I, Lahore, who adjudicated the appeal of the bank vide Order No. 46 dated 30.04.2011 (“the impugned order”). Being aggrieved with the impugned order, the Bank and the Department filed appeals on the following grounds:

Bank’s grounds of appeal

1. That the order of learned Commissioner (Appeals) dated 30.04.2011 against order u/s 121 of Income Tax Ordinance, 2001, to the extent of grounds taken below, is bad in law and against the fact of the case.
2. That the learned Commissioner (Appeals) erred in confirming assumption of jurisdiction by the Deputy Commissioner u/s 121 of Income Tax Ordinance, 2001.
3. That the learned Commissioner (Appeals) erred in confirming assessment completed under section 121 of Income Tax Ordinance, 2001 in the presence of assessment under section 120 of the Ordinance.

Without prejudice to above:

4. That the learned Commissioner (Appeals) erred in confirming computation of income in violation of section 100A read with the provisions of Seventh Schedule to Income Tax Ordinance, 2001.
5. That the learned Commissioner (Appeals) erred in confirming taxation of 'reversal of provision for non-performing advances' at Rs. 4,438,011,000, which the Bank itself offered for tax.
6. That the learned Commissioner (Appeals) erred in confirming disallowance of unabsorbed depreciation related to leased assets at Rs. 114,540,000.
7. That the learned Commissioner (Appeals) erred in confirming disallowance of "provisions against other assets" at Rs. 10,101,000.
8. That the learned Commissioner (Appeals) erred in confirming disallowance of "provision for diminution in value of investment" at Rs. 366,387,000.
9. That the learned Commissioner (Appeals) erred in not adjudicating ground No. 11 relating to disallowance of "provision against compensated absences" at Rs. 27,981,000.
10. That the learned Commissioner (Appeals) erred in confirming disallowance of "contribution to defined benefit plan" at Rs. 42,117,000.
11. That the learned Commissioner (Appeals) erred in confirming proportionate disallowance of financial charges allegedly relatable to dividend income taxable at reduced rate by misapplying the law.
12. That the learned Commissioner (Appeals) erred in confirming proportionate disallowance of financial charges allegedly relatable to capital gains taxable at reduced rate by misapplying the law.

Department's grounds of appeal

1. That the order of the Commissioner Inland Revenue (Appeals-I), Lahore vide No. 46 dated 30.04.2011, is bad in law so far as it ignores the express provisions of section 129(1)(a) of the Income Tax Ordinance, 2001.
2. That the learned Commissioner Inland Revenue (appeals) was not justified in deleting the addition made on account of

provision against non-performing advances and allowance @ 1% of total revenue.

3. That the learned CIR(Appeals) was not justified in holding that allocation of expenses to dividend income and capital gain may be restricted to financial charges claimed as not much administrative cost is involved in this activity.

We have heard the rival arguments on the above grounds, perused the orders passed by the Deputy Commissioner Inland Revenue and Commissioner of Appeals, relevant statutory provisions and case law. The issue-wise adjudication is made as under disposing of grounds of both the bank and the Department:

ORDER UNDER SECTION 121 OF INCOME TAX ORDINANCE, 2001.

The learned Counsel of the appellant-Bank contested that the Bank never resisted audit proceedings and provided documents and details within the scope of Seventh Schedule as from tax year 2009, scheduled banks have to be taxed in terms of section 100A of the Ordinance. He pointed out that both the authorities below wrongly attributed non-compliance of notices. In reality, the Bank made compliance of each and every notice but insisted for strict compliance of the Seventh Schedule to the Ordinance. On the contrary, the Deputy Commissioner misapplied the law and asked for audit violating explicit provisions of section 100A read with the Seventh Schedule to the Ordinance He showed from record that despite repeated requests the Deputy Commissioner did not provide a copy of delegation of powers from the Commissioner under which she initiated proceedings under section 177 of the Ordinance. The learned LA pointed out that both in the order of the Deputy Commissioner and Commissioner of Appeals there was concurrent finding of non-compliance of notice under section 177, therefore, best judgement order under section 121 was justified. The learned AR rebutted the findings of both the authorities below by providing copies of the replies that were submitted from time to time. He contended that findings of non-compliance are factually incorrect. We have examined the letters and documents submitted by the appellant-Bank in response to notices issued by the Deputy Commissioner. The following extracts from the replies submitted by the Bank in response to notice issued under section 177 support the contention of AR:

1. **Reply dated 01-02-2010:** As regards adjustment(s) under Rule 1(b) of the Schedule, the Bank has already added back penalty paid to the State Bank under section 21(g) of the Ordinance. For the purpose of application of section 21(b) or (c) read with Rule 1(b) of the Schedule, the bank has already discharged its onus by filing statements under section 165 showing withholding of taxes wherever required under the law.

2. **Reply dated 12-02-2010:** “As conveyed in our earlier letter dated 01-02-2010, we are ready to provide necessary details that are relevant for the purpose of application of Rule 1(a) to (h). We need, sufficient time of 60 days to provide the details as branches are scattered all over Pakistan and records/documents are also voluminous.
3. **Reply dated 26-02-2010:** As conveyed in our earlier letters dated 01-02-2010 and 12-02-2010, we are providing some details that are relevant for the purpose of application of Rule 1(a) to (h). You are free to check our records/accounts as well to the extent of adjustments permissible under the Seventh Schedule as stated above, for which a mutually agreed schedule can be chalked out.
4. **Reply dated 05-03-2010:** During the hearing on March 1, 2010, it was reiterated that details/record only in respect of adjustments mentioned in Rule 1(a) to (h) of the Schedule will be provided. Substantial compliance in this regard was made on the said date. For rest of the details, we need time as the data, is to be collected from branches situated all over Pakistan.

In the light of our earlier letters dated 01-02-2010, 12-02-2010, 26-02-2010, hearing on March 1, 2010 and in the light of submissions made above, especially at para 2, kindly respond to our legal objections first before proceeding further in the matter.

5. **Reply dated 13-03-2010:** We have been submitting repeatedly that limited scope under the Seventh Schedule to the Income Tax Ordinance, 2001 does not permit your honour to conduct the audit in the manner conveyed and desired. We have not been gaining any time. On the contrary, we have complied with your notice by submitting necessary details relevant for the purpose of Seventh Schedule. We are also providing certificate required under Rule 1(c) of Seventh Schedule without surrendering our legal stance that for tax year 2009 entire claim is admissible. As regards audit of deduction of tax at source, we have been filing monthly statements as required under the law. The law provides a check and balance system through monthly statements. All the statements are with the department and no objection was ever raised when these were filed.

We will attend the hearing on 17.03.2010 as desired by you provided the above mentioned documents are made available to us before the said date so that we can prove our point that jurisdiction is still being exercised on the basis of a non-existent law, namely, the Finance (Amendment) Ordinance, 2009.

As regards issues raised in the notice dated 29.01.2010, we have already submitted point-wise reply vide letter dated 26.02.2010.

The underlined portions above prove beyond any doubt that allegation of non-compliance is factually incorrect. Both the authorities below misrepresented the facts and this amounts to miscarriage of justice. It needs serious consideration of the Federal Board of Revenue (FBR). Taxpayer should be treated fairly and justly. In this case, a scheduled bank is portrayed as a non-compliant taxpayer whereas the truth is otherwise. It is for FBR to take notice of this lapse and take appropriate action so that in future taxpayers are not wrongly blamed for non-compliance. For us it is suffice to hold that order under section 121 of 18-03-¹2010 is not maintainable as compliance of notice within the four corners of the Seventh Schedule to the Ordinance was made by the appellant-Bank. If the Deputy Commissioner Inland Revenue was not satisfied with the reply made vide letter dated 26-02-2010 on issues raised in notice dated 29-01-2010, amendment of assessment already in the field could have been made but there was no justification whatsoever to resort to section 121 after compliance by the appellant Bank. Since we have held order 121 untenable on factual matrix, there is no need to adjudicate other grounds related to assumption of jurisdiction under section 177 or retrospective application of section 177(10) inserted through a Presidential Ordinance on 28th October 2009.

COMPUTATION OF INCOME UNDER SECTION 100A READ WITH SEVENTH SCHEDULE

The learned AR contended that from tax year 2009 onwards, the banks are to be taxed in terms of section 100A read with the provisions of Seventh Schedule [“the Schedule”] to the Ordinance, 2001. According to him, the scheduler assessment in the case of banks from tax year 2009 came at par with insurance companies taxed under the Fourth Schedule to the Ordinance. He further contended that Seventh Schedule did not permit re-computation of income as done by the Deputy Commissioner in view of explicit language of section 100A read with Rule 1 of the Seventh Schedule. The learned AR argued that the Deputy Commissioner could make only permissible additions and adjustments as provided in the Seventh Schedule itself. Relying on *CIT Central Zone ‘A’ Karachi v Phoenix Assurance Co Ltd* (1991) 64 TAX 173 (S.C. Pak), he argued under the scheduler assessments, the acceptance of accounts was a *fait accompli* for tax authorities. The learned LA contested this position and argued that in view of Rule 9 of the Schedule, all the provisions of the Ordinance were applicable and both the authorities below did not misinterpret the law.

It is an undisputed fact that from tax year 2009, the Seventh Schedule to the Income Tax Ordinance, 2001 read with section 100A overrides all other provisions as far as computation of income and tax payable in the case of banks are concerned. This vital aspect escaped the

¹ Due to typographical error papering as 2011 in the order.
2011

attention of both the Deputy Commissioner and the Commissioner of Appeals. Rule 1 of the Seventh Schedule says that the balance of income, from all sources before tax, disclosed in the annual accounts required to be furnished to the State Bank of Pakistan subject to adjustments permissible under sub-rule 1(a) to (h) of the said Rule 1 of the Seventh Schedule to the Ordinance,¹ are to be accepted.

It is a cardinal position of law that enactment of special rule excludes general provisions when the subject matter of both is the same (*generalibus specialia derogant*). Since for the computation of income and tax, special schedule is enacted, the provisions on the same subject provided elsewhere in the Ordinance are excluded. The plain reading of section 100A read with Rule 1 of the Seventh Schedule testifies to this. As regards Rule 9 of the Schedule, it applies only to provisions that **“are not specifically dealt with”** in the Seventh Schedule. Since computation of income and tax payable thereon is specifically provided in the Seventh Schedule, Rule 9 cannot be interpreted in a way that would defeat the very purpose of its enactment. Rule ²1 is not a non obstante provision that overrides all other provisions of the Seventh Schedule. On the contrary, Rule 9 says that if something is not provided in the Seventh Schedule then all other provisions of the Income Tax Ordinance will apply *mutatis mutandis*.

The Commissioner of Appeals and Deputy Commissioner misinterpreted and misread Rule 9 of the Seventh Schedule. They have failed to appreciate that it applies only for provisions that **“are not specifically dealt with”** in the Seventh Schedule. If Rule 9 is to be applied in respect of provisions specifically enacted in the Seventh Schedule, it would render the entire Schedule redundant. Such an interpretation would be violative of *ratio decidendi* of many judgements of Supreme Court cited below and latest order of this Tribunal reported as 2010 PTD (Trib.) 679.

The honourable Supreme Court while examining similar provisions in the case of insurance companies has held that law gives sanctity to the accounts prepared under the provisions of the Insurance law and that an Assessing Officer has no authority to upset the integrity of such accounts. The following cases decided by honourable Supreme Court and High Courts clearly establish that provisions contained in the Fourth Schedule — similar provisions have been provided for banks under the Seventh Schedule—are non obstante in nature which override other provisions of the Ordinance:

1. *EFU General Insurance Co. Ltd. Co. Ltd. v. Federation of Pakistan* 1997 SCC 1174 = 1997 PTD 1693 = (1997) 76 TAX 213 (S.C. Pak)

¹ It should have been “is”

² Figure “1” is missing

2. *Central Insurance Co. and others v. CBR Islamabad etc.* (1993) 68 TAX 86 (S.C. Pak)
3. *CIT Karachi v Queensland Insurance Company Ltd. Karachi* (1992) 65 TAX 229 (S.C. Pak)
4. *CIT Central Zone 'A' Karachi v Phoenix Assurance Co. Ltd.* (1991) 64 TAX 173 (S.C. Pak)
5. *Habib Insurance Co. Ltd. v. CIT* 1989 SCC 736 = (1990) 61 TAX 88 (S.C. Pak)
6. *CIT Companies III, Karachi v Central Insurance Companies Ltd.* (2003) 88 TAX 235 (H.C. Kar)
7. *Home Insurance Co. Ltd. v CIT* (1992) 66 TAX 33 (H.C. Kar.)

The crux of the above cases is that no variance in the audited accounts of bank submitted to State Bank of Pakistan can be made. The unambiguous language of section 100A read with Rule 1 of the Seventh Schedule to the Ordinance provides that only specified adjustments/additions mentioned in Rule 1(a) to (h) can be made. Thus, the acceptance of balance of income as per accounts was a *fait accompli* for the Tax Department. By not adhering to it, gross violation of law has been committed by the Deputy Commissioner while the Commissioner of Appeals was not correct in law to justify it. The Commissioner of Appeals dismissed appeal on this point with the observation that Rule 9 of the Schedule authorized department to go beyond Seventh Schedule on the issues not specifically dealt with in the Schedule. Relevant part of the order is reproduced below:

"I have noticed nowhere in 7th Schedule it has been mentioned that computation of income and tax payable thereon will be made in accordance with rule 1 only. Why the learned AR is trying to add/insert his own words to the clear language used by the Legislature itself? This is beyond me. In fact he is trying to construe 7th Schedule in isolation, even ignoring rule 9. It is a settled law that schedule is the part of the main statute and not a standalone legislature. In particular where rule 9 itself refers to the provisions of the Ordinance the restriction as desired by the learned AR on the assessment cannot be placed that is confined to rule 1 only. As regards the expression used overriding suffice to say that there is no conflict between the schedule and the Ordinance which may attract the concept of overriding effect.

It is, therefore, held that the additions have been rightly made under different provisions of the statute as far as this ground is concerned."

The above observations of Commissioner of Appeals are untenable. Section 100A read with Seventh Schedule to the Ordinance is a special non-obstante provision that overrides all other provisions as far as

computation of income and tax payable by the banking companies is concerned. Tax authorities are bound to accept the audited accounts from tax year 2009 in the case of banks subject to specified additions and adjustments. This position of law has also been admitted and explained by FBR in Para 10 of its Circular No 1 of 2007 dated 02-07-2007, Circular No. 2 of 2008 dated 28-02-2008, Circular No. 3 of 2009 dated 17-07-2009 and Circular No. 8 of 2009 dated 25-09-2009. These instructions are strictly as per law having binding force for all subordinate tax officials under section 206(2) and 214(1) of the Ordinance. In the presence of unambiguous position of law and legally binding instructions, the Deputy Commissioner was bound to accept the balance of income as per audited accounts subject to additions/adjustments mentioned in Rule 1(a) to (h) of the Seventh Schedule. On the basis of misinterpretation of Rule 9 of the Seventh Schedule, as elaborated above, the authorities below concluded that Seventh Schedule is not a self-contained provision as far as computation of income is concerned in the case of banking companies. We disapprove this interpretation and hold that for computation of income of the banking companies, the Seventh Schedule to the Income Tax Ordinance, 2001 provides rules for computation of the profits and gains of a banking company and tax payable thereon. From tax year 2009 onwards, a banking company's income as disclosed in the annual accounts furnished to the State Bank of Pakistan, subject to specified adjustments, shall be taken as "Income from Business". Rule 9 in no way can be interpreted to unsettle this requirement laid down by the Legislature. It applies for things not provided for in the Seventh Schedule.

TAXATION OF REVERSAL OF PROVISION FOR NON-PERFORMING ADVANCES'

The learned AR pleaded that this addition was not only against the express provision of Rule 1 of the Schedule, but was also misconceived. The gross charge for the year under this head was Rs. 23,301,591,000 that was reduced by Rs. 4,438,011,000 (reversals) and net charge to the accounts was Rs.18,863,580,000. Since the gross charge of 23,301,591,000 for the year was reduced by this amount, the same cannot be taxed again. It was argued that this Tribunal in ITA No.3061LB/2009 dated 08.08.2009 on this issue held as under:

We also endorse the point of view of the taxpayers that even otherwise it was double taxation as reversal/recoveries related to non-performing loans were offered for tax"

The learned AR also claimed that the above decision of the Tribunal had attained finality under section 132(10) of the Ordinance as Department did not file appeal under section 133 against it. AR further informed that the same Commissioner of Appeals following the above judgement of Tribunal in the case of Allied Bank Limited vide Order No.20 dated 31.03.2011 ordered the deletion. But strangely, in this

Tax Review 2011

case, he gave a contrary finding violating the rule of consistency and in utter violation of matter already settled by this Tribunal. The learned LA during his arguments did not refute the arguments advanced by the AR.

We have examined the facts and case law cited. In this case, reversal has been taxed without any justification. The appellant-Bank undisputedly claimed total provision of Rs.23,301,591,000 but reduced it to Rs.18,893,580,000 meaning by difference representing reversals and recoveries was offered for tax. The Department by disallowing amount of Rs.23,301,591,000 (which included reversal of Rs. 4,438,011,000) taxed it not only twice but thrice as it added back an amount of Rs. 4,438,01,000 in total income. Following our judgement in ITA No. 306/LB/2009 dated 08.08.2009, we delete this addition.

DISALLOWANCE OF UNABSORBED DEPRECIATION RELATED TO LEASED ASSETS

The learned AR argued that the learned Deputy Commissioner did not mention provision of law for making this addition. He contended that Rule 1 of the Seventh Schedule to the Ordinance required the Deputy Commissioner to accept the net profit of the bank as per audited accounts submitted to the State Bank of Pakistan. He contended that the learned Commissioner of Appeals was not justified in confirming this addition when no cogent reasons for the same were given by the Deputy Commissioner. Learned LA opposed the arguments of the AR contending that claim was in violation of Rule 1(b) of the seventh Schedule. The learned AR read Rule 8A(3) in his rebuttal. This Rule reads as under:

(3) The provisions of this Schedule shall not apply to any asset given or acquired on finance lease by a banking company up to the tax year 2008, and recognition of income and deductions in respect of such asset shall be dealt in accordance with the provisions of the Ordinance as if this Schedule has not come into force:

Provided that un-absorbed depreciation in respect of such assets shall be allowed to be set-off against the said lease rental income only

Plain reading of the above Rule shows that claim of the appellant-bank was strictly as per law and there was no justification to disallow the same. We hereby order the acceptance of unabsorbed depreciation allowance related to leased out assets claimed under Rule 8A(3) of the Seventh Schedule.

DISALLOWANCE OF “PROVISION AGAINST OTHER ASSETS”

According to learned AR the Deputy Commissioner did not mention provision of law for making this addition. He relied on Rule 1 of the Seventh Schedule to the Ordinance that says the net profit as per audited

accounts should be accepted. The AR claimed that the learned Commissioner of Appeals did not pass a speaking order and was not justified in confirming this addition which was made in utter violation of law. The learned LA however, pleaded that action of both the authorities was correct in law. However, he could not cite the exact provision of law under which this disallowance was made. We are of the considered view that this amount was allowable in view of Rule 1 of the Seventh Schedule. We disapprove the action of both the Deputy Commissioner and Commissioner of Appeals.

DISALLOWANCE OF “PROVISION FOR DIMINUTION IN VALUE OF INVESTMENT”

The learned AR contended that disallowance of provision for diminution in the value of investment was against Rule 1 of the Schedule. He reiterated that from tax year 2009, the Seventh Schedule to the Income Tax Ordinance, 2001 read with section 100A overrides all other provisions as far as computation of income and tax payable in the case of banks were concerned. According to AR, the Deputy Commissioner could make adjustments and additions in net profit as per books of account that were specifically mentioned in Rule 1(a) to Rule 1(h) of the Schedule. The learned LA contended that this provision was inadmissible as per Rule 1(g) of the Seventh Schedule. The AR refuted this claim saying that International Accounting Standards 39 and 40 mentioned in Rule 1(g) was still not implemented in Pakistan and therefore reliance on the said Rule was irrelevant.

We have examined the record and found that in the orders of the Deputy Commissioner and the Commissioner Appeals there is no mention of any Rule of the Seventh Schedule or section of the Ordinance. Before the Commissioner of Appeals, the appellant-bank relied on the Full Bench judgement of this Tribunal reported as (2010) 101 TAX 73 (Trib.) wherein it is held as under:

The reliance placed by the learned counsel on the decision of the Hon'ble Supreme Court of Pakistan in the case of Habib Insurance Co. Ltd. reported as PLD 1985 Supreme Court 109 and the decision of the Tribunal reported as (1988) 57 Tax 127=PTD 140 is also very relevant. We note that the Hon'ble Supreme Court in the above decision has already held that notional appreciation in the value of investment taken credit for in accounts is taxable under the relevant provisions of the First Schedule to the late Income Tax Act, 1922 and the Tribunal also has taken a similar view. On the same analogy, notional loss or depreciation/diminution is also allowable as a deduction. It may be appreciated that this particular provision is available only in the cases of Insurance business right from the year 1927 both for Life and General Insurance business and in the income Tax Ordinance, 2001 similar provisions also exist. We also note that the Hon'ble Supreme Court has

granted sanctity to the accounts prepared under the provisions of the Insurance law and it has been held that an Assessing Officer does not have authority to upset the integrity of such accounts. What he is authorized to act within the limitations provided in the Rules available in the Fourth Schedule. Here we may refer with advance (1981) 44 Tax 1 re: CIT, Central Karachi v. Alpha insurance Co. Ltd and Home Insurance Co. Ltd, (1997) 76 Tax 213 (S.C. Pak.)= 1997 SCC 1174= 1997 PTD 1693 re: E.F.U. General Insurance Co. Ltd v. Federation of Pakistan and Habib Insurance Co. Ltd. v. CIT reported as PLD 1985 SC 109, relevant excerpts of which have been already reproduced and discussed above. In all these cases the provisions contained in the Income Tax Law both in the late Act of 1922 and the repealed Ordinance of 1979 were discussed and it was noticed that these provisions are non-obstante in nature which overrides the other provisions.

24. Based on the above discussion, it is our considered opinion that the claim of depreciation/diminution/provision in the value of investment is allowable in terms of Rule 5(b) of the Fourth Schedule to the repealed Ordinance being a specific provision if the same is accounted for in the account and Rule 5(a) of the Fourth Schedule cannot be invoked to disallow the above claim.”

The above case adjudged by Commissioner of Appeals as irrelevant being related to insurance companies. It is obvious that Commissioner of Appeals had not appreciated the fact that assessment of banks with effect from tax year 2009 had come at par with the assessments of insurance companies. The language of section 100A read with Seventh Schedule is exactly the same as section 99 read with the Fourth Schedule to the Income Tax Ordinance, 2001. Since neither any specific provision of law has been quoted for this disallowance by the Deputy Commissioner of the Commissioner of Appeals, nor were International Accounting Standards 39 and 40 made applicable in Pakistan during the tax year under view, we order deletion of this addition.

NON-ADJUDICATING GROUND NO.11: “PROVISION AGAINST COMPENSATED ABSENCES”

The learned AR said that Deputy Commissioner disallowed “provision against compensated absence” at Rs.27,981,000 and addition was specifically agitated in Ground No.11, but learned Commissioner of Appeals confirmed this addition by not adjudicating this ground. The addition according to him is against the law as Rule 1 specifically provides that in the case of banks net profit as per audited accounts is to be accepted, subject to certain adjustments mentioned in the Schedule itself. There is nothing in the Schedule that authorises Deputy Commissioner to disallow this amount. He said that the same

Commissioner of Appeals allowed this claim in the case of another bank (Order No.16 dated 30.11.2011). According to learned AR this claim represents ascertained liabilities that are allowable as expense and merits acceptance as per ratio decidendi of judgement of honourable Supreme Court of Pakistan in *CIT v. Oriental Dyes and Chemicals Co. Ltd* [1992] 65 Tax 254 (S.C. Pak.) holding that any such liability is an allowable expenditure on accrual basis. By following the above judgement of apex court, the honourable Sindh High Court has specifically adjudicated this issue in *Commissioner Legal Division v. Civil Aviation Authority* (2008) 97 TAX 301 (H.C. Kar.) as under:

“This Income Tax Reference application has been filed by the Commissioner of Income Tax u/s 133 of the Income Tax Ordinance 2001, seeking the opinion of this Court on the following proposed question:-

*“Whether on the facts and in the circumstances of the case, the learned ITAT was justified in law to hold that provision made in the books of account of **compensated absences** was allowable expenses even though it was not based on the demand in this regard?”*

“We have also examined the judgement of Honourable apex Court reported in the case of Commissioner of income Tax v. Oriental Dyes and Chemical Co. Ltd reported in (1992) 65 Tax 254 (S. C.Pak.) = 1992 SCMR 763 in which the Honourable Apex Court had held that the provision for gratuity being an ascertained liability is an allowable expense even, though not actually paid during the year”

“Respectfully following the above judgements we uphold the judgement of the Income Tax appellate Tribunal and since the matter has already been adjudicated by the Honourable apex Court, we refuse to answer the proposed question.”

The learned LA in his arguments offered no arguments on this issue. Following the ratio of the judgments of the honourable higher courts cited above, we hold that there was no justification for disallowance of this deduction. It should be allowed as such.

DISALLOWANCE OF “CONTRIBUTION TO DEFINED BENEFIT PLAN” AT RS.42,117,000.

According to the learned AR, the Deputy Commissioner disallowed contribution to defined benefit plan (gratuity fund) without assigning any reason and without taking into account the following:

- i) Rule 1 of the Seventh Schedule to the Ordinance requires acceptance of the net profit of the bank as per audited accounts submitted to the State Bank of Pakistan.

- ii) The fund was approved by Commissioner vide letter No. CIT (Legal)/LTU/634 dated 2010.2009 in reply to application dated 12.11.2008.
- iii) The disallowance, if any, in respect of contribution to gratuity fund was provided in section 21(e) [parallel to section 24(g) of the repealed Income Tax Ordinance, 1979] of the Income Tax Ordinance, 2001. It reads as under:
 - (e) *any contribution made by the person to a fund that is not a recognized provident fund approved pension fund, approved superannuation fund, or approved gratuity fund*

According to AR, it is explicit from plain reading of above that the disallowance is possible only in the case of a fund which is not recognised. Appellant's is a recognised fund and, therefore, is not hit by section 21(e) of the Income Tax Ordinance, 2001. The learned Commissioner himself observed in the impugned order "*The DCIR has made this addition without assigning any reason*". After giving this finding, the Commissioner of Appeals was not justified in confirming disallowance of Contribution to Defined Benefit Plan (Gratuity Fund). Learned LA did not offer any arguments on this issue. We are of the considered opinion that this addition is without any legal basis and merits deletion for detailed reasons cited above.

PROPORTIONATE DISALLOWANCE OF EXPENSES RELATABLE TO DIVIDEND & CAPITAL GAINS

The learned AR narrated that learned Deputy Commissioner disallowed proportionate financial and administrative expenses by allocating them to dividend and capital gain taxable at reduced rate. In appeal, the learned Commissioner of Appeals disapproved allocation of administrative expenses. However, he confirmed disallowance to the extent of financial expenses. Cross appeals have been filed on this issue. The Bank has contested confirmation of allocation of financial expenses whereas department has contested disapproval of allocation of administrative expenses. The learned AR argued that both the learned Deputy Commissioner and Commissioner (Appeals) failed to appreciate that Rule I of the Schedule does not permit any such allocation. He further argued that section 67 read with Rule 13 has no implication because Rule 6 says that "Income computed under this Schedule shall be chargeable to tax under the head "income from business...." All incomes are to be taxed under the head 'Income from Business' as far as Seventh Schedule is concerned. This dismantles the very basis of addition.

The learned LA however argued that in view of Rule 9 of the Seventh Schedule, section 67 was rightly invoked. We are afraid this interpretation is untenable under the law. Rule 6 specifically provides that all income should be taxed in the case of banks under the head

“income from business”. In the presence of this unambiguous provision of law, resort to section 67 read with Rule 9 of the Seventh Schedule is incorrect and legally untenable. We, therefore, disapprove allocation of financial expenses to dividend and capital gain taxable at reduced rate being unlawful. Departmental appeal on this issue also fails.

PROVISION FOR NON-PERFORMING ADVANCES ETC UNDER RULE 1(c), SEVENTH SCHEDULE

The Department's only grievance is allowance of provision for bad debts as per Rule 1(c) of the Seventh Schedule to the Ordinance. The learned LA said that the Commissioner of Appeals was not justified to allow this as no certificate from the external auditor was given. The learned AR provided the copy of the letter dated 13-03-2010 sent to the Deputy Commissioner of Income Tax wherein the fact of furnishing the certificate is mentioned as under:

“We have been submitting repeatedly that limited scope under the Seventh Schedule to the Income Tax Ordinance, 2001 does not permit your honour to conduct the audit in the manner conveyed and desired. We have not been gaining any time. On the contrary, we have complied with your notice by submitting necessary details relevant for the purpose of Seventh Schedule. We are also providing certificate required under Rule 1(c) of Seventh Schedule without surrendering our legal stance that for tax year 2009 entire claim is admissible.”

The Commissioner of Appeal thus was justified to allow provision for bad debt strictly as per law. The objection of the learned LA is against the facts. The bank did provide the certificate and it was unjustified on the part of Deputy Commissioner to disallow the entire claim. The Commissioner's order on this point is unexceptionable and Departmental appeal resultantly fails.

2011 PTR 1722 (H.C. Del.)

HIGH COURT OF NEW DELHI**A.K. Sikri and M.L. Mehta, JJ.***ITA 1278/2010, ITA 1280/2010, ITA 1281/2010**ITA 1282/2010, ITA 1284/2010**Rolls Royce Singapore Pvt. Ltd.*

v.

*Assistant Director of Income Tax**ITA Nos. 249 to 260/2011**Assistant Director of Income Tax*

v.

Rolls Royce Singapore Pvt. Ltd.

FACTS/HELD

1. **Profits attributable to “Dependent Agent Permanent Establishment” Taxable in India**
2. The assessee, a Singapore company, rendered repair and maintenance services and supplied spares to customers in India. While the income from repairs was offered to tax as “fees for technical services”, the income from supply of spares was claimed to be not taxable on the ground that it had accrued outside India. The AO, CIT (A) and Tribunal took the view that the assessee had a “permanent establishment” on the basis that it had a “dependent agent” in India under Article 5(9) of the India-Singapore DTAA and that the income earned from supplying spare parts was taxable in India. The AO held that 25% of the profits on sales of spare parts were chargeable to tax which was reduced to 10% by the CIT (A) & the Tribunal. On appeal to the High Court, HELD:
 - (i) To constitute a “**Dependent Agent Permanent Establishment**” under Article 5(9) of the DTAA it has to be seen whether the activities of the agent are “devoted wholly or almost wholly on behalf of the assessee”. While the issues as to (a) whether the agent is prohibited from taking competitive products and (b) whether the assessee exercised extensive control over the

agent were relevant, they are not conclusive. **It is not correct to say that merely because the agent is prohibited from taking a competitive product means that it is not an agent of independent status.** What has to be seen is whether the “activities” of the agent are **devoted wholly or almost wholly on behalf of the assessee.** If the assessee can show that it was **not the sole client** of the agent and that **activities of the agent were not devoted** wholly or almost wholly on behalf of the assessee, there may be no DAPE. The income earned by the agent from **other clients and the extent of such income** is very relevant to decide whether the criteria stipulated in Article 5(9) is satisfied or not. (Matter remanded for fresh consideration);

- (ii) While in principle it is correct that if a **fair price is paid by the assessee to the agent** for the activities of the assessee in India through the DAPE and the said price is taxed in India at the hands of the agent, then no question of taxing the assessee again would arise, **this is subject to a Transfer Pricing Analysis** being undertaken u/s 92. The facts showed that the manner in which the commission/ remuneration had been fixed was usually not done between **independent parties in an uncontrolled transaction.** The assessee was in a position to dictate terms to the agent and so it could not be said that the commission was at “arms length” within the meaning of Article 7 (2) of the DTAA. **The Transfer Pricing analysis to determine the “arms length” price has to be done by taking the “Functions, Assets used and Risk involved” (FAR).** As this has not been done, the assessee’s argument on “arms length” price is not acceptable (**Morgan Stanley** 292 ITR 416 (SC) & **Set Satellite (Singapore)** 307 ITR 205 (Bom) distinguished);
- (iii) As the commission paid by the agent to the DAPE is not at “arms length”, the estimation that 10% of the profits on sales of spare parts were attributable to the activities carried out by the agent in India and taxable is reasonable. **The test is “profits expected to make” and has to be determined bearing in mind the fact that the agent was merely rendering support services and had no**

authority to negotiate and accept contracts and also assumed limited risk.

Appeals dismissed.

ITA Nos. 1278/2010, 1280/2010, 1281/2010, 1282/2010, 1284/2010, 249/2011, 250/2011, 251/2011, 252/2011, 253/2011, 254/2011, 255/2011, 256/2011, 257/2011, 258/2011, 259/2011 and 260/2011.

Heard on: 19th July, 2011.

Decided on: 30th August, 2011.

Present at hearing: S. Ganesh, Sr. Advocate with Mukesh Butani, H. Raghavendra Rao and Arjit Prasad, Advocates for Appellant. Sanjeev Sabharwal, Sr. Standing Counsel for Respondent in ITA No. 1278/2010. S. Ganesh, Sr. Advocate with Mukesh Butani, H. Raghavendra Rao and Arjit Prasad, Advocates for Appellant. Sanjeev Sabharwal, Sr. Standing Counsel for Respondent in ITA Nos. 1280 to 1282/2010. S. Ganesh, Sr. Advocate with Mukesh Butani, H. Raghavendra Rao and Arjit Prasad, Advocates for Appellant. Sanjeev Sabharwal, Sr. Standing Counsel for Respondent in ITA No. 1284/2010. Sanjeev Sabharwal, Sr. Standing Counsel for Appellant. S. Ganesh, Sr. Advocate with Mukesh Butani, H. Raghavendra Rao and Arjit Prasad, Advocates for Respondent in ITA Nos. 249 to 260/2011.

JUDGMENT

A.K. Sikri, J.-

1. These 17 appeals arise out of the common order dated 19th March, 2010 passed by the Income-Tax appellate Tribunal (hereinafter referred to as the ITAT), 5 appeals are filed by the assessee and 12 appeals are filed by the Revenue. Particulars of the five appeals of the assessee are as under:-

SL. NO.	APPEAL NO.	ASSESSMENT YEAR
1	ITA 1278/2010	2003-04
2.	ITA 1280/2010	2000-01
3.	ITA 1282/2010	2004-05
4.	ITA 1284/2010	2001-02
5.	ITA 1281/2010	2002-03

These appeals pertain to the assessment year 2000-01 to 2004-05.

2. Before coming to the respective grievances of the Assessee and the Revenue, we would like to trace the genesis of the dispute and the nature of impugned order passed by the Tribunal as narration thereof would make it easier to understand the grounds on which the impugned orders are challenged by both the parties.

3. The assessee viz Rolls Royce Singapore Ltd. (hereinafter referred to as the “Singapore Company”) is a company incorporated under the laws of Singapore. The principal activities of the Singapore Company are sale of spares parts for oil field equipment and engines and turbine compressor systems and electronic retrofit projects and services rendered in connection with repair and overhauling of such equipment. The Singapore Company is a non-resident for the tax under the provisions of Income-Tax Act, 1961.

4. The Singapore Company rendered repair and maintenance services and supply spares to customer in India in the Oil and Gas industry. The major clients of the Singapore Company in India include public sector undertakings like ONGC, Gail etc. The largest customer of the Singapore Company in India is ONGC. As per the standard practice adopted by ONGC, before making remittance to foreign suppliers/service provides, ONGC used to obtain a certificate from the tax authorities at Dehradun to apply the appropriate withholding rate and thereafter obtained a “No Objection Certificate”, on the basis of which remittance is made outside India. This practice continued for some time.

5. The assessee filed its return of income for the assessment years 2001-02, 2002-03 and 2003-04 on 31st December, 2003 voluntarily with the Assistant Director of Income Tax, Circle 2 (1), International Taxation, New Delhi. Likewise, for the assessment year 2004-05, the Singapore Company filed return on 14th September, 2004.

6. For all these years in the voluntary Income Tax Return filed by the Singapore Company, it had disclosed Fees for Technical Services (hereinafter referred to as the FTS) income. The returns were processed by issuing notice under Section 143 (2) of the Income-Tax Act (hereinafter referred to as “the Act”) and ultimately different assessment orders were passed making various additions. Summary of the returns filed and income assessed by the Assessing Officer for these years is as under:

Assessment Year	Income declared by the Company	Income assessed by the Assessing Officer
2001-02	Rs. 26,07,430/-	Addition of Rs. 2,36,15,935/- as business income. FTS income assessed at Rs. 96,85,586/-
2002-03	FTS income of Rs. 92,35,097/-	@ 20% under section 115A holding the income at Rs. 33,46,61,049/-.
2003-04	FTS income of Rs. 11,100,491/-	Addition towards business income at Rs. 28,461,672/- and assessing FTS at Rs. 33,868,226/-
2004-05	FTS income of Rs. 17,522,950/-	Addition towards business income at Rs. 86,059,759/- assessing FTS income at Rs. 25,346,740/-.

7. As is clear from the above, the Singapore Company filed voluntary return for the first time starting from assessment year 2001-02. According to the Assessing officer, return for the previous years namely assessment years, 1998-99, 1999-2000, 2000-01 should also have been filed. Notices under Section 148 of the Act for all these three years were accordingly issued pursuant to which the Singapore Company filed its return declaring „Nil“ income for assessment year 1998-99 and 1999-2000. In respect of assessment year 2000-01, return was filed declaring an income of Rs. 280,00,213/-, the Assessing Officer had assessed the income for these years. However, the contention of the Singapore Company was that since it had acquired the energy business from M/s Cameroon Energies Private Limited only in the financial year 1999-2000 (corresponding to assessment year 2000-01), no income was earned by it in the assessment year 1998-99 and 1999-2000. Though, the Assessing Officer did not accept this plea and made the assessment, the CIT (A) granted the relief agreeing with the contention of the Singapore Company and his order has been affirmed by the ITAT as well. Insofar as assessment year 2000-01 is concerned, against the declared income of Rs. 28,00,120/-, the Assessing Officer made addition of Rs. 5,135,140/- towards business income and accepting the FTS income as declared by the Singapore Company.

8. With this, we revert back to the assessment years 2000-01 to 2004-05 which are the subject matter of appeals filed by the Singapore Company. It can be seen from the returns filed by the Company that during this period, the Singapore Company has been offering its service fee income on cash basis as “Fees for Technical Services” under Section 9 (1) (vii) read with Section 115A of the Act, Section 43 (2) and Section 145 of the Act. According to the Company, the income from supplies is not taxable in India on the ground that it does not have any Permanent Establishment in India. This plea was not accepted by the Assessing Officer who held that the Singapore Company had Permanent Establishment (PE) in India and for this purpose income from supplies made by the company is taxed in India as business income. The Assessing Officer while making additions on this account in respect of these assessment years had returned the following findings:

- (i) The appellant has a business connection/PE in India.
- (ii) The supplies and services are intricately and inextricably linked with each other.
- (iii) The AO taxed business profits from supplies by attributing 100% of the profit (and 75% of the profits in AY 2004-05) to the Business connection/PE by applying profit earned by M/s Rolls Royce Plc, an entity incorporated in the UK. However, he accepted the position taken by the appellant that service fees shall be subject to tax at the rate of 20% plus surcharge and cess even though he alleged that services and supplies are inter-

related and they are effectively connected with the business connection/PE.

It would also been seen that the Assessing Officer did not accept the income from FTS as declared by the assessee and made additions thereto. The reason, according to the Assessing Officer, was that the Singapore Company was liable to pay tax from its income from services and supplies on accrual basis.

9. The Singapore Company filed separate appeals for these years which were disposed of by the CIT (A) vide consolidated orders dated 19th April, 2008. Vide this order, the CIT (A) granted partial relief to the Singapore Company in the following manner:—

- a) profits should be attributed to PE in India, for the assessment years 2000-01 and 2001-02, at 10% of net profit, and for 2002-03, 2003-04 and 2004-05 at 25%.
- b) No income is chargeable to tax in the hands of the company during the assessment years 1998-99 and 1999-2000 since it did not earn any income during these periods.

Against the above consolidated order of the Ld. CIT (A), the appellant filed the appeals before the Tribunal. The revenue has also filed appeals against the Ld. CIT (A)'s order in reducing the rate of profit attributable to PE in India in A.Y. 2000-1 to 2004-05.

10. In the appeals filed by the assessee before the Tribunal, the first issue before the Tribunal was as to whether FTS was taxable on accrual basis or on cash basis. The Singapore Company had offered the income „receipt or cash basis“ on the ground that this was the method of accounting followed by it. The Assessing Officer had not accepted the same in respect of assessment year 1998-99 and 1999-2000 holding that the method of accounting of Singapore Company should have been mercantile basis as per the Income Tax Law and the income of the company was accordingly re-casted. Insofar as assessment year 2002-03 and 2004-05 are concerned, the Singapore Company had declared the receipts from Indian companies as FTS and subject it to tax under Section 115 A of the Act. Again, the Assessing Officer held that the Singapore Company was supposed to maintain the accounts on accrual or mercantile basis. This view of the Assessing Officer was affirmed by the CIT (A) and the ITAT has also upheld the same in the impugned order. We may add at this stage itself that this issue does not arise in the present appeals as the decision of the ITAT in this aspect has been accepted by the Singapore Company.

11. The second issue taken up by the ITAT pertained to the validity of Assessing officer's action in initiating the proceedings under Section 147 of the Act in respect of assessment year 1998-99 to 2001-02. We have already pointed out above that in respect of these three years, the assessee /Singapore Company had not filed any return and the returns

were filed after the notices under Section 148 of the Act were issued. The CIT (A) held that reopening of the assessment by invoking the provisions of Section 147 of the Act was valid which is upheld by the ITAT also. Again, this is not the subject matter of the present appeals.

12. The bone of contention in the appeals filed by the Singapore Company are the findings returned by the ITAT on the questions as to whether the Singapore Company had no business connection or Permanent Establishment in India insofar as its business activity of supplying the goods or spare parts to Indian customers is concerned. As already indicated in brief above, the Assessing Officer had held that the assessee is having PE in India and, therefore, the income earned by it from supplying the goods or spare parts to Indian customers was taxable in India. This view has been upheld by the CIT (A) as well as the ITAT. We may now proceed to give some details for forming such a view.

13. As pointed out above, though in the income tax return filed by the Singapore Company it had shown income from maintenance services as Fee for Technical Services (FTS) and paid tax @ 20% thereupon as per the provisions of the Income Tax Act, it had not declared any income for supply of equipments made to the Indian clients on the ground that it had no PE in India and, therefore, its business income from supply of spare parts is not chargeable to tax in India.

14. The AO, on the other hand, was of the view that it was the responsibility of the assessee company flowing from the supply of original equipment supplied by the other companies belonging to Rolls Royce Group, to supply spare parts to the Indian clients, whom the equipments were supplied by the other companies of Rolls Royce Group. In other words, the AO had taken a view that since the assessee company was discharging the contractual obligation of the supplier of the original equipment, providing maintenance services as well as making supply of spares by the assessee company was incidental to the supply of original equipment made by the other company of Rolls Royce Group. The AO had also taken a view that such services and spares cannot be procured by the India customer from any independent party, and it was only the assessee, who could provide such services to the Indian clients. The AO, therefore, had taken a view that the assessee company has business connection and source of income in India in terms of Section 9 (1 (i) of the Act. The A.O. has also taken a view that the assessee company has permanent establishment in India as well. The AO, therefore, held that by reason of existence of business connection and source of income and permanent establishment in India, the assessee is liable to pay tax in respect of income earned on supply of spares as business profit. It was further observed by the AO that assessee has an executive agent in India in the form of ANR, whose only source of income in India is from the assessee, and M/s ANR was responsible to the assessee and was not doing any activities other than what were directed by the assessee. The AO,

therefore, had taken a view that the assessee has a business connection or PE in India in the form of ANR.

15. The AO further stated that the income of the assessee from maintenance services accrues or arise in India by deploying engineers and personnel for undertaking maintenance of the equipment at the sites of the Indian clients located in India, and the maintenance activities cannot be isolated from the supply of spares. He further observed that supply of spares and services or maintenance of the equipments are inextricably linked to each other as the service engineers would certainly required spares parts to be replaced or overhauled.

16. The AO further stated that the assessee company has placed one Mr. Venketaramana as Exclusive Regional Sales Manager in India and, thus, income of the assessee from supply of spares accrue or arise in India from the activities of its Sales manager as well.

17. The CIT (A) agreed with the A.O's view. In the light of various points raised by the A.O. the CIT (A) held that the assessee company has a PE in India on following counts:-

- (i) That the assessee has a source of income in India;
- (ii) That the assessee has established a complete set up of facility for providing services to the customers, during the whole year; and those services and facilities were provided in respect of the original equipment supplied by some other who are related/associated concern of the assessee for a period of more than 30 days.
- (iii) That office of the ANR was used for receiving and soliciting orders;
- (iv) M/s ANR is a dependent agent permanent establishment of assessee.

18. In other words, the CIT (A) took a view that the Singapore company has a permanent establishment in India within the meaning of Article 5 (1), 5(2) (f), 5 (2) (i), 5 (5), 5(6) and 5(8) of the DTAA.

19. In the appeals filed by the Singapore Company against the aforesaid findings of the CIT (A), it was submitted that ANR Associates private Ltd. (ANR) was an independent entity and was not related to the Singapore Company at all; ANR had various other clients from where it was earning the revenue and the appellant was the sole customer; ANR did not have the power to negotiate and conclude the contracts on behalf of the Singapore Company and the transactions between the ANR and the Singapore Company were on principal to principal basis. Therefore, ANR could not be treated as an independent agent, or Permanent Establishment of the Singapore Company. In any case, even if ANR presumed to be the PE of the Singapore Company, fee of US \$ 40,000/- per annum paid by the Singapore Company to ANR was Arms Length

Price (ALP). The said fee was already taxed at the hands of the ANR and, therefore, having regard to the provisions of the Double Taxation Avoidance Agreement (DTAA), there was no question of taxing any income at the hands of the Singapore Company in respect of supplies made by it to Indian customers.

20. We would like to point out at this stage that on multiple grounds, the Assessing Officer and the CIT (A) had held that the Singapore Company had PE in India. Many of these grounds have not been accepted by the Tribunal. It has given detailed reasons for knocking out the various basis adopted by the Assessing Officer for forming the opinion that the assessee had PE in India. For example, the ITAT has not accepted that merely because the Singapore Company is a part of a Group Company of Rolls Royce which has world wide operation, because of other operations of the Group Companies, the Singapore Company shall be deemed to have PE in India. According to ITAT the Singapore Company, like each company belonging to Rolls Royce Group is a separate entity and a separate tax assessee. Likewise, merely because some income has accrued to the Singapore Company in India from deployment of Engineers and personnel in undertaking the maintenance and service of equipments at the sites of Indian clients located in India is not ground to hold that it has PE in India. In the absence of any material showing and indicating that the contract for providing service and supplying spare parts are inter-connected and related. Similarly, findings of the Assessing Officer that Singapore Company shall be deemed to have Permanent Establishment in India to carry on the business through PE as it has been providing service facility in India for a period of 183 days in a fiscal year to ONGC and GAIL in connection with their activity of exploration, exploitation or extraction of material oil in India has been upset and turned down by the Tribunal holding that no material has been brought on record to prove and establish the same.

21. In fact, the only reason given by the Assessing Officer, accepted by the CIT (A) and affirmed by the ITAT for holding that the Singapore Company has PE in India is premised on the relationship between the Singapore Company with ANR, which makes the ANR as the PE of Singapore Company within the meaning of Article 5 (1) and 5 (2) of DTAA between India and the Singapore, is that the said ANR is a dependent agent of the Singapore Company within the meaning of Article 5 (8) read with Article 8 and 9 of DTAA.

22. We would like to point out here that the Assessing Officer as well as the CIT (A) had *inter alia*, held that the activities of ANR are much more than those provided for in the contract entered into between the Singapore Company and ANR. The Assessing Officer had recorded in its order that the Singapore Company had paid the commission of 5% of the contract value to ANR over and above, the US\$ 40,000/- per annum payable under the written contract made with ANR. This finding has not

been accepted by the ITAT. It concluded that the Singapore Company paid commission @ 5% of sales value to ANR before the written agreement was entered into on and from 1.1.2002. From the date of agreement, instead of paying commission @ 5% of the total invoice value, a lump-sum commission of US\$ 40,000/- was paid to ANR. There was no evidence to hold that in addition to this US\$ 40,000/- the Singapore Company was paying commission @ 5% on sale as well and claim of the Revenue that activities of ANR are much more than what is provided for in the agreement has also held to be wrong and was rejected.

23. After holding so, the Tribunal proceeded to discuss the question as to whether in the light of nature of activities carried out by the ANR as per the agreement, the Singapore Company can be said to have a PE in India in the form of ANR. The Tribunal after extracting the terms of the agreement as to the nature of the services to be provided by ANR to the Singapore Company and terms relating to "Limitation and Restrictions", "Representations and warranties of ANR", "Confidentiality" etc. in the light of provisions of DTAA held that relationship between the Singapore Company and ANR was not on principal to principal basis. Instead, the ANR acted as a dependent agent of Singapore Company and its activities were controlled by the Singapore Company. The ANR was, therefore, could not be regarded as an agent of an independent status within the meaning of Article 5 (9) of DTAA. For arriving at this conclusion, the Tribunal has, *inter alia*, recorded the following findings:-

- (1) Activity of ANR Associates during the period from 1.1.2002 was more or less similar what has been stipulated in the written agreement dated 1.1.2002, except the amount and basis of payment of commission/ remuneration to ANR.
- (2) The purpose of entering into agreement or understanding that ANR was the replacement of Singapore Company to have certain in-country support services in relation to the promotion and supporting its project in India. ANR was chosen since it has the infrastructure in India to provide such services.
- (3) ANR was to provide services in relation to promoting and supporting the sale of „projects“ in India. The expression “products” has been deleted in the Schedule A to the agreement which has two sections. Section-I is with regard to new unit products used by oil and gas industries and Section-2 is with regard to the customers service products under oil and gas industry.
- (4) Clause 8.2 of the Agreement imposed certain limitations and restrictions upon ANR with stipulation that it shall Act exclusively for the assessee in relation to the promotion of its product and shall not directly or indirectly assist any other person, the firm or company competing with the assessee or

shall not advise or represent or be concerned with or interested in the business of any such person, firm or any company in India.

24. Thus, ANR was prohibited from promoting identical products of any such person, firm or company competing with the firm of assessee. These unusual restrictions imposed upon the ANR would suggest that ANR never intended to work as an independent agent in its ordinary course of business. Reading the agreement as a whole would suggest that ANR was a Singapore Company exclusively in respect of nature of products mention in Schedule A of the agreement. Thus, this would suggest that ANR was not acting in the independent status and in the ordinary course of their business while rendering to the assessee in-country support services of the nature described in condition 3 of the agreement in relation to promote and supporting the sale of products in India.

25. As per Clause 5 of the agreement, ANR was supposed to take instructions and advice from, and make the services available to the Singapore Company through Mr. Sudhir Mayor for the products identified in Section 1 of Schedule-A and Mr. Dave Klug for products identified in Section-2 of Schedule A or other nominees. Agreement also provided that Mr. Robert Turner will only liaison on behalf of the Singapore Company.

26. Thus, the ANR's activities was subject to close supervision of the Singapore Company as it was to report to take instructions and advice from and make the services available to Singapore Company through Mr. Sudhir, Mr. Dave and Mr. Robert Turner. Consequently, ANR has to perform its services under the exclusive control and detail instructions of the Singapore Company which goes to suggest lack of legal independents on the part of ANR.

27. According to the ITAT, the ANR was the sole agent of the Singapore Company and it was "almost wholly" earning from Singapore Company. Likewise, the Singapore Company was the client of ANR. This conclusion was drawn from the circumstances that though it was stated that the ANR was providing services to other companies and was earning commission from them, the extent of service rendered by ANR and the amount of commission had not been disclosed. Only a certificate was given by ANR by rendering services and earnings commission from other companies which were not sufficient to prove and establish that ANR was not getting "almost wholly" on behalf of the Singapore Company. The effect and difficulties about the services rendered and commission earned from other companies was within the knowledge of the ANR but the Singapore Company has chosen not to collect this information and given to the authorities, therefore, adverse inference was to be necessarily drawn when Singapore Company has failed to furnish any such documents as requested by the Assessing Officer.

28. Even the commission of US\$ 40,000 per annum paid by the Singapore Company to ANR was not at arm's length payable to the agent had not termed with reference to the value of foreign products sold in the relevant year. Prior to 1.1.2002, commission was being paid @ 5% of invoice value, which had now been changed to lump-sum amount of US\$ 40,000/- payable annually. This sort fixation of remuneration is usually not done between two independent parties in any uncontrolled transaction. The remuneration payable, therefore, seems to be in the nature of transaction controlled by the Singapore Company and cannot be considered to be made on arm's length. More so, when Singapore Company had not furnished any instance of transaction entered into between the two independent parties in uncontrolled manner in support of its contention that remuneration of lump-sum amount of US\$ 40,000/- was determined at arm's length.

29. On the basis of the aforesaid findings the ITAT has summarised the activities of ANR in connection with the Singapore Company as under:

- “(i) That ANR is maintaining premises in India to carry out its obligation as an agent of the assessee company.
- (ii) ANR exclusively or almost wholly carries out the business on behalf of the assessee at their premises in India.
- (iii) The activities of ANR includes promotion of products of the assessee, maintaining relationship with customers and potential customers of the assessee with regard to their equipments need.
- (iv) Making liaison with operators of equipments, which has been sold to oil and gas industry.
- (v) Making customers aware of suitable products sold by the assessee company.
- (vi) Arrangements of sales presentation and demonstration for assessee's customers.
- (vii) Assisting assessee in creating technical and commercial environment about its products required in oil and gas industry in India.
- (viii) Providing logistic services to the assessee.

All these activities have been provided by ANR to the assessee in India from its fixed place of business maintained in India. This makes it clear that ANR or its offices are used by the assessee company for soliciting order by performing the activities or services mentioned in para 3 and 4 of the agreement. It also makes it clear that ANR is acting almost exclusively for assessee in relation to promotion of assessee's products in India.

Therefore, in the light of the aforesaid factors discussed and pointed out by us, that is, (i) that ANR was not acting in its ordinary course of business while acting for the assessee to provide services as per agreement dated 01.01.2002, and (ii) an extensive control was being exercised by the assessee upon, ANR who was bound to take instructions and advice from the assessee or its representative and (iii) that assessee has been rendering services almost wholly for the assessee, and (iv) and the transaction between them is not at Arm's length, we hold that ANR is not an independent agent within the meaning of para (9) of the Article 5 of DTAA between India and Singapore."

30. On this basis, the ITAT concluded that Singapore Company had Permanent Establishment in India within the meaning of Article 5 (1) of DTAA through its dependent agent ANR. The Tribunal has also held that even in terms of Article 5 (8), Article 5 (9) of the DTAA, ANR would be deemed to be the "Permanent Establishment" in India. This position is discussed in para 98 of the impugned order which reads as under:

"In the instant case, it is an admitted position that clause (a) and (b) of para (8) of Article 5 does not apply inasmuch as there is no material or evidence brought on record to show and establish that the ANR habitually exercised an authority to conclude contracts on behalf of the assessee company in India or ANR habitually maintained in India a stock of goods or merchandise from which it regularly delivers goods or merchandise on behalf of the assessee company. However, having regard to the fact that ANR has been rendering services to negotiate and secured orders in India since long it can be said that ANR associates habitually secured orders in India wholly or almost wholly for the assessee company. This would be established from the very fact that prior to 01.01.2002, the assessee used to get commission at the rate of 5% of invoice value and that commission was deducted by ONGC from invoice value payable to assessee company and then paid to ANR. In other words, a role played by ANR in securing orders from ONGC on a consideration of % of invoice value was even recognized by the assessee's customer, namely, ONGC. The payment of 5% of commission of sale value is substantial amount having regard to the over all net profit of about 12 to 14% earned by the assessee from supply of spares. The agent ANR had a relation or connection with ONGC with regard to contract of supply of spares by assessee company is well established from the fact that even the commission payable to ANR was directly deducted by ONGC from sale value and then paid to ANR. Further, the very fact that remuneration for the services by ANR to assessee company in any year has been fixed at a fixed fee of US\$ 40000 from 01.01.2002 also suggest that ANR was

dependent agent as he agree to remuneration at a fix amount of US\$ 40000 as against earlier arrangement of payment of specific percentage of sale value of items or products sold by assessee company to Indian clients. The nature of overall services rendered by ANR to assessee company as described in clause 3, 4, and 5 read with clause 8,9 and 10 relating to limitations and restrictions, representations and warranties of ANR and confidentiality would show that ANR was instrumental in securing orders in India for the assessee company and was acting at the instructions of assessee company. Therefore, ANR shall be deemed to be agency PE in India within the meaning of para (8) and (9) of Article 5 of the Treaty.”

31. After giving the aforesaid findings, the Tribunal proceeded to determine the income that would be chargeable to tax in the hands of Singapore Company in India from the business activity of the sale of spare parts in view of Article 7 of the DTAA which provides that “so much of the profit as is attributable to PE in India can be taxed in India”. As lump-sum commission of US\$ 40,000 was not treated at arm’s length, the Tribunal went into the issue of percentage of the income and arrived at a conclusion that the amount of profit attributable to PE at 10%, as determined by CIT (A) would be proper as against the Assessing Officer’s view that it should be 25%. As a result, the order of the CIT (A) on this aspect has been sustained and appeals filed by the Revenue for increase of the profits from 10% to 25% have been dismissed.

32. In the appeals filed by the Singapore Company, the appellant has confined its challenge to the findings of the ITAT that ANR is a Permanent Establishment of Singapore Company in India as per Article 5 (9) of the DTAA between India and Singapore.

33. In the alternative, it is also argued that order of the Tribunal is also questioned where it is held that the lump-sum commission of US\$ 40,000 per annum is not at arm’s length and fixing 10% of the profits on sales of the spare parts made in India by the Singapore Company is to be carried out by ANR in India and chargeable to tax in India.

34. These appeals were admitted on as many as seven substantial questions of law reproduced below:–

- a. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant has a business connection in India?
- b. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the Appellant has a Permanent Establishment in India as per Article 5 of the DTAA between India and Singapore?
- c. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant partly carried on a

business in India through the premises of ANR under Article 5 (1) of the DTAA between India and Singapore?

- d. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that the appellant should be regarded as having a permanent establishment by way of premises used as a sales outlet or for soliciting and receiving orders in India under Article 5 (2) (i) of the DTAA between India and Singapore?
- e. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that ANR should be regarded as a Dependent Agent Permanent Establishment of the Appellant under the Article 5 (8) of the DTAA between India and Singapore on the premise that ANR habitually secures orders wholly and mainly on behalf of the appellant?
- f. Whether in the facts and circumstances of the case, the ITAT grossly erred in concluding that ANR has not been compensated at arm's length price, without adequate basis to arrive at such a conclusion?
- g. Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that 10 percent of the profits on sales of spare parts made in India by the Appellant should be attributable to the activities carried out by ANR in India and should be chargeable to tax in India under the Act?."

35. However, focus of learned counsel for the appellant remained on the aforesaid two aspects viz question of law at 'e' and 'f'. Infact, Mr. Ganesh, learned Senior Counsel appearing for the appellant submitted that the issue of arm's length price be decided first because of the reason that if it is held that the payment of aforesaid commission to the ANR was at arm's length, the issue as to whether the Singapore Company acted through ANR as its PE in India or not would be rendered academic. He thus, opened his arguments on the alternate issue of ALP and in fact entire emphasis of Mr. Ganesh was to convince this Court that the commission payable was at ALP.

36. In view of the aforesaid approach of the learned counsel for the appellant limiting scope of its challenge to the ITAT order, we proceed on the basis that the assessee has business connection in India through ANR. It is also an admitted fact that ANR is an agent of the assessee India. In these circumstances, we answer questions of law no. 'a' to 'd' in favour of the Revenue and against the assessee.

37. In this backdrop, the only two issues that need to be decided are:-

- (i) Status of ANR – Whether dependent agent within the meaning of Article 5 (8) of DTAA.
- (ii) The payment of US\$ 40,000 per annum made by the assessee to the ANR can be treated as ALP.

38. On this, questions of law 'e' and 'f' are formulated. If answer to any of these questions is in favour of the assessee, then no further discussion is needed. However, if these questions are decided against the assessee then the last question would be as to whether 10% of the profits of sales on spare parts made in India held as exigible to tax by the ITAT is wrong. We may again point out here that the Assessing Officer had attributed 25% of profits on sales of spare parts to the activities carried out by the ANR as chargeable to tax which was reduced to 10% by the CIT (A). The Revenue has also filed appeals challenging this part of the order of the Tribunal as Revenue claims that order of the Assessing Officer fixing 25% profits on sales on spare parts was proper and valid. Therefore, while discussing the question of law no. 'g', appeals of the Revenue shall also be taken into consideration.

Question of Law-'e'

“Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that ANR should be regarded as a Dependent Agent Permanent Establishment of the Appellant under the Article 5 (8) of the DTAA between India and Singapore on the premise that ANR habitually secures orders wholly and mainly on behalf of the appellant?”

39. This question becomes relevant having regard to the provisions of Article 5 of the DTAA between India and Singapore, the relevant provisions of this Article is as under:-

ARTICLE 5 – Permanent Establishment

1. For the purpose 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:-
 - (a)
 - (b)
 - (c)
 - (d)
 - (e)
 - (f)
 - (g)
 - (h)
 - (i) A premises used as a sales outlet or for soliciting and receiving orders;
 - (j)
- 3

- 4
- 5
- 6
- 7

8. Notwithstanding the provisions of paragraph 1 and 2 , where a person – other than an agent of an independent status to whom paragraph 9 applies – is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if–
 - (a) he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise;
 - (b) he has no such authority but habitually maintains in the first-mentioned State a Stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or
 - (c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprise controlling, controlled by, or subject to the same common control, as that enterprise,
9. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State **merely because it carries on business in that other State through a broker**, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are **devoted wholly or almost wholly on behalf of that enterprise** itself or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.

40. The endeavour of the assessee is to demonstrate that ANR is an agent of an independent status and, therefore, paragraph-8 of this Article have no application. Additionally, it was also argued that ANR had not undertaken any of the activities specified in said paras 8 (a) to (c) of para 8 of Article 5 and for this reason also, this para have no application. It was further argued that the activities of ANR as an agent were not devoted wholly or almost wholly on behalf of the assessee and thus conditions stipulated in para 9 of Article 5 are not fulfilled and on this

reckoning also ANR would not be considered as an agent of independent status within the meaning of said para.

41. We have already taken note of the reasons which are given by the Tribunal in support of its findings that provisions of para 8 & 9 of Article 5 stand attracted in the instant case.

42. His submission was that the Tribunal had given two reasons for drawing the conclusion which were totally immaterial having regard to the provisions of Article 5 (9). In this behalf, he referred to the following discussion in the Tribunal's order containing these reasons:

- (1) The Tribunal had held that ANR was prohibited from taking competitive products. In the agreement, certain limitation and restriction has also been imposed upon ANR vide condition 8.2 that ANR associates shall act exclusively for assessee in relation to the promotion of its product and shall not directly or indirectly assist any other person, the firm or company competing with assessee or shall not advise or represent or be concerned with or interested in the business of any such person, firm or company in India. In other words, in respect of the products mentioned in Section 1 and 2 of Schedule-A, ANR was restricted to assist directly or indirectly any other person, firm or company competing with the assessee or directly or indirectly advise or represent or be concerned with or interested in the business of any other person, firm or company in India competing with assessee. It is, thus, clear that ANR was prohibiting from promoting the identical products of any other person, firm, or company competing with assessee. This unusual restriction imposed upon ANR would suggest that ANR never intended to act as an independent agent in the ordinary course of its business. Reading the agreement as a whole would suggest that ANR has been rendering services to assessee company exclusively in respect of the nature of the products mentioned in Schedule A of the agreement, and has been restrained or prohibited from assisting, advising or representing any other person, firm or company competing with the assessee in the same line of business. This sort of restriction and limitation imposed upon ANR associates would suggest that ANR associates was not acting in the independent status and in the ordinary course of their business while rendering to the assessee in-country support services of the nature described in condition No.3 and 4 of the agreement in relation to promote and supporting the sale of products in India, details of products being described in Schedule-A of the agreement. Therefore, on this count, ANR cannot be regarded as an agent of an independent status within the meaning of para (9) of Article 5 of DTAA between India and the Singapore. Further, para (9) of

Article 5 provides that when the activities of an agent of an independent status acting in the ordinary course of his business are devoted wholly or almost wholly on behalf of the enterprise itself or on behalf of that enterprise and other enterprises controlling, controlled, by, or subject same control, as that enterprise, he will not be considered an agent of an independent status within the meaning of para (9) of Article 5 of DTAA.

- (2) The Tribunal also held that the assessee exercised extensive control over ANR as for various actions, the ANR was supposed to take instructions and advice from the representatives of the assessee. The discussion of the Tribunal in this behalf is reproduced as under:-

“It is pertinent to note that Clause-5 of the agreement dated 01.01.2002 between the assessee and ANR provides that ANR shall report to, take instructions and advice from, and make the services available to the assessee through Mr. Sudhir Mayor for the products identified in section 1 of Schedule A and Mr. Dave Klug for the products identified in section 2 of Schedule A, or their nominees. Mr. Robert Turner will handle liaison on all administrative aspects of this agreement on behalf of company. The assessee may change the person or persons nominated under this clause at any time by notice in writing to ANR. Further clause 8.2 of the said agreement provides that ANR shall act exclusively for the assessee in relation to the promotion of its products and shall not directly or indirectly assist any other person, firm or company competing with the assessee company or advise or represent or be concerned with or interested in the business of any such person, firm or company in India. This clause makes it clear that ANR is prohibited and restrained from handling identical products or goods for principal. As per the condition enumerated in clause -5 of the agreement, it is clear that his activities are subject to close supervision of the assessee company as in the said clause it has been provided that ANR shall report to, take instructions and advice from, and make the services available to the assessee through Mr. Sudhir Mayor for the products identified in section 1 of Schedule A and Mr. Dave Klug for the products identified in Section 2 of Schedule A, or their nominees, and Mr. Robert Turner will handle liaison on all administrative aspects of this agreement on behalf of company. The assessee may change the person or persons nominated under this clause at any time by notice in writing to ANR. This makes it clear that ANR has to perform his services under the extensive control and detailed instructions of the assessee

company, which goes to suggest a lack of legal independence on the part of the ANR. Furthermore, the stipulations about representations and warranties of ANR and confidentiality, which has already been reproduced above, also indicate an extensive control exercised by the assessee company over ANR while ANR was acting for the assessee.”

43. Mr. Ganesh, learned Senior Counsel appearing for the assessee rebutted those reasons by arguing that ANR was already an existing company and was not created by the assessee. The said ANR had its own infrastructure and its own business etc. before it entered into the agreement with the assessee. He submitted that Article 5 (9) was self-working and highly evolved provision and only those conditions mentioned therein was to be seen. According to him, the Tribunal committed fundamental error of law by giving its own reasons which were irrelevant in the context of Article 5 (9).

44. We are not impressed by that part of the submission of Mr. Ganesh where he argues that the Tribunal has taken into consideration those aspects which are not relevant for the purposes of Article 5 (9). As is clear from the extracted portion of the Tribunal’s order, that the focus of the Tribunal was entirely on Article 5 (9) and it was discussing as to whether the activities of ANR was devoted wholly or almost wholly on behalf of the assessee and further as to whether the assessee was exercising extensive control over the ANR. These very criteria are laid down in Article 5 (9) for the purposes of determining as to whether such an agent of independent status or not.

45. It would, however, be a different question as to whether the reasons given by the Tribunal are sufficient to hold that the criteria stipulated in Article 5 (9) treating ANR as dependent agent are satisfied. Coming to this aspect, the argument of Mr. Ganesh was that merely because ANR was prohibited from taking a competitive products would not mean that it was an agent of independent status. What was to be seen was that the „activities“ of ANR are devoted wholly or almost wholly on behalf of the assessee. According to Mr. Ganesh, ANR had many other activities and was doing business for many other parties. Agency of the assessee held by ANR was only one of those many activities. This contention of the assessee is not accepted by the Tribunal as according to the Tribunal the assessee had not stated as to the extent of services rendered by ANR to other companies as well as the amount of commission earned by ANR from them. The particulars of other clients and commission earned by ANR from them was within the knowledge of ANR but the assessee did not chose to collect the same and provide it to the Assessing Officer. The Tribunal further observed that the assessee failed to furnish all such details on requisition by the Assessing Officer. It was disputed by the learned counsel for the assessee that there was no such requisition made and the assessee was never asked to furnish such

information. The fact remains that it was the contention of the assessee that the assessee was not the sole client of ANR and that activities of ANR were not devoted wholly or almost wholly on behalf of the assessee. The assessee produced a communication dated 18th January, 2007 addressed to it by ANR conforming that ANR had rendered services and had earned commission from companies other than the assessee during the final year 2003-04 and that the assessee was not the only source of income during the year. After this letter was produced, the Assessing Officer did not ask for further information. The learned counsel for the Revenue could not show anything to the contrary or dispute the fact that the Tribunal has gone on the wrong premise that the assessee failed to furnish all such details even after requisitioned by the Assessing Officer. It could not be denied that there was no such requisition made and the assessee was never asked to furnish any such information. On this wrong premise, the Tribunal has arrived at wrong conclusion.

46. We may record here that Mr. Ganesh produced the Income-Tax Returns of M/s ANR for certain relevant years which show that ANR had been rendering services to other companies as well from where it had been earning commission and the commission earned from the assessee was not the only source of income during the year. We do not want to comment more. The question whether ANR has income from other clients as well and the extent of such income is very relevant to decide as to whether the criteria stipulated in Article 5(9) is satisfied or not. Since the Assessing Officer did not look into the matter from this angle and the ITAT also disposed of the issue deciding against the assessee on wrong premise, we are of the opinion that for this limited issue matter needs to be remanded back to the Assessing Officer. The Assessing Officer shall decide the question of applicability of Article 5 (9) as to whether the ANR was providing services to companies other than the assessee as well and had substantial income from those other companies and whether the company stipulated in Article 5 (9) namely ANR was wholly or almost wholly working on behalf of the assessee will have to be determined afresh by the Assessing Officer.

47. The assessee is permitted to file the evidence in the form of Income Tax Return or otherwise on this issue. We may, however, make it clear that onus would be on the assessee to show that ANR had been rendering services and earning commission from other companies on the basis of which it cannot be said that the ANR devoted wholly or almost wholly on behalf of the assessee. These matters are thus remanded back to the Assessing Officer for fresh adjudication.

Question of Law – ‘f’

Whether in the facts and circumstances of the case, the ITAT grossly erred in concluding that ANR has not been compensated at arm's length price, without adequate basis to arrive at such a conclusion?

48. The submission of the assessee in this behalf is that even if the ANR is to be treated as PE of the assessee company in India as per Article 7 (2), only that income is to be treated as business profits which is reasonably attributed to the Permanent Establishment namely the profits which Permanent Establishment might be accepted to make if it were a distinct and separate enterprise. It was argued that the remuneration of US\$40,000 per annum paid by the assessee to ANR could be treated as the profit on reasonable basis. It was argued that the question of ALP could arise only there was a connection between the two. Even if the ANR was PE of the assessee as that had no bearing on the fixation of the price i.e. commission agreed to between the parties. Stress was laid down to the fact that there was no way the assessee could dictate the commission to be charged by ANR. ANR was negotiating at third party in the market place and, therefore, sum of US\$ 40,000 agreed to between the parties which was payable by the assessee to ANR was at arm's length and could be treated as reasonable. In support of his submission, he relied upon the judgment of the Supreme Court in the case of *DIT (International Taxation) Vs. Morgan Stanley and Co. Inc.* (2007) 292 ITR 416 (SC) and specifically referred to paras 29,31 and 32 of the said judgment which reads as under:

- “29. As regards determination of profits attributable to a PE in India (MSAS) is concerned on the basis of arm's length principle we have quoted Article 7(2) of the DTAA. According to the AAR where there is an international transaction under which a non-resident compensates a PE at arm's length price, no further profits would be attributable in India. In this connection, the AAR has relied upon Circular No. 23 of 1969 issued by CBDT as well as Circular No. 5 of 2004 also issued by CBDT. This is the key question which arises for determination in these civil appeals.
31. Article 7 of the U.N. Model Convention inter alia provides that only that portion of business profits is taxable in the source country which is attributable to the PE. It specifies how such business profits should be ascertained. Under the said Article, a PE is treated as if it is an independent enterprise (profit center) de hors the head office and which deals with the head office at arm's length. Therefore, its profits are determined on the basis as if it is an independent enterprise. The profits of the PE are determined on the basis of what an independent enterprise under similar circumstances might be expected to derive on its own. Article 7(2) of the U.N. Model Convention advocates the arm's length approach for attribution of profits to a PE.
32. The object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2) not all profits of MSCO would be taxable in India but only those which have economic nexus with PE in India. A foreign enterprise is

liable to be taxed in India on so much of its business profit as is attributable to the PE in India. The quantum of taxable income is to be determined in accordance with the provisions of I.T. Act. All provisions of I.T. Act are applicable, including provisions relating to depreciation, investment losses, deductible expenses, carry-forward and set-off losses etc. However, deviations are made by DTAA in cases of royalty, interest etc. Such deviations are also made under the I.T. Act (for example: Sections 44BB, 44BBA etc.). Under the impugned ruling delivered by the AAR, remuneration to MSAS was justified by a transfer pricing analysis and, therefore, no further income could be attributed to the PE (MSAS). In other words, the said ruling equates an arm's length analysis (ALA) with attribution of profits. It holds that once a transfer pricing analysis is undertaken; there is no further need to attribute profits to a PE. The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to the PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporate on the basis of the concept of Economic Nexus is an important feature of Attributable Profits (profits attributable to the PE).”

49. He also referred to the judgment of the Bombay High Court in *Set Sattellite (Singapore) PTE Ltd. Vs. Deputy Director of Income-Tax, International Taxation and another* (2008) 307 ITR 205 (Bom) wherein the Court held that when an agent in India was taxed on the fare value of activities in India, the same could not be taxed all over again in the hands of the assessee as being income attributable to deem permanent establishment. This very Treaty between Singapore and India was interpreted in the following manner:

“From a reading of Article 7(1) of the DTAA it is clear that 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. 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. In para.2 while determining the profits attributable to the permanent establishment the expression used is “estimated on a reasonable basis”. The DTAA does not refer to arms length payment. The principles contained in the matter of income from international transaction on an arms length price are contained in Section 92 of the Income Tax Act. The principles have been clarified by the Finance Act, 2001 as also Finance Act, 2002. From the order of the C.I.T. which has been accepted it is clear that the Appellant herein has paid to its P.E. on arms length principle.”

50. There is no quarrel if it is a fair price paid by the assessee to ANR for the activities of the assessee in India through its PE namely ANR and the said price i.e. US\$ 40,000 per annum has already been taxed in India at the hands of ANR, then no question of taxing the assessee again would arise. However, on the facts of this case, we are of the opinion that Mr. Sabharwal, learned counsel for the Revenue rightly argued that the judgment of Supreme Court in *Morgan Stanley & Co. and Bombay High Court in Set Satellite (Singapore) PTE Ltd. Vs. Deputy Director of Income-Tax, International Taxation and another* (supra) would not apply to the facts of this case. In *Morgan Stanley*, the Supreme Court accepted the payment as reasonable and fulfilling the ALP criteria only because the remuneration paid to the agent in India was justified by a Transfer Pricing Analysis. This Transfer Prices Analysis (TPA) is to be undertaken by invoking the provisions of Section 92 of the Act. Similar was the position in *Set Satellite* (supra) No such exercise is done in the instant case. The entire thrust of Mr. Ganesh was that ANR was a third party and had negotiated and could not be dictated by the assessee insofar as commission paid by the assessee to ANR is concerned. This argument may look attractive when considered in isolation. However, the surrounding facts and circumstances under which the aforesaid commission came to be fixed would negative the submission of Mr. Ganesh. The agreement in question under which aforesaid commission of US\$ 40,000 per annum was fixed, was dated 1st January, 2002 made effective from that date. Prior to this agreement executed between the parties in writing, the arrangement between the assessee and ANR profit for 5% commission of invoice value by the assessee to ANR on the sales. The Tribunal thus held that this sort fixation of remuneration is usually not done between two independent parties in any uncontrolled transaction. The remuneration payable, therefore, seems to be in the nature of transaction controlled by the Singapore Company and cannot be considered to be made on arm’s length. More so, when Singapore Company had not furnished any instance of transaction entered into between the two independent parties in uncontrolled manner in support of its contention that remuneration of lump-sum amount of US\$ 40,000/- was determined at arm’s length.

51. From the aforesaid it is clear that the assessee could dictate the terms of the payment by altering the same and reducing it to the US\$ 40,000 per annum from 5% of invoice value when assessee found that on the basis of 5% total commission payable could be much higher. This clearly leads to the inference that the assessee was in a position to dictate the terms and in the absence of any Transfer Pricing Analysis by the Transfer Pricing Officer in the instant case, it cannot be said that such commission could fit the description of “reasonable profits” within the meaning of Article 7 (2) of DTAA.

52. FAR formally takes into consideration the Functions, Assets used and Risk involved. Thus to find out whether the agent is remunerative at arm’s length, it is necessary to take into account all the risk taking function of the multi-national enterprise. If all the risk taking functions of the enterprise have not been taken into account, there would be a need to attribute profits to the PE for those functions/risks of the dependent agent that have not been considered. In the absence of such an exercise and any material on record on these aspects, we are of the opinion that the assessee has not been able to establish that the remuneration paid to ANR was equal to arm’s length remuneration. We are of the opinion that the Assessing Officer in his order has rightly pointed out that the Supreme Court has referred to the “functions performed only the risk assumed by the enterprise” as distinguished from the functions performed and the risk assumed by the agent (who may constitute a dependent agent PE). The Assessing Officer has also quoted Rule 10B (2) of the Income-Tax Act which provides that uncontrolled transaction shall be judged with reference to following:–

- (a)
- (b) the functions performed, taking into account assets employed or to be Employed and the risk assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transaction which lay down explicitly or implicitly how the responsibility, risks are benefits are to be divided between the respective parties to the transactions;
- (d)

53. No such exercise is undertaken in the present case. Further, it also needs to be highlighted that no plausible or justifiable reason is coming forthwith for changing the commission from 5% of the invoice value to US\$40,000 per annum.

54. We thus, are quite in agreement with the conclusion of the Tribunal on this aspect and answer this question in the negative i.e. in favour of the Revenue and against the assessee.

Question of Law 'g'

“Whether in the facts and circumstances of the case, the ITAT grossly erred in holding that 10 percent of the profits on sales of spare parts made in India by the Appellant should be attributable to the activities carried out by ANR in India and should be chargeable to tax in India under the Act?”

55. Once we hold that commission of US\$40,000 per annum does not represent the ALP, it is difficult to find fault in the order of the CIT (A) as well as ITAT fixing 10% of the invoice value for the purpose of taxation, inasmuch as the test is “profits accepted to make”. The CIT (A) has pointed out in this behalf that the performance of ANR is to render support service in relation to promotion of sale and the products of the assessee in India and it has no authority negotiate, accept any order or make or vary any contract or to make any warranty or representation in terms of paragraph 8.1 of the Agreement. Therefore, the risk assumed by the ANR is limited. Even otherwise, it has not come on record that ANR has performed or assumed responsibility for anything beyond what is written in the agreement. ANR is performing the functions of promoting the sale, soliciting orders and those proceed relatable to market activity within India has to be attributable to the part played by the PE. On this account, very significant aspect noted by the two authorities below is that details of business transactions obtained from ONGC under Section 131 of the Act, in the form of various documents supplied by ONGC revealed that supplies constitute the major part of the business. Therefore, the income with respect to the supplies was to be computed in terms of Article 7 of DTAA and not under Article 12. This was the reason that the CIT (A) reduced the percentage from 25% to 10%. For this purpose, the CIT (A) referred to the judgment of Bombay Tribunal in the case of *Ingersoll Rand Company Vs. ITO* 4 ITD 654 (Bom.) The ITAT while agreeing with the aforesaid view of CIT (A) additionally referred to the judgment of the Supreme Court in *Annamali timber Trust Co. Vs. CIT* 41 ITR 781 (SC) wherein it is held that there was justification only of apportionment of 10% of assessee’s share of profit of the trading operations carried out in India when except entering into contract in taxable territory all other operations were carried out outside taxable territory. The CIT (A), however, held the view that attribution of income at the rate of 10% will not represent adequate attribution to all activities including services being performed in India by ANR. Thus, while restricting the attribution to 10% in respect of supplies, insofar as assessment year 2002-03, 2003-04 and 2004-05 are concerned, the CIT (A) maintained the attribution of income @ 25% of the profits.

56. We are agree with the following conclusion of the ITAT:–

“The order of the CIT (A) in applying the rate of 10% of the profit attributable to PE in India is, thus, upheld, which would be applied for all the assessment years under consideration. In

other words, the CIT (A)'s order in applying the rate of 25% of the profit being allocated to PE in India in assessment years 2002-03, 2003-04 and 2004-05 has been reduced to 10% and the AO is, therefore, directed to compute the profit accordingly."

57. The issue is accordingly answered and, therefore, on this point, while rejecting the plea of the assessee, we also reject the appeals of the Revenue for taxing 25% of the invoice value.

58. As a result, the appeals of the assessee are partly allowed to the extent indicated while answering Question No. 'e' referring the matters back to the Assessing Officer for the limited purpose.

59. In the appeals preferred by the Revenue only the extent of income attributable to the PE is questioned. The case of the Revenue is that it should not have been restricted as done by the CIT (A) and modified by the ITAT. The submission is that the order of the Assessing Officer be maintained.

60. Since we have upheld the order of the ITAT in its entirety including on this aspect while discussing the appeals of the assessee, as a consequence, all the appeals of the Revenue on this aspect are also dismissed.

2011 PTR 1748 (H.C. Mad.)

HIGH COURT OF MADRAS

Elipe Dharma Rao and D. Hariparanthaman, JJ.

Uttam Bir Singh Bedi

v.

1. *Union of India*
2. *Establishment Officer to the Government of India*
3. *The President, ITAT*
4. *P. Mohanarajan, Vice-President, ITAT*
5. *The Registrar, Central Administrative Tribunal,
Chennai Bench, Chennai*
6. *H.L. Karwa, Vice President, ITAT,
Lucknow Bench, Lucknow*
7. *O.K. Narayanan, Vice President, ITAT,
Bangalore Bench, Bangalore*
8. *N. Bhartvaja Shankar, Vice President, ITAT,
Chandigarh Bench, Chandigarh*
9. *G.C. Gupta, Vice President, ITAT,
Hyderabad Bench, Hyderabad*

FACTS/HELD

1. **The President of the Tribunal has no power to write the Member's ACR**
2. The Petitioner, a Judicial Member of the Tribunal, was superseded to the post of Vice President by his junior Mr. P. Mohanarajan. The Petitioner claimed that the supersession was on account of adverse Annual Confidential Reports ("ACRs") written by the President of the Tribunal which had misguided the high level Selection Committee without the Petitioner being given an opportunity to represent against the ACR. The Petitioner's challenge before the Central Administrative Tribunal was rejected on the ground that the Selection Committee had decided on the basis of merit. The Petitioner challenged the decision before the High Court and raised two issues: (i) whether the post of Vice President is a promotional post to that of the Member of the ITAT or not? & (ii) whether the President of the ITAT has the authority to record the ACRs of the Members & if so, whether the Government has the right to review the ACRs of the Members? HELD by the High Court:
 - (i) The Vice Presidents of the Tribunal are appointed from amongst the Members in terms of Rule 7A of the Tribunal Members (Recruitment and Conditions of Service) Rules, 1963. Under Rule 7C, the criteria for selection is merit. **The argument that because there is a merger of the pay scales of the posts of Members and Vice Presidents, there is also a merger of the posts and hence the Members cannot be subjected to selection process is not acceptable.** There is only a unification of the pay and not a merger of the posts. **Under the scheme of the Act, the post of Vice President is over and above the level of Member & carries higher responsibilities, higher pay band and is definitely a promotional post from that of the Member;**
 - (ii) The Tribunal is a judicial body and while the President exercises administrative control over the Benches, **he has no power to write the ACRs of the Members.** Further, being a judicial body, **the Tribunal should have judicial**

autonomy and therefore, the Government cannot act like a reviewing authority;

- (iii) On merits, the Petitioner's ACR showed that while he was a hard working and knowledgeable person, he behaved in a **rude manner** with the colleagues and his **rigid tendency** and **non-adjustable nature** had invited many problems, resulting in his frequent transfers. These must have weighed with the Selection Committee. **As the ACRs were illegally recorded by the President and reviewed by the Government, the Selection Committee must reconsider the claim of the Petitioner on merits de hors the ACRs;**
- (iv) On the conduct of the Petitioner, the Court observed that it was "pained" & "disturbed" by the material on record that showed the he was "arrogant" and "would always throw to winds the well established judicial conventions" including "instances of keeping the matters for writing dissenting orders for months together and fighting with the other Members on silly aspects are some of them". Noted that the Petitioner was "transferring his personal feelings against his colleagues into the orders circulated by them and nurturing unnecessary hatred and ill-feelings" and advice given that the Petitioner should "mend his ways and conduct himself in a dignified manner and follow the established judicial conventions, so as to maintain the decorum on and off the dais".

Order accordingly.

Writ Petition No.7715 of 2010 and M.P.No.3 of 2010.

Decided on: 30th November, 2011.

Present at hearing: Vijaynarayan, S.C. for M/s. Karthik for Petitioner. M. Ravindran, Addl. Solicitor General, assisted by K. Mohanamurali, ACGSC for Respondents Nos. 1 & 2. S.Vijayakumar for Respondents Nos. 4, 7& 8.

JUDGMENT

Elipé Dharma Rao, J.-

The petitioner, a Judicial Member of the Income-tax Appellate Tribunal, Chennai, is challenging the appointment of the fourth respondent/Mr.P.Mohanarajan as Vice President of the Income-tax Appellate Tribunal (ITAT in short) in these writ proceedings.

2. The petitioner would contend that the high level Selection Committee has been misguided by the Annual Confidential Reports (ACRs in short) of all the eligible candidates placed before it. According to the petitioner, the third respondent/President of the ITAT has no right or authority to write Annual Confidential Reports of the Members and the first respondent cannot act like a reviewing authority. The petitioner, without prejudice to the above contention, would further contend that the ACRs were not liable to be taken into account, unless they had been communicated to the concerned officers, their representations obtained and considered by the competent authority, in terms of the judgment of the Honourable Apex Court in *Dev Dutt vs. Union of India* (AIR 2008 SC 2513). According to the petitioner, the fourth respondent is junior to him and only based on the incorrect and incomplete information furnished by the official respondents, in the sense the damaging observations made by the Honourable Apex Court against the fourth respondent in *Rajiv Ranjan Singh vs. Union of India* [W.P.(Crl.)No.197-198 of 2004, dated 21.8.2006 reported in Current Tax Reports (SC) 53/2006 156 Taxman 512 (SC)] were not placed before the Selection Committee, the Selection Committee proceeded to make its recommendations and the first respondent proceeded to appoint the fourth respondent as Vice President, in supercession of the petitioner.

3. It is also the contention of the petitioner that the post of Vice President ceased to be a promotion/selection post in view of the upgradation of the post of Members to the level of Vice President w.e.f. 1.1.2006 and consequential merger of the pay scales of both the posts. On such and other grounds, the petitioner has filed Original Application No.1001 of 2009 before the Central Administrative Tribunal, Chennai.

4. The official respondents have contended that the Selection Committee, headed by a sitting Judge of the Honourable Supreme Court, has taken into consideration various aspects and since merit alone is the criteria for selection, the Selection Committee has recommended the name of the fourth respondent and there is no reason whatsoever to cause interference into the findings arrived at by the Selection Committee.

5. The Central Administrative Tribunal, Chennai has accepted the contentions urged on the part of the official respondents and further taking into consideration the fact that the fourth respondent, after getting selected as Vice President, has attained superannuation on 6.11.2009, has dismissed the original application filed by the petitioner, resulting in him approaching this Court with this writ petition.

6. After hearing all the parties at length, two points that arise for consideration are:

1. Whether the post of Vice President is a promotional post to that of the Member of the ITAT or not?

2. Whether the President of the ITAT is having any authority or right to record the Annual Confidential Reports of the Members. If so, whether the first respondent/Government of India is having any right to review the ACRs of the Members?

POINT No.1:

7. The Vice Presidents of ITAT are appointed from amongst the Members in terms of Rule 7A of the Income Tax Appellate Tribunal Members (Recruitment and Conditions of Service) Rules, 1963, which reads as follows:

“The Central Government may appoint from among the Members one or more persons as Vice-President or, as the case may be, Vice Presidents of the Tribunal to assist the President in the discharge of his functions.”

8. A Selection Committee has been constituted under Rule 7C, consisting of a sitting Supreme Court Judge, to be nominated by the Chief Justice of India, the President and the Secretary, Ministry of Law and Justice (Department of Legal Affairs) based on merit, shall recommend persons for appointment as President, Senior Vice-President and Vice-Presidents. Therefore, the criteria for selection is merit.

9. The contention of the petitioner is that consequent to the merger of both the posts of Members and Vice Presidents w.e.f. 1.1.2006, the post of Vice President ceased to be a promotional post to that of the Member. According to him, prior to 1.1.2006, the vice Presidents and the Members were placed in the pay scales of Rs.24050-26000 and Rs.22400-26000 respectively, however, w.e.f. 1.1.2006, both the posts of Vice President and Members are placed in the same scale of pay i.e. Rs.75500-80000 and hence, the process of selection of Vice Presidents, which was valid till 1.1.2006, was ceased to be valid from 1.1.2006 in view of the merger of both the pay scales and therefore, the Members cannot be subjected to selection process for placing them in the same scale of pay.

10. True, on and from 1.1.2006, the pay scales of both the Members and the Vice Presidents has been fixed as Rs.75500-80000. But, it can only be called as unification of the pay and not the merger of both the posts. Had it been a merger, the post of Member would not have been in existence on and after 1.1.2006. While on the part of the respondents 1 and 2 it has been strenuously argued that though the pay of both the posts is one and the same, the pay band differs, nothing has been placed before us by the petitioner to pooh-pooh this stand of the respondents 1 and 2.

11. The ITAT is headed by a President, followed, in hierarchy, by one Senior Vice President, Nine Vice Presidents and Judicial and Accountant Members (totalling 126). The ITAT is constituted at 27 cities of the

country as Benches. The provisions of Sections 252 and 255 of the Income-tax Act confer a statutory power upon the President to constitute Benches. In *INCOME TAX APPELLATE TRIBUNAL vs. A.KALYANASUNDARAM* [(2006) 1 LW 626], a Division Bench of this Court has held that the position of President of the ITAT is like the position of the Chief Justice of the High Court, as it is the Chief Justice who decides which Judge is to sit in which Bench and at which place (in High Courts where there are Benches in two or more cities). Therefore, there cannot be any doubt that the President of ITAT exercises a prerogative right of constituting the Benches and transferring the members and others from one Bench to other.

12. Under Section 252(5), the President can delegate his powers and functions, for the sake of administration, in respect of the Benches either on Senior Vice President or on Vice Presidents of the Benches. The delegation of powers of the President could only be to either a Senior Vice President or to the Vice Presidents, but not to the Members. Therefore, even though the pay of the Vice President and the Members has been unified, it cannot, in any way be called that the posts of Vice President and Member have been merged. When the scheme of things contemplated under the Income-tax Act, as narrated above, would keep the Vice President over and above the level of Member, the reliance placed by the petitioner on O.M.No.AS14017/66/2008-Estt RR, dated 9.3.2009, to bring home the point 'where all posts in a particular grade have been granted a higher replacement pay scale/grade pay, as per upgradation recommended by the 6th CPC, suitability of the incumbents need not be assessed for granting them the higher replacement scale/grade pay and here also, there is no need for the incumbents to complete any minimum eligibility service in the earlier scale of pay', will have no application since it is the well established principle of law that 'no administrative order or G.O. can arrogate or override the statutory provision'.

13. Therefore, we have no hesitation to hold that since the post of Vice President carries higher responsibilities, with higher pay band, it is definitely a promotional post from that of the Member. This point is answered accordingly.

POINT No.2:

14. From the voluminous materials placed before us, we are able to see that the President of the ITAT has recorded the ACRs. of the petitioner, which were reviewed by the first respondent, as a Reviewing Authority. The gist of the ACRs. from the year 2002-03 to 2007-08 has been placed before us. From the remarks in the ACRs. of the petitioner, it is seen that though he is a hard working and knowledgeable person, he behaves in a rude manner with the colleagues and his rigid tendency and non-adjustable nature has invited many problems, resulting in his frequent transfers.

15. While the Selection Committee met for selection of the Vice President, these ACRs are also seem to have been placed before the Committee. It is but natural that the ACRs of the petitioner, which do not depict the petitioner in a bright light, would have weighed against him. Therefore, an argument has been advanced on the part of the petitioner that the President cannot write his ACRs and in turn, the first respondent cannot act like a Reviewing Authority.

16. The ITAT is a judicial body and under the provisions of Sections 252 and 255 of the Income-tax Act, statutory powers are conferred on the President, including delegation of powers to the Senior Vice President or the Vice President. The President exercises administrative control over the Benches. But, no provision of the Income-tax Act or for that matter the Income Tax Appellate Tribunal Members (Recruitment and Conditions of Service) Rules, 1963 confer any power on the President to write the ACRs of the Members. When a question has arisen as to whether the President of the Customs, Excise and Service Tax Appellate Tribunal can write the ACRs of the Members, in *REVENUE SECRETARY vs. SYED LIAQUATH PEERAN* [2007 (208) ELT 331 (Madras)], a Division Bench of this Court, speaking through one of us (Justice Eliphe Dharma Rao) has held that the 'President not competent authority and having no power to write ACRs of Members.' Pursuant thereto, it is seen from the proceedings of the Government of India, Ministry of Finance, Department of Revenue in R-20011-32/2010-ADIC-CESTAT, dated 28.10.2010, that the President, CESTAT, who used to write ACRs of its Members till the above said order of this High Court, dated 1.12.2006, is not writing ACRs. of its Members. We have also been informed by the learned counsel appearing on either side that though an appeal has been preferred before the Honourable Apex Court as against the above said order of this Court, (but, no SLP number has been furnished by either of the parties), no stay order has been passed by the Honourable Apex Court.

17. Therefore, following the above order of this Court, we hold that the President of the ITAT has no power or authority to write the ACRs of the Members. Further, being a judicial body, the ITAT should have a judicial autonomy and therefore, the first respondent cannot act like a Reviewing Authority. Point No.2 is answered accordingly.

18. Since in the case on hand, the ACRs recorded by the President and reviewed by the first respondent seems to have thrown the petitioner to a disadvantageous position, when compared to other competitors and since the remarks made against the fourth respondent by the Honourable Apex Court in *Rajiv Ranjan Singh vs. Union of India* (cited supra), were also not placed before the Honourable Selection Committee, we have no hesitation to hold that

no proper material has been placed before the Honourable Selection Committee to arrive at a just conclusion.

19. In these circumstances, without going into many other aspects urged on behalf of all the parties, we set aside the order of the Tribunal and resultantly, this writ petition entitles to be allowed.

Conduct of the petitioner:

20. We are very much pained to see that the entire material on record would depict a gloomy picture about the petitioner that he is arrogant and would always throw to winds the well established judicial conventions. Instances of keeping the matters for writing dissenting orders for months together and fighting with the other Members on silly aspects are some of them. This has very much disturbed us. Personal enmity or difference of opinion, if any between the Judges or the authorities discharging quasijudicial functions, must take a back seat and it is the bounden duty of the Judges to maintain utmost decorum on off the dais. Deviations in this regard by the Judges would result in loss of confidence about the entire judiciary by the Public and the Bar. The allegations made against the petitioner by the respondents that he sans such decorum are quite alarming. It is also to be mentioned that there is no allegation made against the petitioner touching his integrity. Therefore, what comes to be known is that the petitioner is rigid even to his colleagues - whether junior or senior - and behaves in a harsh manner with them and he seems to have not maintaining any cordial relation with any of his colleagues or for that matter with the Bar also, further throwing to winds the judicial conventions. Keeping the matters circulated by other members without either accepting or offering any dissent order also does not seem to be in good lines with the established judicial conventions. From this, we understand, that the petitioner is transferring his personal feelings against his colleagues into the orders circulated by them and nurturing unnecessary hatred and ill-feelings.

21. No institution could survive in a democracy unless it earns public esteem; and it can earn the public esteem only by discharging its duties impartially and expeditiously. Judiciary is no exception for this principle. While constructive criticism is always welcome, cynical attitude retards rather than helps to remedy the defects. It is not often realised that any uniformed criticism or loose talk from any quarter, though for the moment it appears to be innocuous, may ultimately destroy the prestige of the Judiciary and the confidence of the public reposed therein. The impartiality of the Judges has to be not only actual but also manifest and apparent. This is in conformity with the oft-repeated maxim-"Justice must not only be done but also appear to be done.'

22. No justification whatsoever was advanced and can be advanced for such an intentional default and the casual attitude of the officers/officials concerned in the hierarchy. These authorities are instrumentalities of the State and the officers are empowered to exercise the power on behalf of the State. Such exercise of power attains the greater significance when it arises from statutory provisions. The level of expectance of timely and just performance of duty is higher, as compared to the cases where the power is executively exercised in discharge of its regular business. The well established precepts of public trust and public accountability are fully applicable to the functions which emerge from the public servants or even the persons holding public office.

23. People occupying higher positions in the society and enjoying the respect and benefits attached to such exalted positions at the cost of the taxpayer's money, must adorn the positions in a responsive manner and to be role models for others to follow. Nobody has raised his little finger against the petitioner about his honesty and integrity, but all the allegations are pinpointed towards his arrogant behaviour and ignoring the judicial conventions. All these would force us to direct the petitioner to mend his ways and conduct himself in a dignified manner and follow the established judicial conventions, so as to maintain the decorum on and off the dais.

24. Though the fourth respondent has retired from service on 6.11.2009, after serving as Vice President, since we are of the considered view that sufficient material necessary for determination of the merit of the eligible candidates has not been placed before the Honourable Selection Committee, without going into many other aspects urged on behalf of all the parties, we set aside the order of the Tribunal and allow this writ petition with a request to the Honourable Selection Committee to re-consider the claim of the petitioner, de hors, the ACRs illegally recorded by the President and reviewed by the first respondent. We hope and trust that the Honourable Selection Committee would complete the entire exercise within two months from the date of receipt of a copy of this order. No costs. Consequently, connected Miscellaneous Petitions are closed.

2011 PTR 1757 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "T" BENCH, NEW DELHI

Rajpal Yadav, Judicial Member and
Shamim Yahya, Accountant Member

FACTS/HELD

1. **Transfer Pricing: Despite FAR matching, Loss Co to be excluded**
2. The assessee was engaged in providing franchise support services to Pizza Hut, Kentucky Fried Chicken and Taco Bell franchisees and received royalty. From the list of comparables provided by the assessee (after excluding persistent loss-making companies), the TPO rejected some other loss-making companies & determined the ALP applying the TNMM and made an adjustment of Rs. 2.28 crores. This was upheld by the DRP. Before the Tribunal, the assessee relied on **Sony India** 114 ITD 448 (Del) & **Quark System** 38 SOT 307 (SB) and claimed that loss was a normal incident of business and merely because a company is showing loss, it does not cease to be a comparable. HELD dismissing the appeal:
3. **Merely because a company is showing losses, it does not lose its status of comparable** if the other criteria depict its status as a comparable because the declaration of loss is an incident of business which is at par with profit. However, while the assessee considered these companies on the basis of their FAR Analysis i.e. (function performed, assets employed and risk assumed), the TPO held that **FAR of a company indicated the avowed objective of the company and the tools that it sought to employ to achieve that objective but it was the financial result which decided whether that company has been successfully in achieving the objective or not.** The TPO held that **if the assessee's contention based on FAR analysis only is accepted then the process of choosing comparable will not proceed beyond the matching of FAR. All types of other tests i.e. data base screening, quality and quantitative screening or use of diagnostic with ratios will**

be rendered meaningless and unnecessary. Further, while the assessee itself applied a filter of persistent operative losses and companies on that basis, what was the basis for inclusion of the loss making companies? The loss making companies had not been excluded simplicitor on the ground that they are declaring loss but the TPO had pointed out that their **comparability has been taken into consideration by the assessee on the basis of FAR analysis and “other aspects” have not been considered.** TPO had looked into “other aspects” also.

Appeal partly allowed.

ITA No. 3796/Del/2006 Assessment Year: 2002-03, ITA No. 4154/Del/2006 Assessment Year: 2002-03, ITA No. 142/Del/2007 Assessment Year: 2003-04, ITA No. 480/Del/2007 Assessment Year: 2003-04, ITA No. 5122/Del/2010 Assessment Year: 2006-07.

Decided on: 31st May, 2011.

Present at hearing: Salil Kapoor, V. Iyer and S. Kapoor, ARs for Appellant. Maharish Verma, CIT(DR) for Respondents in ITA No. 3796/Del/2006. Maharish Verma, CIT(DR) for Appellant. Salil Kapoor, V. Iyer and S. Kapoor, ARs for Respondents in ITA No. 4154/Del/2006. Salil Kapoor, V. Iyer and S. Kapoor, ARs for Appellant. Maharish Verma, CIT(DR) for Respondents in ITA No. 142/Del/2007. Maharish Verma, CIT(DR) for Appellant. Salil Kapoor, V. Iyer and S. Kapoor, ARs for Respondents in ITA No. 480/Del/2007. Salil Kapoor, V. Iyer and S. Kapoor, ARs for Appellant. Maharish Verma, CIT(DR) for Respondents in ITA No. 5122/Del/2010.

JUDGMENT

Per Rajpal Yadav:- (Judicial Member)

The assessee and revenue are in cross appeals. In order to appreciate various details in more scientific way, we deem it appropriate to take note of the following details in the tabular form:

Sr.No.	ITA Nos.	Appellant	A.Ys	Dt. Of CIT(A)'s order	Date of A.O.'s order & U/s.
1.	3796/Del/2006	Assessee	2002-03	27.9.2006	2.12.2005 U/s. 143(3)
2.	4154/Del/2006	Department	-do-	-do-	-do-
3.	142/Del/2007	Assessee	2003-04	10.11.2006	30.3.2006 u/s. 143(3)
4.	480/Del/07	Department	-do-	-do-	-do-

5.	5122/Del/2010	Assessee	2006-07	DRP 23.09.2010	16.12.2009 u/s 143(3)/144C
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First we take appeal of the revenue in Asstt. year 2002-03 i.e. ITA No. 4154/D/2006

2. In the first ground of appeal, it has been pleaded by the revenue that Ld. CIT(A) has erred in holding the service income receipt of ` 12,67,04,206/- as business income.

3. The brief facts of the case are that assessee has filed its return of income on 28.10.2002 declaring total income at NIL. The case of the assessee was selected for scrutiny assessment and a notice u/s 143(2) dated 17/24-10-2005 was sent through registered post. The AO felt that accounts of the assessee are of complex nature after taking necessary approvals he sent for special audit of the accounts. Shri S.C. & Associates was appointed as Special Auditor. This reference was challenged before the Hon'ble High Court but ultimately issue was decided against the assessee. The Special Auditor has handed over the report dated 5th October, 2005. Before advertng to the issue disputed in this ground of appeal, we deem it necessary to note brief background of the assessee and the alleged business module of the assessee company. According to the assessee, it was incorporated under the Indian Companies Act and is engaged into the business of Pizza Hut ("PHILLC") and Kentucky Fried Chicken (KFCEEC) Restaurant in India. The assessee has entered into a technology license agreement with Kentucky Fried Chicken International holdings Inc. and Pizza Hut international LLC to operate Pizza Hut and KFC Restaurant in India. As per these agreements, the assessee could enter into various franchise agreements with entities in India to operate such restaurants. As per the AO main source of assessee's income is service income, also called stewardship fees and supply chain management fees hereinafter referred to (SCM). The service income is governed by an agreement entered into by the assessee with M/s. Tricon Restaurant International Inc. (re named as Yum Restaurant International SWC and referred as YRI hereinafter). This agreement was entered on 1st April, 2001. As per this agreement, assessee is under an obligation to provide following services:-

- i) "Providing assistance to existing and future licensees in India, Mauritius, Pakistan, Sri Lanka and such other areas upon which the parties may agree from time to time;
- ii) Providing TRI with such reports concerning the above matters as may be reasonably required by them from time to time.
- iii) Collection and onward remittance of license fee, and such other fees as may be payable by the licensees, to KFCIH and PHILLC.

- iv) Acting generally on behalf of TRI in a liaison capacity in connection with the existing and the potential licensees and/or such other matters.”

4. For the services stated above, assessee is entitled to service fee equal to 110% of all costs reasonably incurred by it in the performance of such service i.e. referred above. The next important source of income is Supply Chain Management Fees. This is recognized income as per agreement entered into with supplier of materials to the franchise. The assessee has earned service income aggregating to Rs. 12,67,04,206/-. The computation of this income has been noticed by the Ld. CIT(A) on pages 5-6. The AO treated this service income as income from other sources . According to the AO, in earlier assessment years, the service income received was equivalent to the cost incurred. Whereas in this asstt. year, the income received as equivalent to 110% of the expenditure. The AO doubted the agreement itself. According to him, the agreement is not duly signed, witnessed nor executed on stamp paper. He further observed that the very dominant intention of the assessee, right from the beginning was never to enter into any business activity, but to secure and pass on the income earned by the international companies in Indian Sub continent without payment of tax. He also observed that in order to claim the expenditure incurred in excess of its receipts as in earlier years, the assessee through some device alleged during such years claimed such losses as business, contrary to the facts and circumstances. According to the AO, the income alleged to have been received by the assessee i.e. 10% of the total expenditure reimbursed is not on account of exploitation for business or use of commercial assets. He also alleged that in the service agreement countries consisting Pakistan, Sri Lanka and Mauritius, whereas service income has been received in respect of expenses incurred by assessee in India only. In this way, Ld. AO has held that it is income from other source and not the business income.

5. Dissatisfied with the asstt. order, assessee carried the matter before the Ld. CIT(A). Ld. CIT(A) after a detailed discussion accepted the contention of assessee. The findings recorded in paragraph No.3.1 are worth to note which read as under:-

- 3.9 “On comparing the facts of the appellant’s case in the light of the legal position discussed above I am of the view that Services have been provided to Yum! Restaurants International Inc. (formerly known as Tricon Restaurants International Inc. – TRI) for development of business systems (of the respective brand holders) outside USA, by the appellant. The services provided are of multifarious nature viz. provision of support services to franchisees, collection and remittance of royalty to brand holders in the US, assistance provided for R&D activity, etc. Against such services, service income equivalent to 110% of all costs incurred has been earned by the appellant. The act and

course of services provided by the appellant constitute a systematic organized activity conducted with a special purpose as the provision of services is not an isolated transaction but the same has been continuously provided since A.Y. 1998-99 and as informed the appellant continuing even in the present date. Hence, the earning of service income cannot be classified under any other head but business income since all the essential parameters of classifying the said activity as business are fulfilled in the facts and circumstances of present case. Further, it not in dispute that the entire expenditure debited in the P&L account has been accepted by the A.O. as business expenditure. Now, if expenditure is held to be business expenditure, service income computed on the basis of 110% of such expenditure cannot be anything but Business Income. Although, the AO has propositioned that the service income earned by the appellant is not a Business Income but Income from Other Sources, however, in complete contradiction, the expenditure which forms the basis for computation of the service income has been held to be business expenditure.

Also the perusal of assessment order reveals that the A.O. has not given any concrete reasons to support the action of treating service income as 'income from other sources'. There is a lack of reasoning to support the A.O.'s conclusion that the appellant was not carrying on any business, or that the service income earned by it was not derived from business. In my view, the existence and operation of the Pizza Hut Restaurants and KFC Restaurants in various cities across India can be seen by any body and needs no proof. These outlets are either operated by the appellant or operated through franchisees. These franchisees have been provided with support services on behalf or the brand holders as discussed earlier. In addition to the provision of these services to the franchisee, the appellant has also provided services to the brand holders in USA by way of collection and remittance of royalty, providing them services by way of research and development etc. All such activities visible and there is evidence to substantiate these activities. There exists a contractual agreement under which the services have been provided, and the service income has been earned, received and accounted for as such, all of which remains uncontroverted. In my view if the assessing officer had any doubt about the genuineness of the services rendered by the appellant company, nothing prevented him from calling upon the franchisees or the principals to confirm the facts. Not only that, he could plan a visit incognito on his own or through the appellant to any of the outlets and see for himself the services being rendered by the appellant under the service agreement. He could not have

arrived at a unilateral decision based on his own whims and fancies, when the facts could easily be ascertained by direct inquiry from the parties concerned.

- 3.10 Finally the appellant has drawn my attention to the fact that the service income earned by the appellant has been continuously assessed under the head 'business' in the past. Although the principle of res-judicata does not apply to income tax proceedings but it has been repeatedly held by various courts that, for the sake of consistency and in order to achieve finality in all litigations, earlier treatment on the same question should not be disturbed unless some fresh facts are found in the subsequent year as held in the following cases:

Radhasoami Satsang v. CIT (1992) 193 ITR 321 (SC)

Asstt. CIT v. General Hazarilal and Co. (2003) 263 ITR 679 (MP).

CIT v. A.R.J. Security Printers (2003) 264 ITR 276 (Del).

CIT v. Lagan Kala Upvan (2003) 259 ITR 489 (Del).

CIT v. Neo Poly Pack (P) Ltd. (2000) 112 Taxman 363 (Delhi).

Sardar Kehar Singh v. CIT (1992) 195 ITR 769 (Raj).

CIT v. Girish Mohan Ganeriwala (2003) 260 ITR 417 (P&H)

Sonepat Hindu Educational and Charitable Society v. CIT (2005) 278 ITR 262 (P&H).

In my view, the inclusion of service fee income as Business income in earlier year's could not be disturbed without any fresh facts being brought on record.

- 3.11 Therefore, in view of the reasons discussed above the A.O. it is held that service income receipts aggregating Rs.12,67,04,206/- are to be treated as Business Income only and the appeal is allowed on this ground."

6. Before us, Ld. DR relied upon the order of AO and pointed out that AO has observed that income was earned by the assessee without exploitation of any business assets.

7. On the other hand, Ld. Counsel for the assessee relied upon the order of Ld. CIT(A). He took us through the submissions reproduced by the Ld. CIT(A) on pages No. 5 to 10 of the impugned order.

8. We have duly considered the rival contention and gone through the record carefully. Ld. First Appellate Authority has reproduced the submissions of the assessee. The assessee in its submissions has pointed out that section 2 (13) provides the definition of expression "business" according to which business includes any trade, commerce, manufacture or any adventure or concern in the nature of trading, commerce or

manufacture. In various authoritative pronouncement of the Hon'ble Supreme Court and Hon'ble High Court, meaning and scope of expression "business" has been propounded. It is not necessary to recite and recapitulate of those decisions, but on the strength of them, it would suffice to say that word "business" is one of wide import and which means an activity carried out continuously and systematically by a person by the application of his labour and skill with a view to earn income. The case of the assessee is that right from asstt. Year 1998-99, it is providing various types of services to the franchise in India and also to its associate enterprises, because it is collecting fees etc. from the franchise and remitting it to YRI in US. The main object of the assessee company, as discernable from Memorandum of Association is to own, purchase, lease, develop, operate, franchise and manage restaurant etc. Similarly, its next object is to provide consultancy and advisory services in connection with the establishment, organization, financing, management and operation of restaurant, café...etc. This business, assessee has been performing right from 1998-99 and the department has accepted this. Assessee has shown additional receipts which means higher taxes would be payable. The assessee has also pointed out at the time of hearing that a reference to the TPO to determine the arms length price u/s 92 (CA) 3, in respect of the international transaction entered into by the assessee was made and the TPO has also accepted that the transaction are at arms length price. With regard to the objection of the AO, on account of authenticity of the agreement by the assessee that agreement has duly been signed by the both the parties. There is no specific defect referred by the AO. According to the assessee under the Indian Tax Act even on oral agreement or an agreement on plain paper entered into by two or more parties is valid and binding upon the contracting parties. With regard to allegation of AO about payment of dividend by the assessee to the parent company is concerned, it was contended by the assessee that AO has observed that possibility of payments being made in lieu of dividend on contribution toward development / business from time to time made by parent company by the assessee cannot be ruled out. There is no evidence with the AO in this regard. The assessee is receiving the income from parent company i.e. YRI and not making payment to it. Taking into consideration the detailed submission by the assessee, which have duly been reproduced by the Ld. CIT(A) coupled with the finding recorded by the Ld. CIT(A) (extracted supra), we are of the view that AO miserably failed to appreciate the facts and circumstance. The assessee has been offering income from consultancy etc. as a business income. It has duly been accepted by the department since 1998-99. The AO without assigning any valid reason concluded that it is an income from other sources. On the other hand, Ld. First Authority has considered this issue in right perspective. Therefore, we do not find any merit in this ground of appeal it is rejected.

Ground No. 2:

9. In this ground of appeal, grievance of the revenue is that Ld. CIT(A) has erred in deleting the addition of Rs. 12,60,21,989/- . The brief facts of the case are that assessee is in the business of franchising 'Pizza Hut and Kentucky Fried Chicken Restaurant in India for which it has entered into technology licence agreement with the respective brand owners i.e. KFC and Pizza Hut International LLC. It has entered into a service agreement on 1st April, 2001 with M/s. Tricon Restaurant INC USA (now known as Yum Restaurant International YRI). The assessee has raised through separate invoices of M/s YRI / TRI amounting to Rs. 9,39,30,265/-, Rs. 3,20,91,724/- and Rs. 6,82,217/- totalling to Rs.12,67,04,206/- the amount which has been treated by the AO as income from other sources. It emerges out that two invoices for a sum of Rs. 9,39,30,265/- and Rs. 3,20,91,724/- alleged to have been raised on Pizza Hut International and KFC International were available in the accounts. The first two invoices raised on YRI / TRI i.e. for a consideration of Rs. 9,39,30,265/- and Rs. 3,20,91,724/- were signed by Mr. Rohit Bansal, Manager Finance of the assessee company. The third invoice is under the signature of Mr. Ajay Bansal, Director Finance of the assessee. Whereas the copies of the alleged two invoices have been raised on Pizza Hut LLC and KFC IH were under the signature of Mr. Ajay Bansal. The case of the AO is that assessee has raised two separate invoices on Pizza Hut LLC and KFC IH totalling to Rs. 12,60,21,989/-. It has filed to disclose these receipts. On the other hand, case of the assessee is that service agreement which was entered with YRI and YRIPL for the first time on April 1, 2001. Prior to this agreement, a similar agreement was entered into by YRIPL directly with KFCIH and Pizza Hut LLC for asstt. year 2001 and earlier years. This year no such agreement was available with these two concerns. Inadvertently on the basis of past practice invoices have been prepared for asstt. Year 2002-03 also. The invoices were prepared for raising them on KFCIH , PHLLC as well as YRI. The amount could be collected only from YRI. The amounts mentioned in the first two invoices alleged to have been raised of YRI and KFC Pizza Hut are similar. Thus, according to the assessee in fact, no amount was to be received from KFC and Pizza Hut. These invoices were prepared inadvertently and lying in the accounts. The AO did not accept this contention. He observed that invoices alleged to be raised inadvertently, were attached with original voucher, "Advances others" was debited instead of the name of the party in the voucher. Why different invoices were signed on the same day by different persons etc. Ld. CIT(A) has deleted the addition by observing that AO has made the addition only on presumption basis. The said assumption is purely on two pieces of paper, whether they have been acted upon or not? How the money has travelled not discernable.?

10. With the assistance of Ld. Representative, we have gone through the record carefully. Assessee has explained its position that these invoices were prepared inadvertently. It has filed the affidavit of the Director Mr. Ajay Bansal who has explained the mistake. The TPO had also accepted the case of assessee about arm's length prices. The invoices involved an international transaction. Had they paid by virtue of the alleged invoices then there should be entries in the bank account and there should be trail of the money. AO has unnecessarily treated two documents as sufficient for demonstrating the alleged undisclosed income. The assessee has explained its position properly and no addition deserves to be made. Ld. First Appellate Authority has considered this issue elaborately and has rightly deleted the addition. We do not see any reason to interfere in his finding. This ground of appeal is rejected.

Ground No. 3

11. In this ground of appeal, grievance of the revenue is that Ld. CIT(A) has erred in deleting the addition of Rs. 39,50,000/-. The brief facts of the case are that assessee has a wholly owned subsidiary company by the name of *YUM Restaurant Marketing Pvt. Ltd.* (Hereinafter referred to as YRMPL). This company was incorporated on 8th June 1999 as a private Ltd. Company after taking prior approval from the competent authorities. This company was formed with a sole objective of undertaking advertising media and promotional activities exclusively for the assessee and its franchise at the regional and national level. According to the assessee, the object of forming this company was to ensure that franchise concentrate on business of running restaurant while marketing and promotional activities are being taken by other entities which is wholly owned subsidiary company. The assessee used to carve out budget for advertisement and promotional activities at the commencement of every year. This was carved out after consultation with the franchise. Each franchise is required to contribute certain fixed percentage of its sales for advertising, media and promotional activities to YRMPL. Any deficit in the budget as compared to the contributory receipt from the franchise is being met by the assessee in the form of its contribution towards advertisement, marketing, promotional activities. Apart from all these Pizza Hut and Kentucky Fried Chicken restaurants, products of Pepsi Food Ltd. are also sold exclusively as per the joint marketing agreement entered into between YRIPL and Pepsi Food Ltd. As the product of Pepsi are also advertised in the promotional material for Pizza Hut and Kentucky Fried Chicken restaurant, Pepsi is also required to contribute towards the advertisement for media and promotional activities. The Pepsi food had paid a sum of Rs. 39,50,000/- to the assessee in F.Y. 2001-02. For this purpose, assessee has raised debit note for pepsi for receiving this contribution. While making the payment to the assessee Pepsi had deducted taxes at source. The assessee had passed on this amount to its subsidiary company i.e. YRIPL to be

incurred on advertising media and promotional activities. It had not deducted any tax at source while making this payment. The AO has made the addition on the ground that Pepsi has made the payment to the assessee. The assessee on its own has raised a debit note. Credit for taxes deducted at source by Pepsi was claimed by the assessee in its return of income. The assessee did not claim the amount transferred to its subsidiary concern i.e. YRIPL as its expenditure. It has not deducted taxes at source at the time of transferring the amount. In this way Ld. AO has made the addition.

12. Dissatisfied with the addition, assessee carried the matter in appeal before Ld. CIT(A). It was contended by the assessee that even if this amount was treated as income of the assessee the corresponding expenditure has been allowed to it. Thus, there will not be any tax implication on the assessee. Ld. CIT(A) accepted the contention of assessee on the ground that as far as transmission of this amount to the subsidiary is concerned there is no dispute. The payment of the amount to the subsidiary is an allowable expense because it was to be incurred towards advertising media and promotional activities. The AO has alleged that assessee has not deducted the TDS on this reasoning Ld. First Appellate Authority is of the opinion that section 40(a)(ia) of the Act were not applicable to the asstt. year under appeal i.e. asstt. year 2002-03. It had come on the statute book subsequently.

13. With the assistance of Ld. Representative, we have gone through the record carefully. There is no dispute with regard to the fact that sum of Rs. 39,50,000/- was paid by Pepsi Food to the assessee. In pursuance of a debit note raised by the assessee. M/s. Pepsi Good has deducted the TDS also and assessee has taken credit of the TDS deducted by Pepsi Food. Thus it suggest that as far as accounting treatment is concerned, it is an income in the hands of the assessee. The assessee further contended that it has paid this amount to its subsidiary i.e. YRIPL for incurring these expenses on advertisement media promotional. According to the finding of Ld. CIT(A), assessee has claimed the expenditure of this amount but the AO has recorded a finding that no such expenditure was claimed by the assessee. The assessee has to reconcile that this amount has been paid to the subsidiary concern and it was incurred for the purpose of the business. At page 8. AO has specifically observed that no such expenditure was claimed by the assessee. During the course of hearing, it was contended by the assessee that amount received by Pepsi was not in the nature of its income. The amount received was pursuance to the joint agreement between the two companies and was received by the assessee under an obligation to be passed on to the subsidiary concern. It emphasised that amount was received by it not on its own account but with an overriding obligation to pass on to YRIPL. The assessee has raised an additional ground also, wherein it pleaded that this receipt can not be treated as income in its hand, because it was

received in the capacity of collecting agent. It has relied upon the judgment of Hon'ble Supreme Court in the case of *CIT Vs. Bijli Cotton* reported in 116 ITR 60 *Sheetal Dass Tirth Dass* reported in 41 ITR 367 and the judgment of Hon'ble Allahabd High Court in the case of *CIT Vs. Upbhokta Sahkari Sangh* reported in 288 ITR 106.

14. We have considered all these contentions but we do not find any discussion on these issues in the asstt. order. Somewhat similar is again by the assessee in its ground No. 2 which will be discussing in the later part of the order. The AO has made the observation in one paragraph on page 8. The reasoning assigned by the Ld. CIT(A) is that assessee has debited a similar expenditure of Rs. 51833006/- in the P & L account towards marketing contribution to YRIPL. It has been fully allowed by the AO. From reading of both the orders it is not discernable whether assessee has included this amount in Rs. 5,18,00,000/- or not. The case of the AO is that it has received this amount from Pepsi Food it ought to be accounted an income. How assessee has treated it in the accounts and whether transmitted it to the subsidiary concern is an issue which is to be reconciled. It has taken a credit of tax paid by Pepsi Food. It is a business receipt because it is taking care of all marketing and promotional activities though in this year through its subsidiary concern. Therefore, we set aside the finding of Ld. CIT(A) restore this issue to the AO for verification and readjudication. This ground of appeal is allowed.

Ground No. 4

15. In this ground of appeal, grievance of the revenue is that Ld. CIT(A) has erred in deleting the addition of Rs. 90,000/-. The brief facts of the case are that on perusal of the accounts it revealed to the AO that assessee has drawn certain cheques for withdrawal on a particular dates and entered them on the same date in the cash account in its ledger, whereas actual cash withdrawal from the bank taken place on the subsequent date. A sum of Rs. 30,000/- was alleged to have been withdrawn vide cheque No. 580359. The entry made in the cash book is 10th May, 2001. The actual cash withdrawn from the bank happened on 11th May, 2001. There are three transactions of similar nature in different months. AO has made the addition on account of unexplained cash. Ld. CIT(A) deleted the addition on the ground that assessee has explained its position. That on certain occasions, when cheque was signed entries were made in the cash book. But due to certain practical difficulties actual cash could not be taken out from the bank account. On due consideration of the facts and circumstances we are of the opinion that AO has made the addition in a theoretical way, without realising the practical aspect. There is only one difference between actual withdrawal of cash from the bank. The explanation of the assessee before the AO was that for example a person was handed over a cheque for making withdrawals, he reached the bank late and could not withdraw the money, when cheque was signed entry was passed in the ledger account.

Thus a small discrepancy has happened. The AO has not brought any material on the record that this much of cash was introduced in the books from an unexplained sources and after withdrawal taking place from the bank the said cash was returned to that source. After taking into consideration the detailed finding recorded by the Ld. CIT(A) we do not find any force in this ground of appeal it is rejected.

Ground No. 5

16. The grievance of the revenue in this ground is Ld. CIT(A) has erred in deleting the disallowance of Rs. 3,23,01,939/- which was paid by the assessee on account of royalty expenses.

17. At the cost of repetition, it is observed that primary business activity of the assessee relates to the operation and development Pizza Hut and Kentucky Fried Chicken restaurant, in the Indian sub continent, For this purpose, the assessee company had entered into a technology licence agreement on 1st April, 1995 with Kentucky Fried Chicken HI. Similarly, any technology licence agreement has been executed between the assessee and the Pizza Hut on 15th January, 1996. As per these agreements, the assessee has been granted the rights to use the technology and system in the business of operating service restaurant such as Kentucky Fried Chicken restaurant, outlets and Pizza Hut. In both the agreements, it was settled that for grant of licence as a technology, a licence fee would be payable by the assessee which is equivalent of 5% of sales, net of taxes. According to the assessee, effective rate of technology licence fee, therefore, works out to 6.038%. This has been worked out by the assessee as under:-

1) Licence Fee	5.00%
2) TDS	0.75%
3) R& D cess	0.288%
	6.038%

18. The assessee has been granted approval by the Govt. of India, Ministry of Industry Secretariat for Industrial Assistance (SIA) for setting up a wholly owned subsidiary in India for setting up KFC Restaurant. There is no dispute with regard to the facts to this extent. The assessee was authorized to enter into development agreement with other entities for opening up new outlets. During the accounting period relevant to this asstt. year, it has entered into agreements with number of entities namely Devyani International Pvt. Ltd., Speciality Restaurants, Dodsai Corporation these concerns have set up new outlets. As per the agreements between the assessee and the developers/franchise , a continuing fees @ 6.3% on sales is required to be paid by the franchisee to the assessee. It had received a sum of Rs. 3,37,05,801/- during the accounting period relevant to this asstt. year. From the franchise as continuing fees the assessee has remitted royalty

aggregating to Rs. 3,23,10,030/- to the principals abroad. The AO has disallowed this payment of royalty to the principal. The AO has observed that Govt. of India has restricted payment of royalty in its initial approval and assessee was permitted to pay technical service fee only. Technical service fee and royalty is distinct and separate. The assessee has termed the payment for technical service fee as royalty to circumvent clause in the SIA approval which restricted the payment of technical service fee to a period of 7 years. The AO further observed that payment has been made to parent companies. It cannot be ruled out that said payments have been made in lieu of dividend.

19. Dissatisfied with the conclusion of the AO, assessee carried the dispute before Ld. CIT(A). It pointed out that admissibility of expenditure in the nature of licence fee paid is governed by the provisions of 37 (1) of the Income Tax Act 1961. The expenditure under this section can be claimed by the assessee, if the assessee satisfied the conditions flowing out from the section. The conditions are that expenditure should not be of the nature described u/s 30 to 36. It should not be of a capital nature and it should not be of a personal expenditure. The expenditure should have been laid out or expended wholly and exclusively for the purpose of the business. It was explained before the Ld. First Appellate Authority that Ld. AO has failed to construe the approval letters in true perspective. It was also pointed out that fee paid in technology transfer case can be said to be both royalty and fee for technical services. The SIA has been using the terms royalty and technical service fee loosely and interchangeably in its various approval letters. The assessee has explained that nomenclature licence fee as royalty are irrelevant consideration so long as the licence fee payment is justified and indispensable to the assessee's business. According to the assessee, there exist a direct nexus between the payment of licence fee and business of the assessee. Ld. CIT(A) has considered all these aspects elaborately and has deleted the disallowance. The relevant observation recorded by the Ld. CIT(A) in para No. 9.13 read as under :-

“9.13. The contents of the assessment order, material on record and the written submissions and arguments made by the appellant have been considered by me. The impugned payment of Rs. 3,23,01,939/- has been made by the appellant towards licence fee paid pursuant to the technical license agreements with the owners of the technology and systems and claimed as a business expenditure. Against the expenditure of Rs. 3,23,01,939/-, the appellant has directly earned an income of Rs. 3,37,05,801/- as continuing fee from the franchisees, which is an undisputed fact. Thus, there is accrual of direct income against impugned expenditure claimed as business expenditure by the appellant. Therefore, in my view, the expenditure of Rs. 3,23,01,939/- paid as license fee and shown as royalty payment

in the Balance Sheet deserves to be allowed as a business expenditure. Further, the main contention of the AO for making the disallowance is that the appellant was permitted to remit technical fees as per Government approvals whereas the appellant remitted Royalty which, according to A.O's interpretation (of all the relevant documents), the appellant was forbidden to do. However, the AO has not made out a case that the disallowance of the impugned amount is on account infraction of any law. Thus, the whole approach in the assessment order, on this issue, is based on mere technicalities without any importance being attached to the real sum and substance involved. In my view the AO has grossly erred in making such a high pitched disallowance so lightly without any real application of mind to the substance of the matter. As regards the various observations made in the assessment order, the appellant has been able to successfully meet all these observations as discussed in the preceding paragraphs and, therefore, the same need not be repeated again. The assessment order also stresses the omission on the part of the appellant to report the impugned payment of Rs. 3,23,01,939/- under Section 40A(2)(b) in the Tax Audit Report. As clarified by the appellant the impugned payment is not covered u/s 40A(2)(b) irrespective of this clarification the impugned payment cannot be said to be excessive or unreasonable taking into account the fact that the license fee / royalty has been paid @ 5% (net of taxes) as per Government approvals and also the aforesaid transaction being in the nature of an international transaction, the Transfer Pricing Officer vide its order dated 18.2.2005 has held the same to be at arm's length price. Thus, the disallowance of Rs. 3,23,01,939/- benign without any basis, is deleted.

9.14 In view of the above discussion, the disallowance of Rs. 3,23,01,939/- made by the assessing officer being without any basis is deleted and the appeal is allowed on this ground."

20. With the assistance of Ld. Representative, we have gone through the record carefully. The main reason for disallowing the royalty payment by the assessee to M/s. KFC international holding Inc and M/s. Pizza Hut with whom it had entered into technology licence agreement is that Govt. of India has permitted the assessee to pay technical fees which is restricted to seven years and assessee is paying it as a royalty. Ld. CIT(A) has deleted the disallowance on the ground that assessee has earned an income of Rs. 3,37,05,801/- as continuing fees from the franchise, because of this technology licence agreement. It has been permitted to collect the fees on behalf of KFC International and Pizza Hut. This permission is in pursuance to the technology licence agreement. The AO failed to bring on record any material that assessee has infringed any law in conducting its

business. We have perused the relevant material and also the written submissions of the assessee reproduced by the Ld. CIT(A). In our opinion, AO has misread the approvals granted by the Govt of India while arriving at a conclusion that assessee has not been remitting the payment as per the approvals. In the approval SIA has used expression “royalty as well as fee for technical services” loosely and interchangeably. Apart from all these things, the tax rate for remitting a royalty as well as fee for technical service is 15% plus the research and development cess. The assessee has paid both these amounts while remitting the payment. The expense is directly related to its business. It has been incurred wholly and exclusively for running the franchises within India. Therefore in our opinion Ld. First Appellate Authority has appreciated the facts and circumstances in right perspective and has rightly deleted the disallowance.

Ground No. 6

21. The grievance of revenue in this ground is Ld. CIT(A) has erred in deleting disallowance of Rs. 3,26,01,574/-. The brief facts of the case are that assessee has a wholly owned subsidiary namely Yum Restaurant India Pvt. Ltd. The main object of this company was to carry out advertising, marketing and promotion of KFC, Pizza Hut and other brands currently owned or acquired in future by the assessee. This company was incorporated on 8th June 1999. The AO has observed that company has been operating from the premises of the assessee and, therefore, all administrative expenses in connection with advertisement, marketing, promotional activities of YRMPL is to be allocated to that company. In other words, assessee should not bear the overhead expenses at the head office pertaining to YRMPL. The AO has allocated the expenses in equal i.e, 50% for YRMPL and 50% for assessee. In this way, he worked out a disallowance of Rs. 3,26,01,574/-.

22. On appeal, Ld. CIT(A) deleted the disallowance. With the assistance of Ld. Representative, we have gone through the record carefully. It emerges out from the record that YRMPL was incorporated on 8th June, 1999. It is a 100% owned subsidiary of the assessee. It has been incorporated to carry out advertisement, marketing and promotion activities of the assessee as well as various franchise. The assessee had entered into a tripartite agreement with its franchise and YRMPL. As per this agreement, the franchise shall pay AMP contribution to YRMPL and assessee may not pay a separate contribution. In a way, YRMPL was to carry out the activities on no profit no loss basis. The AO has disallowed the expenses which are attributable to YRMPL but in fact, he ought to have not disallowed any such amount because ultimately it is the assessee who has to contribute for all these sums. The assessee can bear the cost of administrative expenses alleged to be incurred by YRMPL or it can separately remitted the amount to YRMPL towards such cost. From both the angles, it is the assessee or its franchise who has to contribute

this amount. The AO, therefore, has erred in carving out the disallowance. Ld. CIT(A) has rightly deleted this disallowance and we do not find any force in this ground of appeal. It is rejected.

Ground No. 7 – 10

23. These grounds of appeal shall be taken up alongwith ground No. 3 and 4 of the assessee's appeal.

Ground No. 11

24. In this ground, grievance of the revenue is that Ld. CIT(A) has erred in deleting the disallowance of Rs. 1,35,67,376/-. The AO has observed that assessee failed to produce register maintained for the fixed assets. In Asstt. year 1999-2000, it has transferred its business undertaking at Bangalore and Delhi as a going concern whereas such assets continued to be shown as fixed assets even through in asstt. Year 2002-03 and depreciation has been claimed on such non existent assets. He also observed that assessment in asstt. Year 1999-2000 has already stands reopened u/s 148 of the Income Tax Act. The AO also found that depreciation was claimed in respect of assets purchased for the benefits of employees and utilised by such employees. The AO thereafter made a reference that expenses were found to be incurred, where assets purchases during asstt. Year 2002-03 were not found recorded in the books. On the basis of these discrepancies the AO has allowed the entire depreciation aggregating to Rs. 13567376/-. Dissatisfied with the disallowance assessee carried the dispute before the Ld. CIT(A). The assessee has pointed out that as far as assets used by the employees are concerned prerequisite value has been included as part of the salary of respective employees. The assessee pointed out had these assets were not provided to the employees as per the terms and conditions of employment then assessee would have reimbursed the cost of those assets for personal use upto a limited specified purpose. Ld. CIT(A) has considered these aspects and observed that assessee has produced schedule of assets before the AO. There may be some discrepancy but that does not mean that total depreciation would be disallowed to the assessee. As far as the assets sold out in asstt. year 1999-2000 is concerned, Ld. CIT(A) has already directed the AO to give effect the outcome of assessment proceeding in asstt. Year 1999-2000 in this year also.

25. On due consideration of the facts and circumstances, we are of the view that AO has highlighted certain discrepancies in the maintenance of WDV of the assets as well as identification of each assets. There may be some shortcomings but that does not mean that assessee was not having any assets and they were not used for the purpose of business. In our opinion, AO ought to have identified each item and find out how that item is treated in the block of assets, if it is established that those assets were not used for the purpose of the assessee's business then he should make out a care for disallowance of depreciation. By making

general observation, he cannot deny the total claim of the depreciation of the assessee. Taking into consideration these aspects, we do not find any merit in this ground of appeal. Ld. CIT(A) has already directed the AO to give effect outcome of 1999-2000. The depreciation disallowed in asstt. year 1999-2000 would be considered for disallowance in this year also. The effect of outcome in asstt. year 1999-200 would be given after giving an opportunity of hearing to the assessee.

Ground No. 12

26. In this ground of appeal grievance of the revenue is that Ld. CIT(A) has erred in including an income of Rs. 31,01,500/- in asstt. year 2002-03 whereas it pertains to asstt. year 2001-02. The brief facts of the case are that AO has observed that on pages No. 152 – 155 part I of the Special Audit Report, the auditor has pointed out that three receipts accounted by the assessee pertains to earlier asstt. years. These receipts are :-

- 1) SCM Local fees
- 2) SCM International fees
- 3) Reimbursement of general and administrative expenses
 - 1) Rs. 4,97,000/-
 - 2) Rs. 2,46,000/-
 - 3) Rs. 23,62,500/-

27. The AO has observed that these are taxable in asstt. year 2001-02 and he reduced the income of assessee in this asstt. year to this extent. The assessee has contended before the Ld. CIT (A) that AO has selectively considered page No. 155 of the special audit report. It drew the attention of the Ld. CIT(A) towards page No. 253 of the Special Report and pointed out that bill for general and administrative expenses raised on Pizzeria Fast Food Restaurant Madras Ltd. by debit note No. DN/003/12 is on 24.8.2001. This accounting period falls in the asstt. year under appeal and this is the major amount. Ld. CIT(A) has held that tax rate in both the asstt. years are same. It does not make much difference if these receipts are included in the present asstt. years. He directed the AO to tax this income also in this asstt. year.

28. With the assistance of Ld. Representative, we have gone through the record carefully. The major item appears to be taxable in the present asstt. years. The other two items have been considered by the Ld. CIT(A) as taxable in this year on the ground that tax rate are similar. It will create unnecessary complication by excluding these receipts from here and including them in asstt. year 2001-02. Considering the finding of Ld. CIT(A), we do not wish to interfere in it. This ground of appeal is rejected.

Ground No. 13

29. This ground will be taken along with the ground No. 6 of assessee's appeal.

Ground No. 14

30. In this ground of appeal grievance of revenue is that Ld. CIT(A) has erred in deleting the disallowance of Rs. 5,56,428/-. The brief facts of the case are that at the end of year, assessee has made certain provisions on the basis of mercantile system of accountancy followed by it. According to the AO, this provision was not utilised by the assessee in the next asstt. year. Therefore, in his opinion, excess provision deserves to be disallowed. Ld. CIT(A) deleted the disallowance on the ground that provision is being made by keeping in view the possibility of certain expenses. If the provision has not been exhausted by the assessee, then it does not mean that there was no possibility of arising such type of expenditure when provision was made. The AO has erred in disallowing the provision.

31. On due consideration of the facts and circumstances, we do not see any reason to interfere in the order of Ld. CIT(A). The assessee has made the provision by keeping in view past experience and the possibility of certain expenses. It has filed the details exhibiting the nature of intending expenses. It is a separate issue that such occasion did not arise to incur those expenses but that does not mean that when provision was made it was not bonafide. If some amount remained unutilised it will be offered for tax in the next asstt. year. Hence, this ground of appeal is rejected.

Ground No. 15

32. In this ground of appeal, grievance of the revenue is that Ld. CIT(A) has erred in deleting the addition of Rs. 2,33,950/-. The assessee has been showing a liability of Rs. 2,33,950/-. The AO has made the addition on the ground that liability to pay has seized. He formed this opinion on the ground that such liability has been shown as outstanding from a number of years. Ld. CIT(A) has deleted the disallowance on the ground that AO cannot classify a particular liability as "liability no longer required". It is the assessee who has to proceed after taking into account the requirement of its business for writing of such liability. If assessee is willing to pay the amount, then it would not be construed as liability no longer required. On due consideration of the Ld. CIT(A)'s order, we do find any merit in this ground of appeal. It is rejected.

Ground No. 16

33. In this ground of appeal, revenue has pleaded that Ld. CIT (A) has erred in directing the AO to allow the set off and carry forward of the past unabsorbed losses and depreciation. Ld. Counsel for the assessee at the very outset pointed out that this issue become infructuous because on

an application moved by assessee u/s 154 of the Income tax Act, AO himself has rectified the order. In view of the above, this ground of appeal is rejected.

Ground No. 17

34. In this ground of appeal, grievance of the revenue is that Ld. CIT(A) has erred in deleting the interest charged by the AO u/s 234D of the Income Tax Act. Ld. Counsel for the assessee at the very outset submitted that this issue is covered in favour of the assessee by the order of the special bench of the Tribunal in the case of ITO vs. Ekta Promoters reported in 305 ITR (AT) page 1. He also pointed out Hon'ble Delhi High Court has also affirmed the order of Tribunal in ITA No. 491/2008 rendered in the case of *Director Income Tax vs. M/s Jacabs*. He placed on record copy of the Hon'ble High Court's decision dated 30th August, 2010. The special bench of the Tribunal has held that interest u/s 234D cannot be leviable prior to the asstt. year 2004-05 because operation of this section would be perspective in nature. In view of the judgment of Hon'ble Delhi High court this ground of appeal is rejected.

35. In view of the above discussion, the appeal of the revenue is partly allowed for statistical purpose.

36. Now we take the appeal of assessee in assessment year 2002-03 i.e. ITA No. 3796/Del/2006. First ground of appeal taken by the assessee is general in nature, it does not require any specific finding to be record, hence it is rejected.

37. In ground No.2, grievance of the assessee is that Learned CIT(Appeals) has erred in upholding the addition of Rs.11,35,994. The assessee has a wholly owned subsidiary, namely 'Yum Restaurant Marketing (P) Ltd. (hereinafter referred to YRMPL). The subsidiary used to undertake advertising, media and promotional activities. The assessee has received a sum of Rs.26,01,700 from one of the franchise M/s. Dodsals Hotels and Resorts (P) Ltd. towards its contribution for advertising, media and promotional activities. This amount, according to the assessee, was paid by Dodsals Hotels for advertising and promotional activities for KFC outlets. Assessee could spent a sum of Rs.14,65,706. The balance of Rs.11,35,994 was shown as liability under the head of 'accrued marketing'. Assessing Officer has made the addition of the balance by observing as under:

"Business Income Understated

During the course of assessment proceedings, attention of the assessee was drawn towards page no. 165-166 of the special audit report part II and page 153-154 of the special audit report part I, according to which:

- "As far the expense of Rs.14.65,706 on KFC is concerned, the expense relates to the amount received from one of the

Franchisee namely M/s. Dodsel Hotels & Resorts Pvt. Ltd. who actually contributed Rs.26,01,700 during the relevant assessment year out of which Rs.14,65,706 was actually incurred as expense by the assessee and the balance amount of Rs.11,35,994 was shown as Accrued Marketing Liabilities as on 31.03.2002. Thus, in view of the above we can say that the moment amount was received by the assessee, it was its income and the expenditure incurred could have been treated separately but the assessee has shown as amount of Rs.14,65,706 only as its income as well as expense, thus the whole exercise has resulted in to under statement of income to the tune of Rs.11,35,994.

- During the year under consideration, the assessee received the advertising contribution from M/s. Dodsals Corporation to the tune of Rs.26,01,700 without deducting the TDS, out of which Rs.14,65,706 was actually spent by the assessee during the year. The amount of Rs.14,65,706 was actually spent by the assessee during the year. The amount of Rs.14,65,706 was booked as income as well as expenditure and also showed the balance amount of Rs.11,35,994 as liability under the head of Accrued Marketing”.

It is noticed that the assessee disclosed and spent Rs.14,65,706 as advertising contribution out of a total of Rs.26,01,700 received from M/s. Dodsals Hotels & Resorts (P) Ltd. The balance, Rs.11,35,994 was shown as liability under the head of Accrued Marketing. The assessee was thus required to explain as to why a credits of Rs.11,35,994 be not treated as your income. The assessee failed to place on record any reply. It is thus presumed that the assessee has nothing to say, thus Rs.11,35,994 is treated as income.

(Understated Income Rs.11,35,994/-)

38. Appeal to the learned CIT(Appeals) did not bring any relief to the assessee.

39. The assessee has contended that every receipt is not an income. Assessing Officer has wrongly recorded that assessee failed to file any explanation. The assessee has submitted its reply. The learned counsel for the assessee drew our attention towards page No. 754 of the paper book No.II, wherein letter of the assessee dated 18.1.2005 is available. On the strength of this letter, he pointed out that assessee has contended before the Assessing Officer that advertisement contribution was collected by the assessee with a over riding title that it will be spent on advertisement activities. The assessee had cited decision of the Hon'ble Supreme Court in the case of *Sheetal Dass Tirath Dass* reported in 41 ITR 367 and appraised the Assessing Officer about the concept of

overriding title. The assessee also relied upon the decision in the case of *Calcutta Supply Co. Ltd. Vs. CIT* reported in 37 ITR 1. The thrust of assessee's argument was that it acts only as collecting agent. The amounts received by the assessee is with a predefined obligation. If something has been received with a pre-defined object then assessee was under a compulsory obligation to spend the amount received and the same cannot be regarded as income in its hands. The assessee relied upon the decision of the Hon'ble Supreme Court in the case of *CIT vs. Bijli Cotton Mills* reported in 116 ITR 60. The learned counsel for the assessee pointed out that contribution which received by the assessee from its franchise are not received by it as an income but as a predefined obligation under the terms of franchise agreement. On the other hand, Learned DR relied upon the order of the Assessing Officer. He pointed out that neither the clauses of franchise agreement was brought to the notice of the Assessing Officer nor it was demonstrated why assessee has acted as a collecting agent. From the business module of the assessee, it was assessee's outlook to look after all these aspects. It is immaterial whether assessee is carrying out itself or it has got done by a subsidiary.

40. We have duly considered the rival contentions and gone through the record carefully. In the letter written to the Assessing Officer as well as in the written submissions filed before us, the assessee has taken a plea that amounts were collected with a predefined obligation, therefore, it cannot attain the character of income in the hands of the assessee. While dealing with ground Nos.1 and 2 of revenue's appeal in the preceding paragraph, we have considered the nature of business carried out by the assessee. As per its Memorandum of Association, it is required to provide consultancy and advisory services in connection with the establishment, organizations, financing, management and operation of restaurants, cafes and cafeterias etc.

In performance of activities, it is also conducting advertisement media and marketing operations. The assessee had made an arrangement that this AMP activity would be carried out by way of its 100% subsidiary i.e. "YRMPL". It may be true that the subsidiary is actually carrying out advertisement activities but it is the assessee who is collecting the money first and then transmitting to the subsidiary concerned. The business line of the assessee is also similar. Its arrangement with the subsidiary would not make much differences. The decision of the Hon'ble Supreme Court relied upon by the assessee in the case of *Bijli Cotton* is concerned, in that case, assessee has received certain amounts towards Dharmarth charges. This nominal amount was collected from the customers and it was meant for Dharamsthal. In that background, Hon'ble Supreme Court has observed that it does not contain the character of income in the hands of the assessee. In the case of the assessee, it is collecting as a business receipts but contending that it is meant for YRMPL, therefore, it is not the income in the hands of the assessee. There is no distinguishing

feature of these receipts as to why it cannot be a revenue receipts in the hands of the assessee. It may be a different case that the moment amount is transferred to YRMPL, it can attain the character of business expenditure but it cannot be concluded that this amount was not a revenue receipts in the hands of the assessee. Learned CIT(Appeals) has rightly confirmed the addition and we do not find any error in it. This ground of appeal is rejected.

41. Ground Nos. 3 and 4 of the assessee's appeal are inter connected with grounds 7 to 10 of revenue's appeal. In ground no.3, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the disallowance of lease rent at Rs.9 lacs and in ground No.4, it has pleaded that Learned CIT(Appeals) has erred in upholding the disallowance of Rs.7,50,000 out of house maintenance expenditure. The brief facts of the case are that M/s. Mezbaan Hoteliers (P) Ltd. had entered into a lease agreement with Mrs. Surendra Judge on 1st of June 1997 for taking a house property on lease. The annual lease rentals were settled at Rs.2,40,000. M/s. Mezbaan Hoteliers (P) Ltd. is a private limited company in which the relatives of the managing director of the assessee company were directors, namely, the father and wife of Mr. Sandeep Kohli. The assessee took this house property on a sub-lease from M/s. Mezbaan Hoteliers for providing a residence to its director Mr. Sandeep Kohli. The annual lease rent has been settled at Rs. 15 lacs per annum. The assessee had also paid a security of Rs.50 lacs to the hotel. It also spent huge amount for renovation. The tax auditor had not reported this transaction for the purpose of section 40A(2)(b) of the Act. Assessing Officer has held that entire transaction was a sham. Assessee has paid excessive security deposit. Assessing Officer further observed that a property which fetch rent of Rs.20,000 in the hands of the original landowner, how can it fetch a rent of Rs.1,25,000 per month, more so by way of agreement of even date.

42. In ground No.4, assessee has challenged the disallowance of Rs.7,50,000. It emerges out from the record that assessee has incurred a sum of Rs.22,50,000 for repair, renovation and up-gradation of the facilities in the house properties. It has amortized the expenses in three years because lease agreement was for a period of three years and thereafter it was to be renewed. In this way, in the present assessment year, assessee has claimed the deduction of Rs.7,50,000. This deduction was disallowed to the assessee by the Assessing Officer on the ground that lease agreement is a bogus one.

43. On appeal, Learned CIT(Appeals) has observed that rent paid for the residential accommodation of the managing director is an allowable expenditure. He estimated the reasonable rent at Rs.50,000 and disallowed the balance i.e. nine lacs of rupees has been disallowed. With regard to Rs.7,50,000, Learned CIT(Appeals) has observed that this amount could be allowed in the year in which it was incurred.

44. The assessee in its appeal is challenging the disallowance of Rs. 9 lacs. Assessing Officer has made a total disallowance of Rs.25,71,600 out of lease rentals. Learned CIT(Appeals) has allowed the lease rent paid by the assessee except a sum of Rs. 9 lacs.

45. With the assistance of learned representatives, we have gone through the record carefully. It emerges out from the record that assessee has paid Rs. 15 lacs of rent for the residence of Mr. Sandeep Kohli. It has paid a sum of Rs. 50 lacs as security deposits. Assessing Officer has estimated notional rent @ 12% of the interest free deposits which worked out to Rs. 6 lacs. He computed the disallowance of Rs. 21 lacs for the residence for Mr. Sandeep Kohli. The assessee had incurred a sum of Rs.4,20,700 on the residence of Shri Ajay Bansal. In this case also, payment was made to Mrs. Pushpa Bansal and Sheetal Bansal who are the wife and mother of Ajay Bansal. Assessing Officer has also found a security deposit paid by the assessee and he estimated the notional rent on such deposit at Rs.50,900. The disallowance has been worked out to Rs.4,71,600.

46. There is no dispute that the payments have been made to the persons who are covered under sec. 40A(2)(b) of the Act. Under this section, if it is established that assessee has paid an amount in excess, then the one available in open market for availing such services from a person or entity falling within the ambit of this section then such excess amount would be disallowed to the assessee. We fail to understand how a house property giving a rent of Rs.20,000 to the original land owner would immediately fetch a rent at Rs.1,50,000. This much of rent has been given by the assessee after incurring a huge sum of Rs.22,50,000 on repair which gives an indication that if this sum of Rs.22,50,000 was not incurred then it would not fetch this amount of rent. Apart from this, assessee had paid interest free security deposits of Rs.50 lacs. Assessing Officer has discussed that this payment of rent is associated with the salary of the executive director & house rent allowance is fixed @ 60% of their salary. On the basis of the facts emerging out from the assessment order, we find that assessee has extended extra pecuniar benefit to its managing director. Thus, taking into consideration the over all evidence on record, we set aside the order of the Learned CIT(Appeals). We direct the Assessing Officer to allow payment of rent to the extent of Rs.20,000 per month for the accommodation taken on rent for Shri Sandeep Kohli, the balance has to be disallowed. The estimation of this rent on the basis of the original rent agreement between the landowner and Hotel Mezbaan would take care of all other notional rent computed by the Assessing Officer on the basis of interest free deposits. In brief, against the claim of any rent made by the assessee for the residence provided to Mr. Sandeep Kohli, only a sum of Rs.2,40,000 would be allowed. There will not be any disallowance on account of notional rent worked out on the basis of interest free security. Assessing Officer shall carry out this

exercise. As far as the rent claimed in respect of the residence of Shri Ajay Bansal, we remit this issue to the file of the Assessing Officer for readjudication because he has not worked out fair rent this property can fetch, which can be allowed to the assessee. As far as the disallowance of Rs.7,50,000 is concerned, we find that this disallowance has been confirmed by the Learned CIT(Appeals) on the ground it was not incurred in the present year. Since the expense does not pertain to this year, its allowability cannot be judged in the present year. Assessee has raised an alternative plea that in case it is not allowable in this year then a direction be issued to the Assessing Officer to allow in the year of incurrence. In our opinion, assessee will be at liberty to approach the Assessing Officer in accordance with law but in the present year, we do not deem it necessary to give any specific direction. In the result, ground No.3 raised by the assessee is allowed for statistical purposes and ground No.4 raised by the assessee is rejected. Ground Nos. 7 to 10 raised by the revenue are allowed for statistical purposes.

Ground No.5:

47. In this ground of appeal, grievance of assessee is that Learned CIT(Appeals) has erred in confirming the disallowance of Rs.7,10,535. With the assistance of learned representatives, we have gone through the record carefully. Assessing Officer has discussed this issue on page Nos. 24 to 26 of the assessment order. Assessee has claimed expenses of Rs.10,62,991. The nature of these expenses are discernible at page Nos. 275 to 277 of Part-I of Special Audit Report. Assessing Officer has confronted the assessee and the assessee has filed its submissions. According to the Assessing Officer, the submissions are general in nature. He worked out that sum of Rs.7,10,535 does not relate to the present assessment year. Therefore, he made the addition.

48. Appeal to the learned CIT(Appeals) did not bring any relief to the assessee.

49. The assessee has pleaded that liability to pay had been crystallized during the current year and, therefore, expenses should be allowed. To buttress this contention, assessee has relied upon a number of decisions, namely, Non-such Tea Estate Ltd. Vs. CIT reported in 98 ITR 189 and CIT vs. Nagri Mills reported in 33 ITR 681. Alternatively, it contended that the expenses be allowed in assessment year 2001-02 and a direction be issued to the Assessing Officer. Learned DR on the other hand relied upon the order of the Assessing Officer.

50. We have duly considered the rival contentions and gone through the record carefully. Out of the total expenses, a sum of Rs.3,52,456, pertains to gratuity which according to the assessee was allowable as per section 43B read with section 40(A)(7) of the Act. Assessing Officer after verification of this aspect allowed this claim. As far as the proposition of law, contended by the assessee that if the liability to pay has been

crystallized during the accounting year relevant to this assessment year then the expenses are allowable is concerned, we do not have any dispute. Our difficulty is that the assessee failed to show crystallization of the liability to pay in the present accounting year. Its accounts are complicated. Special Auditor has been appointed who recommend for disallowance of the expenditure. Assessing Officer has given fair opportunity to the assessee. Before us, it is just merely harping upon the proposition of law instead of buttressing it on facts, therefore, we do not find any force in this ground of appeal, it is rejected.

51. In ground No.6, grievance of the revenue is that Learned CIT(Appeals) has erred in upholding the disallowance of Rs.1,64,999 out of the total disallowance of Rs.3,36,789. This ground is inter-connected with ground No.13 of the revenue's appeal. The revenue is challenging deletion of disallowance in ground No.13. The learned counsel for the assessee submitted that details of expenditure have been placed on record at page Nos. 1419 to 1452 of paper book IIIB. The details of these expenses have been compiled in a tabular form and annexed in the written submission also. Assessing Officer while making the disallowance has observed that bills are either in the name of TRIM, on persons, who are neither directors nor employees or also in the name of sister concern. He made a reference towards the payment of Rs.1 lac made to M/s. Arthur & Anderson who have given advise to M/s. Specialty Restaurant (P) Ltd. In his opinion, the expenses are not incurred for the purpose of the assessee's business. Learned CIT(Appeals) confirmed the disallowance of Rs.1 lac and further confirmed the disallowance in respect of expenses incurred for Specialty Restaurant, J. Sagar & Associates etc. The assessee has contended that if the name of the assessee is not in the invoice, it may not be sufficient ground for disallowance of expenditure. It also contended that assessee is a company where no personal expenditure could be there. For buttressing this contention, it relied upon the decision of Hon'ble Gujarat High Court reported in 253 ITR 749. Learned DR on the other hand, relied upon the order of the Assessing Officer.

52. We have duly considered the rival contentions and gone through the record carefully. Assessing Officer has recorded a brief finding in just one paragraph. His conclusions are based on special audit report as well as failure of the assessee to prove a nexus of business expediency with the expenses. They may not be a personal expenditure but these were not incurred for the purpose of the business. The decision of the Hon'ble Gujarat High Court in the case of Saya Ji Iron is not applicable on these expenses. Learned First Appellate Authority reappraised the expenses and treated some of them as allowable. We have also gone through the chart submitted by the assessee and the details of expenditure available on page Nos. 1420 to 1452 of the paper book. At page Nos. 1420 is a bill in the name of TRICON Restaurant India (P) Ltd. It has some ledger print.

This bill is for a sum of Rs.7,194. They are similar type of bills for different requirements. Taking into consideration the findings of Learned CIT(Appeals), we do not see any reason to interfere in it. The ground of appeal raised by assessee as well as revenue is rejected.

Ground No.7:

53. In this ground of appeal, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the addition of Rs.3,30,474. The brief facts of the case are that the special auditor has quantified certain expenses which are prepaid in nature. According to the special audit report, assessee had incurred certain expenses whose benefit will not be available in the present assessment year rather it will be available in the next assessment year. Assessing Officer has disallowed those expenses on the ground that these are prepaid expenses.

54. Appeal to the learned CIT(Appeals) did not bring any relief to the assessee.

55. The assessee has pleaded that amounts paid were in pursuant to annual maintenance contracts. Once the amounts are paid they are irretrievable and these cannot be claimed back. The assessee also pointed out that certain payments towards annual maintenance contracts were claimed as an expenditure in the present assessment year, they cannot be disallowed by distrusting the method of accounting being irregularly followed. The assessee has cited number of decisions before the Learned CIT(Appeals) as well as in its written submissions. Learned DR on the other hand relied upon the order of Learned CIT(Appeals). The decisions relied upon by the assessee in the submissions are just in order to explain how the quasijudicial authority ought to have appreciated a controversy. On the strength of Hon'ble Supreme Court's decision in the case of *Indian Molasses Vs. CIT* reported in 37 ITR 66. We were appraised how to construe the meaning of expenditure. In our opinion, all these decisions are not of any help to the assessee, because the basic facts for deciding the issue is whether expenses incurred by the assessee are relatable to the assessment year or not. They might be of revenue in nature. They can be allowed in the next assessment year but the expenses which are relatable to the present assessment year can only be allowed. The income against those expenses is assessable in the present assessment year. Assessing Officer has disallowed the claim of assessee on the basis of various defects in its account and the opinion expressed by the special auditor. This is purely a factual issue. There are discrepancies pointed out by the special auditor in the maintenance of accounts and those discrepancies have been affirmed by the learned revenue authorities below. Thus, Learned CIT(Appeals) has rightly disallowed the claim. This ground of appeal is rejected.

56. In the next ground of appeal, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the addition of Rs.5,53,515 as capital expenditure.

57. With the assistance of learned representatives, we have gone through the record carefully. Assessee has placed on record the details of expenses in the tabular form. It has pointed out the major sum of Rs.4 lacs were incurred towards software expenses. The assessee has got developed a software for Piza Hut Call Centre. According to the assessee, it has paid internet charges and other charges for repair of computers. All these expenses are of revenue in nature. Assessee has referred the decision of the Special Bench of the ITAT in the case of Am Way India reported in 111 ITD 112 and contended that if functional tests are applied to the facts of the present case then these expenses would be allowed to the assessee as revenue expenses. On due consideration of the facts and circumstances, we are of the view that Learned CIT (Appeals) has allowed depreciation to the assessee on these expenses. The assessment year involved herein is 2002-03. The amount involved is not a substantial amount in comparison to the financial status of the assessee. The decision of the Special Bench in the case of Am Way India was not available with Assessing Officer as well as Learned CIT (Appeals). The cost incurred on such repairs or development of software must have been recouped by the assessee in the shape of depreciation. We do not deem it necessary to set aside this issue for readjudication at the level of Assessing Officer in the light of Special Bench decision keeping in view the above factual background. No fruitful purpose will be served. The assessee might have a good case on merit as far as expenses incurred on small repairs on such a trivial issue. But in case of reverification is not worth to carry out, in terms of monetary benefit to assessee, therefore, we do not wish to interfere in the order of the Learned CIT (Appeals). This ground of appeal is rejected.

58. In the next ground of appeal, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the disallowance of Rs.15,21,680. The brief facts of the case are that the assessee had incurred a sum of Rs.28,45,630 on conference and seminars. In earlier years, it has incurred a sum of Rs.8,49,643. Assessing Officer on scrutiny of the accounts found that a sum of Rs.15,21,680 was incurred on a conference of Yum's employees at off site meeting at Goa. Assessing Officer found that certain employees went to Goa along with their wives and children and the expenses pertained to them. He directed the assessee to indicate the nature of conference and necessity of employees to carry their family members but it did not submit any explanation. Assessee has relied upon certain decisions which have been noticed by the Assessing Officer and claimed that involvement of wives of employees of the company were essential for the business as per policy requirement

and to understand the culture. Assessing Officer has disallowed the claim of the assessee by making following observations:

- a) the spouse in cases being wife of Chairman/Director/managing director.
- b) The spouses contributed towards business of the assessee.
- c) The participation of wives of two business entities were essential for building business ties between two business organizations.
- d) The courts upon material placed before them had observed that there existed no doubt direct nexus between the visit of wives and business to be contracted.
- e) Thus upon the nexus as proved a commercial exigencies existed as such the expenditure was allowed as exceptional circumstances.

However, considering the reply of the assessee, it is noticed that assessee has made a general reply without proving how a meeting of employees carried out accompanying wives and relatives be treated as business. The cases relied upon by the assessee since framed upon different circumstances and different facts than that of the assessee, clearly distinguishable thus cannot be relied upon.

Thus from the reply furnished by the assessee following automatically arises:

- (a) That no evidence regarding nature of activity carried out at Goa was furnished.
- (b) Need and outcome of Goa visit.
- (c) Objectives of the programmes so carried out.
- (d) Proofs to show that the programmes as alleged and business meetings were carried out.
- (e) Extent of and active participation of family members accompanied by employees in such meetings.

Thus in view of the above followings are inferred:

- a) the meeting was not held for the business purposes.
- b) The cases relied upon since referred in a context where business meetings were held therefore not applicable.

The expenditure thus incurred is the personal expenditure of the employees. The expenditure is thus unconnected and not incurred during the normal course of business, therefore, disallowed”.

59. Appeal to the learned CIT(Appeals) did not bring any relief to the assessee.

60. Before us, assessee has contended that recreational meeting at off-site are organized for the welfare of employees. Such trips are frequently arranged by multi-national companies to keep their employees motivated. It is a very common feature in today's modern business and environment. The purpose of the off site meeting was to discuss the future growth straightgy for the company along with recreational activities for its employees and their spouses. It was also contended that various talks and lectures and programs were conducted. There is no personal expenditure in the case of the assessee as it is a corporate assessee. The assessee has relied upon the decision of Hon'ble Gujarat High Court in the case of *Saya Ji Iron & Engg. Co. Vs. CIT* (supra). It has also relied upon the order of the ITAT in the case of *Midland International Ltd. Vs. DCIT* reported in 109 ITD 198 and *DCIT Vs. Haryana Oxygen Ltd.* reported in 71 ITD 32. The main thrust of assessee's contention is that if expenditure incurred for the welfare of employees and for business purpose then it is an allowable expenditure. The assessee made a reference to the ten decisions in its written submissions, namely, *Pounds India Ltd. vs. DCIT* reported in 59 TTJ 560 and *Delhi Cloth & General Mills Vs. CIT* reported in 158 ITR 64 etc. On the other hand, Learned DR relied upon the orders of the Revenue Authorities Below.

61. We have duly considered the rival contentions and gone through the record carefully. The assessee has raised elaborate arguments and made a reference to large number of decisions and in substance it has highlighted the proposition of law available in those decisions and appraised us how expenses for welfare of staff and business nature can be allowed. The main dispute is how the assessee is able to prove that expenses incurred by it were for the purpose of the business. By making a reference to general proposition or the proposition discussed in other authoritative pronouncement would not be suffice to say that expenses are to be allowed to the assessee, such expenses are to be allowed the moment it is proved that they were incurred wholly and exclusively for the purpose of the business. This aspect, the assessee has miserably failed to prove. We have extracted above the findings of the Assessing Officer and how he has demonstrated that these expenses were not for the purposes of the business. The case laws cited by the assessee are of no help unless it proved factually that expenses were incurred for the purpose of the business. Taking into consideration the findings recorded by the Assessing Officer (extracted supra), we do not find any merit in this ground of appeal. It is rejected.

62. In the result, the appeal of the assessee is dismissed.

ITA No. 142/Del/2006:

63. Ground No.1 is general in nature, hence does not require any adjudication. It is rejected.

64. Ground Nos. 2 and 3 are inter-connected with ground Nos.4 to 7 of the revenue's appeal in this assessment year. All these grounds read as under:

2. That on the facts and circumstances of the case and in law the Learned CIT(Appeals) was not justified in upholding the disallowance of lease rent to an extent of Rs. 9 lacs, paid on account of rent free accommodation provided to the Managing Director of the assessee company.
3. That the Learned CIT(Appeals) was not justified on the facts and circumstances of the case and in law in upholding the disallowance of an amount of Rs.7,50,000 in respect of house maintenance expenditure pertaining to rent free accommodation provided to the Managing Director of the appellant company”.

ITA No. 480/Del/2006:

- “4. On the facts and circumstances of the case, the learned CIT(Appeals) erred in deleting the addition of Rs.6,00,000 on account of lease rent.
5. On the facts and circumstances of the case, the learned CIT(Appeals) erred in deleting the deleting the addition of Rs.6,00,000 on account of notional interest.
6. On the facts and circumstances of the case, the learned CIT(Appeals) erred in deleting the addition of Rs.5,05,500 on account of lease rent paid to Smt. Sheetal Bansal and Smt. Pushpa Bansal relatives of the director.
7. On the facts and circumstances of the case, the learned CIT(Appeals) erred in deleting the addition of Rs.55,527 on account of notional interest”.

65. All these grounds are analogous to ground Nos. 3 and 4 of assessee's appeal for assessment year 2002-03 and ground nos. 7 to 10 in revenue's appeal. We have already adjudicated these grounds of appeal while disposing of the cross-appeals of the parties in assessment year 2002-03 in preceding paragraphs. In this assessment year, same effect be given.

66. Ground No.4: In this ground of appeal, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the disallowance of Rs.30,891. This ground is similar to ground No.5 raised by the assessee in assessment year 2002-03 wherein a disallowance of Rs.7,10,535 has been confirmed by the Learned CIT(Appeals) and we have upheld the order of

the Learned CIT(Appeals). Considering the findings of the Learned CIT(Appeals) in this year also, we do not find any merit it is rejected.

67. Ground No.5: In this ground of appeal, grievance of the assessee is that the Learned CIT(Appeals) has erred in confirming the disallowance of Rs.33,460 out of the total disallowance of Rs.63,033 made in the assessment order under the head “personal expenditure”. This ground is inter-connected with ground No.9 of the revenue’s appeal wherein revenue is impugning the partial deletion of the disallowance.

68. With the assistance of learned representatives, we have gone through the record carefully. It revealed that a sum of Rs.33,460 was incurred towards the fee of Mr. Rajiv Kumar who pursued MBA Course. The assessee failed to bring any policy decision arrived at by the management for reimbursing the fee incurred on education. The fee was paid because of the personal influence of the employee and it was not incurred for any business purposes. The assessee failed to bring any material on the record to this effect. Learned CIT(Appeals) has rightly confirmed the disallowance. As far as the other amounts are concerned, we find that these relates to medical expenses of Mr. Sandeep Kohli who is a director and the expenses incurred on the uniforms of his driver. These expenses are to be termed as expenses relating to the day to day business of the assessee. Thus, the ground of appeal raised by the assessee as well as of revenue are rejected.

69. Ground No. 6: In this ground, grievance of the assessee is that the Learned CIT(Appeals) has erred in confirming the addition of Rs.1498 which has been disallowed on the ground that these expenses were paid for the benefit required to be available for subsequent period. This ground is similar to ground No.7 in assessment year 2002-03. On the basis of our findings, recorded on that ground, this ground is rejected.

70. Ground No.7 : In this ground, grievance of the assessee is that Learned CIT(Appeals) has erred in confirming the disallowance of Rs.33,536 out of the total disallowance of Rs.64,611. This ground is interconnected with ground No.10 of revenue’s appeal wherein revenue is impugning the amount partly deleted by the Learned CIT(Appeals). The assessee had incurred a sum of Rs.64,611 on purchase of projector lamp, purchase of room heater, purchase of imported chair and fire extinguishers etc. Learned CIT(Appeals) has allowed the deduction in respect of purchase of projector lamp, room heaters and purchase of ten imported chairs. She disallowed rest of the expenses. As far as the purchase of project lamp is concerned, it required frequent changes after completed number of hours of running, hence it cannot be a capital expenditure and Learned CIT(Appeals) has rightly allowed it. Similar is the position with regard to other two items. These expenses were incurred for replacement of existing assets. As far as the purchase of fire extinguishers and purchase of electronic equipments are concerned, these have rightly been disallowed by the Learned CIT (Appeals)

because these are in the capital field. In view of the above discussion, both the grounds are rejected.

71. In the result, appeal of the assessee is dismissed.

ITA No.480/Del/2006:

72. In ground No.1, revenue has pleaded that Learned CIT (Appeals) has erred in holding the service income received of Rs.12,38,00,000 as business income. This ground is similar to ground No.1 raised by the revenue in assessment year 2002-03. We have upheld the treatment of these receipts as a business income. In view of our findings, in assessment year 2002-03, this ground of appeal is rejected.

73. In ground No.2, revenue has pleaded that Learned CIT(Appeals) has erred in deleting the addition of Rs.3,25,87,817 which was computed by the assessee as royalty to KFC International Inc and Piza Hut. This ground is analogous to ground No.5 in assessment year 2002-03. In that assessment year, a similar disallowance of Rs.3,23,01,939 was made by the Assessing Officer. Learned CIT(Appeals) has deleted the disallowance and we have upheld the order of the Learned CIT(Appeals). In view of our findings on ground No.5 in assessment year 2002-03, this ground of appeal is rejected.

74. Ground No.3: In this ground of appeal, grievance of the revenue is that Learned CIT(Appeals) has erred in deleting the disallowance of Rs.3,16,08,889. This ground is similar to ground No.6 raised by the revenue in assessment year 2002-03. In this ground, grievance of the revenue is that Learned CIT(Appeals) has erred in allowing on its subsidiary concern, namely, YRMPL. The disallowance made by the Assessing Officer has been deleted by the Learned CIT(Appeals) for assessment year 2002-03 and we have upheld the deletion. Keeping in view of our findings on ground No.6, this ground of appeal is rejected.

75. Ground No.8: In this ground of appeal, grievance of revenue is that Learned CIT(Appeals) has erred in deleting the disallowance of Rs.1,26,49,203. A similar issue was taken up by the revenue in assessment year 2002-03 in ground No.11 wherein Assessing Officer has disallowed the claim on depreciation amounting to Rs.1,35,67,376. Learned CIT(Appeals) deleted the disallowance. We have upheld the order of the Learned CIT(Appeals) subject to certain directions. Similar directions are available in this assessment year. In view of our findings, this ground of appeal is, therefore, rejected.

76. Ground No.11: In this ground of appeal, grievance of the revenue is that Learned CIT(Appeals) has erred in deleting the disallowance of Rs.2,86,478. A similar issue was taken up by the revenue in ground No.14 in assessment year 2002-03. The assessee has made the provision, which was not used in the next year, Assessing Officer on the basis of its non-utilization made the disallowance. Learned CIT(Appeals) has deleted a similar disallowance of Rs.5,56,482 in assessment year 2002-03 and we

have upheld the disallowance. In view of our findings recorded on ground No.14, this ground of appeal is rejected.

77. Ground No.12: In this ground of appeal, grievance of the revenue is that Learned CIT(Appeals) has erred in directing the Assessing Officer to allow the set off and carry forward of the past unabsorbed losses and depreciation. We have been informed that similar issue arose in assessment year 2002-03, Assessing Officer by exercising his powers under sec. 154 of the Act has rectified the assessment order and allowed the set off and carry forward of the past unabsorbed losses and depreciation. In view of this fact, this ground of appeal is rejected in the present year also.

78. Ground No.13: In this ground, revenue has challenged the deletion of charging of interest under sec. 234D. A similar issue was taken up by the revenue in ground No.17 in assessment year 2002-03. We have upheld the deletion of charging of interest under sec. 234 on the strength of Hon'ble Delhi High Court's decision wherein it has been observed that interest under section 234D can be charged from assessment year 2004-05 and not prior to that. Considering our findings in assessment year 2002-03, this ground of appeal is rejected.

79. In view of the above discussion, the appeal of the revenue is partly allowed for statistical purposes.

ITA No. 5122/Del/2010:

80. The present appeal is directed at the instance of the assessee against the order of Learned Dispute Resolution Panel passed under section 144C(5) of the Income-tax Act, 1961 on 23rd September, 2010 in assessment year 2006-07.

81. The grounds of appeals taken by the assessee are not in consonance with Rule 8 of the ITAT's Rules, they are descriptive and argumentative in nature. In ground no.1, assessee has taken 10 sub-grounds. In all these grounds, it has pleaded that learned revenue authorities have erred in making adjustment in the arm's length price disclosed by the assessee with regard to its international transaction and thereby erred in making an addition of Rs.2,28,47,737.

82. The brief facts of the case are that the Assessing Officer had made a reference to the learned Transfer Pricing Officer under sec. 92CA(3) of the Act in respect of international transaction entered into by the assessee during the financial year 2005-06. It emerges out from the record that assessee *M/s. Yum ! Restaurants (India) Pvt. Ltd.* is a subsidiary of Global Restaurants Inc., Mauritius that holds more than 99.99% of shares of YRIPL. The company operates a well known multinational chain of fast food restaurants under the brand names, Pizza Hut, Kentucky Fried Chicken Global BV and Taco Bell. It provides franchise support services to KFC and Pizza Hut franchise in India, Sri Lanka, Pakistan and Mauritius. It advises franchise on restaurant

design, business development, human resources management and financial planning. It also collects royalty from the franchisees and remits the same to its associated enterprises. Learned TPO noticed that assessee has reported three international transactions in form No. 3CEB. These transactions have been noticed on page 2 of his order by the learned TPO. They read as under:

S.No.	Nature of transaction	Method used by Assessee Method	PLI	Value of transaction in Rs.
1.	Payment of Royalty for providing schemes, trademarks and system property	TNMM	OP/OR	11,69,76,923
2.	Provision of franchisee support services	TNMM	OP/OC	20,26,00,000
3.	Provision of supply chain management services	TNMM	OP/OC	35,187
	Total			31.96,12,110

83. Learned TPO has observed that assessee has applied transactional net margin method (TNMM) as the most appropriate method for benchmarking the arm's length price of its international transactions and the profit level indicator i.e. (PLI) has been worked by dividing operating profit by operating cost i.e. OP/OC. The assessee has reported a set of 9 comparable cases and worked out their weighted arithmetic mean of 7.43%. The assessee's NCP margin is 5.79%. It had used multiple year data. Learned TPO after a detailed analysis of the method applied by the assessee for working out its arm's length price and other details accepted the method applied by the assessee as TNMM. The assessee has identified 9 comparable cases. Learned TPO rejected 5 comparable. He had done benchmarking by using remaining 4 comparable to arrive at the mean of 11.89% as arm's length margin. Learned TPO rejected the application of multiyear data. He used current year data. In this way, an adjustment of Rs.2,28,47,737 has been proposed by the TPO which has been incorporated in the draft assessment order by the Assessing Officer. The draft assessment order was forwarded to the assessee on 16.12.2009 which was received by the assessee on the same day. It has filed objection before the dispute resolution penal in time. Learned DRP has considered the objections of the assessee but did not concur with them.

84. Before us, learned counsel for the assessee reiterated the objections of the assessee. His main thrust of arguments was that Learned TPO has excluded the losses making company from the

comparables. He pointed out that assessee itself had applied filter of persistent loss making company to eliminate those companies from the comparables but assessee has excluded those companies which are reporting loss continuously three years. Learned TPO has rejected companies having loss in financial year 2005-06. On the strength of order in the case of Sony India (P) Ltd. Vs. ACIT reported in 114 ITD 448, he pointed out that loss and competition are normal incident of business. Merely a company is showing loss, it does not mean that it will lose its status of comparable and would deserve to be excluded. He also relied upon the order of the Special Bench of the ITAT in the case of Qurk System (P) Ltd., Mohali reported in 210 TIOL page 31 (ITAT Chandigarh Bench). He further submitted that assessee is a risk bearing company and it is not remunerated on a cost plus basis as per the past practice. Thus, according to the learned counsel, assessee can suffer loss show lower profit like any other concern depending upon the industry condition. He also pointed out that there is no provision in the IT Act which can indicate that loss making company would be rejected from comparable. He placed on record a chart in a tabular form containing the details of each comparable, this chart reads as under:

STATUS CHART

Comparable Company	Accepted/Rejected by the TPO	Operating Margins on Operating Cost	Business Description
Agricultural Finance Corporation Ltd.	Rejected	-8.21%	Consulting services w.r.t. agricultural and rural development
Besant Raj International Ltd.	Reject	-14.45%	Management consultancy Services
Capital Trust Ltd.	Reject	-9.18%	Consultancy Services to Foreign Banks
Crisil Limited	Accept	10.63%	Advisory and information services
Educational Consultants Ltd.	Accept	12.56%	Technical assistance and Human resource development
IDC (India) Ltd.	Accept	14.05%	Market Research and Survey
TSR Darashaw Ltd.	Accept	10.32%	Payroll and Trust Fund activity
NTPC Electric supply Co. Ltd.	Reject	3.29%	Technical consultancy in the area of turnkey

			execution, project monitoring, quality assurance and inspection, third party quality inspection
India Tourism Dev. Corpn. Ltd.	Reject	3.38%	Services in relation to organizing international events. Similar to coordination activities of the assessee.
In House Productions Limited	Reject	-5.62%	Healthcare Division which provides access to information, relating to healthcare to healthcare institutions.

85. He also appraised us as to how the comparable shown by the assessee are comparables. On the other hand, Learned DR relied upon the order of the learned DRP. He pointed out that first objection of the assessee before the learned DRP was that learned TPO has recommended adjustment in the arm's length price of international transaction by using current year data, according to the assessee, multiple year data ought to have been used. He pointed out that learned DRP has dealt with this proposition. Learned TPO while making a reference Rule 10B(4) has observed that current year data has to be used. Learned TPO has made a reference to the decision of the Special Bench of the ITAT in the case of Aztec Software & Tech. Services reported in 294 ITR 32 as well as the decision of the ITAT, Delhi in the case of Mentorgraphic (P) Ltd. reported in 109 ITD 101 wherein the ITAT has held that comparable analysis is to be conducted on the basis of current year data. With regard to the objection of the assessee regarding exclusion of loss making company from comparable cases, he pointed out that Learned TPO has eliminated those companies on the basis of assessee's stand. Assessee in its TP report, has observed that it has applied filter of persisting operating losses. Learned TPO has excluded the other loss making company on the basis of FAR Analysis. Learned DR relied upon the orders of the Learned DRP as well as the TPO on this issue.

86. We have duly considered the rival contentions and gone through the record carefully. On page Nos. 159 to 205 of paper book AI, assessee has placed on record its analysis on transfer pricing. We have gone through this report and other relevant record. Before Learned DRP, the assessee has raised a number of objections but before us it did not dispute

with regard to use of current year data for examining its arm's length price in respect of international transaction. Similarly, before Learned DRP, it has raised an objection that royalty expenses should be netted off with royalty income while calculating operating profit/operating cost as profit level indicator. This issue was also not pressed by the learned counsel for the assessee before us. The method applied for determination of the arm's length price as TNMM has been accepted by the Learned TPO and no dispute was raised by the assessee either before the Learned DRP or before us. It emerges out from the record that in order to identify companies that could be considered as comparable to Yum! Restaurants (India) Pvt. Ltd., the assessee has used two data base which contain commercial information. These data base are "PROWESS" & "Capital line plus". The PROWESS has been up dated up to 9.9.2006 when it was used by the assessee. It is a data base compiled and managed by the centre for monitor Indian economic. Similarly, capital line plus was updated until September 8, 2006. This data base has been compiled and managed by capital market publisher. Both these data base contain financial information of more than ten thousand Indian companies. These data base contains business, profile, annual reports, shareholding pattern and names of subsidiaries/joint ventures of listed and major unlisted public companies. The assessee has used different key words for carving out comparable cases. At Annexure 2 of its analysis, it has identified 342 companies on PROWESS, 617 companies on capital line. There are 90 companies which are common and assessee has identified one additional company. After application of filter, it has rejected 861 companies and carved out 9 comparable as noticed by us in paragraph 84.

87. The main argument of the assessee before us is that Learned TPO has excluded three loss making companies. It has highlighted how these companies are comparable. The first comparable is agricultural finance corporation. The learned counsel for the assessee pointed out that this concern is engaged in providing consulting services in the field of agriculture and rural development. The services includes identification of project for promoting investment, preparation of development of projects and assistance in obtaining approval from external agencies and assistance in project implementation, monitoring and e-valuation. With regard to Basant Raj International, it was submitted by the assessee that this company has earned its income from consultancy services, such as management consultancy, training and recruitment services. With regard to capital trust limited, it was submitted that this company offers consultancy services to foreign banks, not having their branches or representative offices in India. The NTPC is engaged in consultancy and other assignment in the area of turnkey executive, project monitoring, quality assurance and inspection. We find that Learned TPO has considered all these contentions of the assessee. She has not excluded the loss making company simply for the reason that they are making losses. We have no hesitation in observing that merely a company is showing

losses would not lose its status of comparable if other criteria depicted status of comparables. Declaration of loss is an incidental of business which is at par with the profit. The assessee has considered these companies on the basis of their FAR Analysis i.e. (function performed, assets employed and risk assumed). Learned TPO is of the opinion that FAR of a company indicates the avowed objective of the company and the tools that it seeks to employ to achieve that objective. It is the financial result which will decide whether that company has been successfully in achieving the objective or not. According to the Learned TPO, if the assessee's contention based on FAR analysis only is accepted then process of choosing comparable will not proceed beyond the matching of FAR. All types of other tests i.e. data base screening, quality and quantitative screening or use of diagnostic with ratios will be rendered meaningless and unnecessary. Learned DRP concurred with this reasoning of TPO. We find from Annexure 2 of assessee's analysis available on page 188 of the paper book IA for assessment year 2006-07 that assessee itself has applied a filter of persistent operative losses. It has excluded three companies out of total 861 on the basis of this filter, then what is the basis for inclusion there loss making company. Learned TPO has examined their financial result by applying other tools, before exclusion from comparable.

88. We have duly considered the other issues also agitated before the Learned DRP though those issues have not specifically been agitated before us, but we do not find any error in the order of the Learned DRP on those issues. Learned TPO has considered all the objections of the assessee in selecting the comparable and thereafter find out four comparables. After going through the order of the Learned TPO as well as of Learned DRP, we do not find any force in the objections of the assessee. The loss making companies have not been excluded simpliciter on the ground that they are declaring loss. Learned TPO has pointed out that their comparability has been taken into consideration by the assessee on the basis of FAR analysis and other aspects have not been considered. Learned TPO looked into other aspects also. The assessee has placed on record a large number of documents in the paper book as well as judgments, namely, in the case of Philips Software Centre reported in 119 TTJ 721 and Ors. We have considered all those issues which were addressed at the time of arguments. In view of the above discussion, we do not find any merit in this ground of appeal, it is rejected.

Ground No.2:

89. The assessee has taken four sub-grounds along with this ground. In brief, it has pleaded that Learned DRP has erred in affirming the observations of the Assessing Officer that service income earned by the assessee at Rs.20,26,00,000 from M/s. Yum ! Restaurants (India) Ltd., Singapore is to be assessed as "income from other sources" as against "business income". On due consideration of the facts and circumstances,

we are of the view that this issue is analogous to the issue raised by the revenue in ground No.1 for assessment year 2002-03. Assessing Officer in that assessment year has assessed service income receipt as income from other sources. Learned CIT(Appeals) treated such receipts as a business income and we have upheld the order of the Learned CIT(Appeals) in the foregoing paragraph. Taking into consideration our findings, we are of the view that this receipt deserves to be assessed as a business income and not income from other sources.

Ground No.3:

90. The assessee has taken five sub-grounds along with this ground. Grievance of the assessee is that learned DRP has erred in disallowing the royalty paid by the assessee to YRMPL amounting to Rs.12,28,75,765. We find that the facts on this issue are similar to the facts agitated in ground No.5 of revenue's appeal in assessment year 2002-03. In that assessment year, assessee has claimed deduction of Rs.3,23,01,931 on account of royalty expenses. This was disallowed by the Assessing Officer to the assessee but allowed by the Learned CIT(Appeals). We have upheld the order of the Learned CIT(Appeals). There is no disparity on facts hence Learned DRP ought to have not upheld the draft proposal made by the Assessing Officer on this issue. Learned DRP should have taken into consideration the findings of the Learned CIT(Appeals) in assessment years 2002-03 and 2003-04. Respectfully following our discussion in those assessment years, we allow this ground of appeal and deleted the disallowance.

Ground No.4:

91. In this ground of appeal, grievance of the assessee is that Learned DRP has erred in making a hypothetical disallowance of the administrative expenses of Rs.8,97,22,346. The facts and circumstances of this ground are similar to the issue agitated by the revenue in ground No.6 of its appeal for assessment year 2002-03. The assessee had a 100% subsidiary, namely, YRMPL who was taking care of advertisement marketing and promotional activities. It is also functioning from the same premises. Assessing Officer allocated the head office expenses in the ratio of 50-50% between the assessee and its subsidiaries. He made a disallowance of the 50% expenses on the ground that this much of expenses are attributable for the activities of the subsidiaries. We have considered this issue in ground no.6 of revenue's appeal for assessment year 2002-03 and delete the disallowance. Considering our findings in the foregoing paragraphs, we allow this ground of appeal and delete the addition.

Ground Nos. 5 to 8:

92. These grounds of appeal read as under:

- "5. That On the facts and circumstances of the case and in law, the Hon'ble DRP/Learned A.O. has erred in deleting the lease rent

paid by the appellant amounting to Rs.27,12,000 to M/s. Mezban Hoteliers Pvt. Ltd. on account of rent free accommodation obtained for its managing director.

6. That On the facts and circumstances of the case and in law, the Hon'ble DRP/Learned A.O. has erred in deleting the lease rent paid by the appellant amounting to Rs.4,44,750 to M/s. Sheetal and Mrs. Pushpa Bansal on account of rent free accommodation obtained for its director.
7. That On the facts and circumstances of the case and in law, the Learned A.O. has erred in adding a notional interest income of Rs.6,00,000 to the returned income of the appellant, on account of security deposits placed with M/s. Mezbaan Hoteliers Pvt. Ltd. for obtaining rent free accommodation for its managing director, without considering the directions of the Hon'ble DRP.
8. That On the facts and circumstances of the case and in law, the Learned A.O. has erred in adding a notional interest income of Rs.55,557 to the returned income of the assessee, on account of security deposits placed with M/s. Sheetal and Pushpa Bansal for obtaining rent free accommodation for its director, without considering the directions of the Hon'ble DRP".

93. Ground Nos. 5 & 7 are inter-connected to each other. We had discussed these issues in assessment year 2002-03. M/s. Mezbaan Hotelier Pvt. Ltd. has taken a premises on lease from Mrs. Surendra Judge for an annual rent of Rs.2,40,000. It gave a security deposit of Rs.50,000 to Mrs. Surendra Judge. The directors in M/s. Mezbaan Hoteliers are relatives to Mr. Sandeep Kohli who is the executive director in the assessee's company. In this year, assessee company has paid a rent of Rs.27,12,000 to M/s. Mezbaan Hotelier. In assessment years 2002-03 and 2003-04, we have upheld the grant of deduction to the extent of Rs.2,40,000 which is equivalent to the rent paid by M/s. Mezbaan Hotelier. This is the assessment year 2006-07. The facts, how much rent was paid by M/s. Mezbaan Hotelier to its landlord is not available on the record. It is not ascertainable whether any enhancement of rent was made by the landlord against M/s. Mezbaan Hotelier. Learned DRP has allowed the deduction of rent paid by the assessee in the capacity of a sub-tenant at Rs.2,40,000 only. We have observed in assessment year 2002-03 that tenancy agreement as well as sub-tenancy agreement were executed on the same day and there cannot be any difference in rent value at this magnitude. Keeping in view our discussion, in assessment year 2002-30, we modify the order of Learned DRP and direct the Assessing Officer to grant a deduction of rent payment to the assessee equivalent to the amount paid by M/s. Mezbaan Hotelier to the original land owner in this assessment year.

94. In assessment year 2002-03, Assessing Officer has added the notional interest in the value of the rent. We have deleted that part because in our understanding that disallowance of rent payment over and above Rs.2,40,000 can take care of all aspects in hiring of the premises. In the present assessment year, Learned DRP has not associated this issue with the rent free accommodation, Learned DRP construed this payment of tax free security as a utilization of fund for non-business purposes. When the tenant can had the accommodation by making a deposit of Rs.50,000 only from the original landowner, we do not see any justification for the payment of Rs.50 lacs by the assessee to the tenant. The assessee has been paying this amount in the capacity of a sub-tenant, in other words, it is just an extension of benefit to the relatives of the directors, Learned DRP has rightly held that it is user of business fund for non-business purposes. Learned DRP has rightly directed the Assessing Officer to verify if any interest expense has been debited to the P & L account and if used, disallow the proportionate interest expense as not having been incurred for the purpose of the business. In view of the above discussion, we do not find any merit in both these grounds of appeal. They are rejected.

95. As far as other two grounds are concerned, i.e. ground Nos. 6 & 8, we have remitted this issue to the file of the Assessing Officer in assessment year 2002-03 for determination of fare rent payable by the assessee for the purposes of making disallowance under sec. 40A(2)(b) of the Act. In view of our findings in assessment year 2002-03, these grounds are allowed for statistical purposes.

Ground NO.9.

96. In this ground of appeal, grievance of the assessee relates to denial of depreciation. We find that Assessing Officer has proposed the order on the basis of his findings in assessment year 2002-03. The depreciation has been allowed to the assessee by the Learned CIT(Appeals) and we have upheld the order of the Learned CIT(Appeals). Considering our findings on ground No.11 of the revenue's appeal, we allow this ground of appeal of the assessee and delete the disallowance.

Ground No.10:

97. The grievance of the assessee is that Learned DRP has erred in disallowing the software expenses amounting to Rs.1,33,000 by holding them to be of capital nature. The assessee has pleaded that these expenses have not resulted in the creation of any capital assets. These expenses pertain to purchase software of the self consultancy charges and maintenance charges. According to it, the Learned DRP ought to have examined the case of the assessee within the right of the special bench's decision of the ITAT rendered in the case of *AM Way India Enterprises Vs. DCIT* reported in 111 ITD 112. It has also relied upon a number of other decisions.

98. On the other hand, Learned DR has relied upon the order of the Learned DRP. Similar expenses were incurred by the assessee in assessment year 2002-03. We would have remitted the issue to the file of the learned revenue authorities below for readjudication in the light of Special Bench's decision, because of the involvement of very small amount we desist. This year also, the amount claimed by the assessee is Rs.1,33,000, depreciation @ 60% has already been allowed to the assessee, now assessee might have recouped its cost. In our opinion, one more round of litigation is not worth, keeping in view the amount involved and the rate of depreciation. The assessee might have a very good case on the merit of its details are required to be looked into in the light of Special Bench's decision at the level of Assessing Officer. That exercise would be a futile exercise. We put it to the learned representative also and they have conceded the proposal on the ground that it may not be treated as a precedent in the subsequent year. In view of the above discussion, this ground is rejected.

Ground No.11:

99. In this ground of appeal, grievance of the assessee is that Learned DRP has erred in directing the Assessing Officer to treat a sum of Rs.6,40,046 as capital in nature. The brief facts of the case are that assessee is in the business of running restaurants and managing the franchise. It is required to continuously development new food items/flavors etc. for this purpose. It has incurred expenses for food tasting and trials. It has also incurred certain expenses for studying demographic trends. The assessee has claimed these expenses as revenue in nature. Assessing Officer has treated these expenses as capital in nature. The learned counsel for the assessee while impugning the order of Learned DRP contended that expenses incurred by the assessee only enable the assessee to carry on its business in more efficient manner, practically it will not give any enduring assets. On the other hand, Learned DR relied upon the order of the Learned DRP.

100. We have duly considered the rival contentions and gone through the record carefully. In its day to day operations, assessee is experimenting new dishes, where it incurred expenses on food items and spices etc. On many of occasions, the flavor may not come to the expectation for commercialized use. Thus, these are the routine research work carried out by the assessee and no capital assets came into existence. Learned DRP has erred in treating this amount as a capital expenditure. We allow this ground of appeal and delete the addition.

Ground No.12:

101. In this ground of appeal, grievance of the assessee is that the Learned DRP has erred in confirming the treatment of interest income as

income from other sources. It emerges out from the record that assessee has a surplus fund which was invested by it. Learned DRP on the strength of Hon'ble Supreme Court's decision rendered in the case of Tuticorn Alakalies & Chemicals reported in 227 ITR 172 had held that such interest income is to be assessed under sec. 56 of the Act. The income is not a part of assessee's business activities. The learned counsel for the assessee submitted that interest income has to be assessed as a business income because in the past, Assessing Officer has assessed such income as a business income except in assessment year 2005-06. He relied upon the decision of Hon'ble Mumbai High Court in the case of *CIT vs. Punnet Commercial* reported in 245 ITR 550 and *CIT Vs. Paramount Premises* reported in 190 ITR 259. Learned DR on the other hand relied upon the order of the Assessing Officer.

102. We have duly considered the rival contentions and gone through the record carefully. The decisions relied upon by the assessee are not applicable on the facts of the present case. The decision of Hon'ble Mumbai High Court in the case of *Puneet Commercial* was in respect of treatment of interest income while computing the deduction under sec. 80-HHC of the Act and it talks about operational profit. The view of Hon'ble Delhi High Court in the case of *Sri Ram Honda Equip* reported in 289 ITR 475 is contrary to this decision, wherein Hon'ble Delhi High Court has held that interest income for the purpose of sec. 80HHC has to be treated as income from other sources. The assessee has nowhere indicated as to how this interest income is linked with its business activity. It has simply surplus fund which has been deposited in the bank giving rise to interest income. Learned DRP has rightly treated this income as income from other sources. This ground of appeal is rejected.

Ground No.13:

103. In this ground, the grievance of the assessee is that Learned DRP has erred in upholding the disallowance of expenses incurred on foreign travel. The brief facts of the case are that the assessee had incurred a sum of Rs.2,72,57,457 on travel and conveyance. Out of this amount, a sum of Rs.95,22,664 is in respect of foreign travel. The assessee has pointed out that Rs.8,33,038 was incurred by the assessee on travel of its directors/employees to the area where its franchise are working. The balance of Rs.86,89,626 was incurred on other countries. Assessing Officer had disallowed the claim of assessee on the ground that in clause No.4 of service agreement, it has been stipulated that the assessee would be entitled to receive a fix service fee along with reimbursement of travel expenses incurred in performance of its duties. The case of the assessee is that this clause has been put inadvertently the expenses were incurred by it on its day to day business and it is allowable in nature.

104. Before us, learned counsel for the assessee raised an alternative contention, wherein he contended that if it is a genuine business expenses incurred during the course of performance of the services. If at all, it was liable to be reimbursement but not done then it should be treated as a commercial loss and should be allowed to the assessee. He relied upon the decision of Hon'ble Supreme Court in the case of *Badridass Dogra Vs CIT* reported in 34 ITR 10. He also submitted that expenses of Rs.86,89,626 is not covered by the service agreement. This was incurred as a part of routine business operation, hence it could have not been disallowed by the Assessing Officer. He relied upon the decision of Hon'ble Supreme Court in the case of *CIT vs. Panipat Woolen & Gen. Mills* reported in 103 ITR 66. Learned DR on the other hand relied upon the order of the Learned DRP as well as of Assessing Officer.

105. We have duly considered the rival contentions and gone through the record carefully. Assessing Officer has made a reference to clause 4 of the service agreement and observed that assessee would receive a fixed service fee along with reimbursement of travel expenses incurred in performance of its duties. The assessee is earning its income from service agreement which provide fixed fee plus reimbursement of travel expenses incurred in performance of its duties. In such situation, how the assessee can say that it has incurred expenses on its own. As far as the arguments of the assessee that it should be allowed as loss is concerned, it has not raised any such plea before the Assessing Officer and has not demonstrated how that loss has been crystallized this year. It is remitting royalty payment under the technical license fee and it is getting service receipt under the service agreement. It is highly improbable that such type of loss would be suffered by the assessee in this situation. As far as the agreement that Rs.86,89,626 was incurred by the assessee at its own is concerned, we find that no material was brought to notice therefore, this ground of appeal is without any merit and accordingly rejected. How these expenses are not related to its duties carried out under the service agreement. The assessee has only raised this argument before the Learned DRP also but failed to produce supporting evidence. There should be the material indicating the fact that these expenses were incurred by the assessee for its business and these are not to be reimbursed. No such facts were brought to our notice. In this respect, we have gone through page 115 of the paper book-I where assessee has placed written objections before the Learned DRP.

106. In the result, all the appeals are partly allowed.

Decision pronounced in the open court on 31.05.2011

2011 PTR 1801 (H.C. Bom.)

HIGH COURT OF BOMBAY

J.P. Devadhar and A.A. Sayed, JJ.

*Writ Petition No.730 of 2009 and
Writ Petition No.345 of 2010
Aditya Birla Nuvo Limited,
(Formerly known as Indian Rayon &
Industries Limited)*

v.

- 1) *The Deputy Director of Income-tax,
(International Taxation)*
- 2) *Union of India, through the Ministry of Finance*

*Writ Petition No.1837 of 2009
New Cingular Wireless Services Inc.*

v.

- 1) *The Deputy Director of Income-tax,
(International Taxation)*
- 2) *Union of India, through the Ministry of Finance*
- 3) *Tata Industries Limited*

*Writ Petition No.38 of 2010
Tata Industries Limited*

v.

- 1) *The Deputy Director of Income-tax,
(International Taxation)*
- 2) *The Additional Director of Income-tax,
(International Taxation)*
- 3) *Union of India, through the Ministry of Finance*

FACTS/HELD

1. Sale of shares by Mauritius Co can treated as sale by 100% USA parent. Sale of shares of foreign company taxable if object to acquire the Indian assets
2. Idea Cellular Ltd, an Indian company, was set up as a joint venture company pursuant to a JV agreement between AT&T Corp, USA, and the Birla Group. As provided by the agreement 49% of Idea Cellular's equity was allotted to AT&T Mauritius, being 100% subsidiary & "permitted transferee" of AT&T, USA. Though the shares were allotted to AT&T Mauritius, all

rights of voting, management, right to sell etc were vested in AT&T USA (subsequently known as “New Cingular Wireless Services Inc, USA” (“NCWS”). Subsequently, Tata Industries was inducted as a joint venture partner in Idea Cellular. Thereafter, 50% of the shares of Idea Cellular held by AT&T Mauritius were sold by AT&T Mauritius to Aditya Birla Nuvo (nominee of the Birla group) and 100% of the shares of AT&T Mauritius (which held the balance 50% of the shares of Idea Cellular) were sold by NCWS to Tata Industries. Aditya Birla Nuvo obtained a NOC u/s 195(2) permitting it to remit the sale consideration to AT&T Mauritius without TDS. The Court had to consider the validity of three proceedings initiated by the AO (i) Order u/s 163 treating Aditya Birla Nuvo as agent of NCWS USA on the ground that though the transferor was AT&T Mauritius, the gains from sale of the Idea Cellular shares was taxable in the hands of NCWS USA, (ii) Order u/s 163 treating Tata Industries as agent of NCWS USA on the ground that though the shares of AT&T Mauritius were purchased, effectively the underlying shares of Idea Cellular were purchased and (iii) Notice u/s 148 asking NCWS to file a return in respect of the gains arising from (indirect) transfer of the Idea Cellular shares. HELD deciding in favour of the department:

- (i) Aditya Birla Nuvo’s argument that the shares of Idea Cellular were **beneficially owned by AT&T Mauritius and that the gains would not be taxable in India under the India-Mauritius DTAA is not acceptable** because under the JV agreement, AT&T Mauritius was merely the “permitted transferee” and acted “for and on behalf” of NSWS, USA. **It was NCWS, USA which was the “beneficial owner” of the shares of idea Cellular and not AT&T Mauritius.** Accordingly, **Azadi Bachao Andolan 263 ITR 706 (SC)** has no application;
- (ii) The argument that s. 163 applies only with respect to income “deemed to accrue or arise” in India u/s 9 and not to income “accruing or arising” is not acceptable. Pursuant to **Eli Lily 312 ITR 225 (SC)**, the income accruing or arising in India to NCWS, USA on transfer of a capital asset situate in India, (shares of Idea Cellular) is **deemed to accrue or arise in India** to NCWS and can

be assessed either in the hands of NCWS or in the hands of the payer as agent of the non-resident u/s 163;

- (iii) The argument that the AO having issued a NOC u/s 195(2) permitting Aditya Birla Nuvo to remit the sale proceeds without TDS could not recover the tax from the payer by treating it as agent is not acceptable because **the said order was obtained by “suppressing material facts”** relating to the circumstances in which the shares of Idea Cellular were issued in the name of AT&T Mauritius. **As the payer had obtained the s. 195(2) Certificate by making a representation which was incorrect to its knowledge, it could not claim that the s. 195(2) Certificate was validly issued.** Further, the proceedings u/s 163 & 195 operate in different fields;
- (iv) The argument that once the AO exercises his option u/s 166 to assess the non-resident NCWS USA directly by issuing notice u/s 148, the proceedings initiated against the payer must come to an end is not acceptable because **there is nothing in the Act to suggest that the option to assess either in the hands of the representative assessee or in the hands of the non-resident must be exercised at the threshold itself and not at the end of the assessment proceedings.** While ordinarily, the AO must not proceed against the representative assessee once proceedings are initiated against the non-resident, in exceptional cases like the present one where **complex issues** are involved and the AO is unable to make up his mind on account of **suppression of material facts**, it is open to the AO to continue with the assessment proceedings against the representative assessee and the non-resident simultaneously till he decides to assess either of them;
- (v) NSWS’ argument that the s. 148 notice is without jurisdiction is not acceptable because **the prima facie belief of the AO that the transaction was in fact a transaction for transfer of a capital asset situate in India (shares of Idea Cellular) was with substance.** It is open to NCWS to prove to the contrary by placing all material facts in the assessment proceedings;

- (vi) Tata Industries' argument that no gains are taxable in India as the subject matter of sale were shares of AT&T Mauritius and not the shares of Idea Cellular is not acceptable because prima facie it appears that the transaction for sale of shares of AT&T Mauritius was a "colourable transaction" and was in fact for sale of the shares of Idea Cellular.

Order accordingly.

Writ Petition Nos.730 of 2009, 345 of 2010, 1837 of 2009 and 38 of 2010.

Heard on: 5th May, 2011.

Decided on: 14th July, 2011.

Present at hearing: Soli E. Dastur, Senior Advocate with R. Murlidhar, Nitesh Joshi and Atul K. Jasani for the petitioner. Mohan Parasaran, Additional Solicitor General with G.C. Shrivastava, Special counsel, B.M. Chatterjee, D.K. Chidananda i/by Suresh Kumar for the respondents in Writ Petition Nos. 730 of 2009 and 345 of 2010. Aspi Chinoy with Percy Pardiwala, Senior Advocates with Jayant Mehta, Jabin Morris, Ruchir Wani i/by Little & Co. for the petitioner. Mohan Parasaran, Additional Solicitor General with G.C. Shrivastava, Special counsel, B.M. Chatterjee, D.K. Chidananda i/by Suresh Kumar for respondent Nos.1 and 2. Rafiq Dada, Senior Advocate with P.K. Katpalkar, Simran Gurnai i/by Mulla & Mulla & Craegie Blunt and Caroe for respondent No.3 in Writ Petition No. 1837 of 2009. Rafiq Dada, Senior Advocate with P.K. Katpalkar, Simran Gurnai i/by Mulla & Mulla & Craegie Blunt & Caroe for the petitioner. Mohan Parasaran, Additional Solicitor General with G.C. Shrivastava, Special counsel, B.M. Chatterjee, D.K. Chidananda i/by Suresh Kumar for the respondents in Writ Petition No. 38 of 2010.

JUDGMENT

Per J.P. Devadhar.,—

1. Though the reliefs claimed in these four writ petitions are different, the core issue raised in all these four writ petitions is, whether any income chargeable to tax in India has accrued or arisen or deemed to have accrued or arisen in India to New Cingular Wireless Services Inc, USA ('NCWS' for short) and MMM Holdings LLC, USA, ('MMM' for short) which has subsequently merged with NCWS, on account of share transactions under two Sale and Purchase Agreements both dated 28th September 2005. Hence, all these four writ petitions are heard together and disposed off by this common judgment.

2. Writ Petition No.730 of 2009 is filed by Aditya Birla Nuvo Limited, formerly known as Indian Rayon and Industries Limited (*'Indian Rayon'* for short) to challenge the order dated 25th March 2009, whereby the Deputy Director of Income Tax (International Taxation) – 4(1), Mumbai (*'DDIT'* for short) has held that Indian Rayon is liable to be assessed as a representative assessee (agent) of NCWS under Section 163(1) of the Income Tax Act, 1961 (*'1961 Act'* for short) in respect of the capital gains accrued to NCWS on transfer of shares of Idea Cellular Limited in favour of Indian Rayon under Sale and Purchase Agreement dated 28th September, 2005. Writ

Petition No.345 of 2010, is filed by Indian Rayon to challenge the order dated 22nd January 2010 passed by DDIT holding that Indian Rayon is liable to be assessed as the representative assessee (agent) of MMMH. By amending the Writ Petition, Indian Rayon has also challenged the notice dated 12th February 2010 issued under Section 148 of the 1961 Act whereby Indian Rayon was called upon to file return of income as an agent of MMMH in respect of capital gains allegedly accrued to MMMH from the aforesaid sale transactions. Writ Petition No.1837 of 2009 is filed by NCWS to challenge the two notices both dated 31st March 2009 issued to NCWS and MMMH respectively under Section 148 of the 1961 Act whereby NCWS and MMMH are called upon to file return of income for A.Y. 200607 in respect of the capital gains allegedly accrued to them from the aforesaid transactions. Writ Petition No.38 of 2010 is filed by Tata Industries Limited (*'TIL'* for short) to challenge orders passed under Section 201(1) / (1A), 163 and also the notices issued under Section 148 of the 1961 Act.

3. Before dealing with the rival contentions advanced by the Counsel on both sides in each of the writ petitions, we may note relevant facts common to all the four writ petitions.

4. On 4th March 1995, a Company known as Birla Communications Limited (presently known as Idea Cellular Limited) was formed by the Birla Group of Companies in India. At that time, the Birla Group consisted of Grasim Industries Limited, Hindalco Industries Limited, Indian Rayon and Industries Limited and IndoGulf Fertilizers and Chemicals Corporation Limited.

5. On 5th December 1995, AT&T Corp, a Company incorporated in the United States of America and Grasim Industries Limited representing the Birla Group entered into a Joint Venture Agreement (*'JVA'* for short), under which, Birla Communications Limited was to be the Joint Venture Company (*'JVC'* for short) for carrying on the wireless telecommunication service in India by obtaining requisite licence from the Department of Telecommunications in India (*'DoT'* for short). Under the joint venture, 51% equity shares of the JVC were to be subscribed and owned by the Birla Group and 49% of the equity shares of the JVC were to be subscribed and owned by AT&T Corp. The JVA was executed by the

Executive Vice President, AT&T Wireless Services Inc, USA. Thus, AT&T Corp / AT&T Wireless Services Inc, USA ('AT&T USA' for short) and the Birla Group were the two joint venture partners holding 100% shares of the JVC.

6. The salient features of the JVA dated 5th December 1995 were:

- a) AT&T USA & the Birla Group, as founders under JVA, were to jointly own and operate the JVC, namely Birla Communications Limited [see preamble and Article 2.01]
- b) The Joint Venture was to provide wireless telecommunication services in India by obtaining a licence from the DoT, Government of India. [See Article 1.01]
- c) The founders were vested with the control, namely power to direct the management and policies, whether through the ownership of voting securities or by agreement or otherwise. [Article 1.01]
- d) AT&T USA was to subscribe to and pay for the number of common shares constituting 49% of the issued equity capital and the remaining 51% were to be subscribed by the Birla Group. [Article 2.01, 2.03 and 2.03].
- e) Owner of the equity capital of the JVC who are parties to the JVA (AT&T USA and Birla Group) would be party shareholders [see definitions]
- f) The 'founders were to exercise their rights as members / shareholders of the Company and ensure that the Articles of Association of the JVC are amended so as to incorporate the provisions of the JVA to the extent possible under the laws of India [Article 2.05].
- g) Each of the party shareholders who are founders agree that it will vote or cause to be voted all shares of equity capital owned by it. The shares of the JVC shall be held by the 'founders' in their own name or through a party fulfilling the role of a 'permitted transferee'. The 'permitted transferee' shall be bound by the terms of JVA. Each founder agrees that its permitted transferees would perform their obligations in accordance with the terms of the JVA. Each founder is jointly and severally liable, as principal obligor for due performance of the obligations imposed on the permitted transferee under the JVA. Each of the party shareholders agree that it will vote or cause to be voted all shares of equity capital owned by it. If any director elected by the founder refuses to follow the terms of the JVA, then the founder shall take steps to remove such director. Any party may proceed against the 'founder' without first proceeding against the 'permitted transferee'. [Article 3.04].

- h) The 'permitted transferee' could be any Corporation which is a 100% subsidiary of the founder who owns the equity shares of the JVC. Each founder shall retain directly or indirectly, ownership of all the voting stock of the permitted transferee. The 'founder' and the 'permitted transferee' were jointly and severally liable for all obligations and on fulfillment of various conditions only would shares for convenience of arrangement be transferred to the subsidiary as a 'permitted transferee'. [Article 12.04]
- i) The Board of the JVC shall consist of four directors appointed by Birla Group, four directors appointed by AT&T USA and four independent directors with the consent of both the 'founders'. One director representing each founder shall be a nonretiring Director. The chairman shall be appointed by the Birla Group and both the founders shall designate one board member each to act as the 'Principal Founding Member'. No director shall be removed without the consent of the 'founder' whom he represents. [Article 5.01].
- j) The company shall have a President nominated by AT&T USA with the concurrence of the Birla Group. Birla Group shall nominate CFO with the consent of AT&T USA [Article 5.02].
- k) Certain key decisions of the group require an affirmative vote of the 'Principal Founding Member' representing AT&T USA and one director representing Birla Group, thus both the founders have 'veto rights'. [Article 5.03].
- l) At the general meeting of the company, the 'founders' will exercise their vote and act in such a manner so as to comply with and to fully and effectively implement the terms of the JVA. 'Founders' undertake to ensure that their representatives or agents who represents them at the Annual General Meeting of the company to implement the agreement. Entire obligation rests on 'founders' and the 'permitted transferee' is no more than a representative of the 'founder'. [Article 6.02].
- m) The 'closing' shall take place within 60 days of receipt of all approvals from Government of India and RBI. Further, at the time of closing, the company shall take steps to allot the shares to the representatives of the 'founders'. [Article 8.01].
- n) It is further stipulated that the approval of the Government of India and RBI shall be, "for offer, allotment and subscription of equity shares of the company to the founders as per Section 2.02 of the agreement". [Article 8.01]
- o) After 'closing' Birla and AT&T USA, shall allot shares as stated in Article 2.02 [Article 2.02 contemplates allotment to Birla

Group and AT&T USA, being the founders in the ratio of 51% : 49%. [Article 8.03].

- p) AT&T USA represents and warrants to Birla Group that AT&T USA has full power to execute and deliver the JVA and the material agreements and to consummate the transactions contemplated under the JVA and material agreements. [Article
- q) The JVA, the material agreements and all such other agreements and written obligations entered into and undertaken in connection with the transactions contemplated under the JVA and other agreements would be legally binding obligations of AT&T USA and enforceable against AT&T USA [Article 9.02]
- r) The JVA shall survive until six months after such time as the JVC no longer has any licenses to provide wireless communication service in India or until either 'founder' sells all of its shares of equity capital. [Article 11.01].
- s) The equity shares of the JVC cannot be sold by any party shareholder till the third anniversary of the closing date and only subject to the terms of the agreement after that date. [Article 12.02].
- t) The Share Certificate of equity capital held by the 'founders' shall carry an endorsement imprinted on it to the effect that any sale of the shares shall be only subject to the JVA and the holder of shares cannot sell, assign or pledge the shares independent of the terms of the JVA. [Article 12.03].
- u) The 'founder' is allowed to transfer all its shares to the permitted transferee with a prior written notice to the other founder. No such transfer shall be effective until such permitted transferee agrees to be bound by the terms and conditions of the JVA. The founder and the Permitted Transferee shall be jointly and severally liable for all the obligations of the Founder. Upon meeting the above requirements for transfer, the JVC at the closing or thereafter shall issue Equity Capital directly to a permitted transferee. [Article 12.04].
- v) If any party shareholder receives any offer for purchase of its shares, the other founder shall have the right of first refusal. [Article 12.07].
- w) Notices in relation to the Joint Venture Agreement are to be sent to AT&T Wireless Services Inc, a US company and a 100% subsidiary of AT&T Corp, USA.

Thus, under the JVA dated 5th December 1995, the AT&T USA as a founder was to own and hold 49% equity shares in Birla Communications Limited [now known as Idea Cellular Limited]. Under the JVA, the

equity shares subscribed by the founders as party shareholders could be issued in the name of a permitted transferee which is a 100% subsidiary of the founder. AT&T Cellular Private Limited, Mauritius ('AT&T Mauritius' for short), being a 100% subsidiary of AT&T USA was eligible to hold 49% equity shares of JVC as a permitted transferee of the AT&T USA. Accordingly, AT&T USA subscribed to the shares of the JVC and equity shares of the JVC were allotted in the name of AT&T Mauritius, as a permitted transferee of AT&T USA. As noted above, though the equity shares were issued in the name of AT&T Mauritius under the JVA as a permitted transferee of AT&T USA, all rights in respect of the said equity shares of the JVC, like voting rights, rights of management, right of sale or alienation etc absolutely vested in AT&T USA.

7. On 12th December 1995, the DoT granted a licence to the JVC (Birla Communications Limited) to provide the telecommunication services in the Maharashtra and Gujarat Telecom Circle.

8. With effect from 30th May 1996, the name of Birla Communications Limited was changed to Birla AT &T Communications Limited ('BACL' for short). The change in the name was effected to take advantage of the worldwide brand equity of the Joint Venture Partner namely AT&T USA.

9. In October 1997, AT&T Mauritius and the Birla Group executed a document titled as 'confirmation with respect to closing of Joint Venture Agreement dated 5th December 1995', which reads thus:-

"In relation to the Joint Venture Agreement dated December 5, 1995 between the undersigned (the 'JVA'), we hereby confirm that

- a) all the Conditions to Closing as stipulated in Article 8.01 of the JVA have been satisfied, and
- b) the actions and deliveries required to be made at Closing as provided in Article 8.03 of the JVA have been made.

The Closing Date, for the purposes of Article 8.01 is September 29, 1997 being the date when the Support Services Agreement and Secondment Agreement were exchanged between the parties; all other actions and deliveries referred to in Article 8.03 having taken place prior to September 29, 1997."

10. AT&T Mauritius was neither a party to the JVA nor was it obliged to pay any amount under the JVA to hold the equity shares of ICL as a permitted transferee of AT&T USA. However, the liability of AT&T USA to pay for the equity shares of the JVC were discharged by AT&T Mauritius during the period from 1996 to 2003. Equity shares of the JVC allotted in the name of AT&T Mauritius were approved by the Reserve Bank of India under Section 19(1)(a), 19(1)(b) and Section 29(1)(b) of the Foreign Exchange Regulation Act, 1973 ('FERA' for short).

11. On 15th December 2000, a Shareholders Agreement was entered into by and between AT&T Wireless Services Inc, USA (acting on behalf of itself and the AT&T Wireless Group), Grasim Industries Limited, India, (acting on behalf of itself and the AV Birla Group) and Tata Industries Limited, (acting on behalf of itself, the Tata Group), wherein it was agreed that the Tata Cellular Limited ('TCL' for short) would merge with BACL and the respective share holdings of the three groups in BACL would be restructured as per the Shareholders Agreement. According to Indian Rayon, after the merger of TCL the shareholding of the JVC were as follows:

Birla Group	–	33.70 per cent.
Tata Group	–	31.69 per cent.
AT&T Group	–	32.91 per cent.
Financial Institutions		1.70 per cent.

The Shareholders Agreement specifically records that AT&T Wireless Services Inc. (signatory to the JVA dated 5th December 1995) is operating Cellular Services in Maharashtra and Gujarat telecom through its wholly owned subsidiary AT&T Mauritius. The Shareholders Agreement further records that AT&T Corp controls AT&T Wireless Services Inc, USA. The Shareholders Agreement records that AT&T USA, the joint venture partner under the JVA would, under the Shareholders Agreement, represent the AT&T Wireless Group. The Shareholders Agreement further records that the terms of the said Agreement would be incorporated in the Articles of Association of BACL. Thus, as a result of the Shareholders Agreement, the shareholdings of the Birla Group as well as AT&T USA (now representing the AT&T Wireless Group) in BACL stood reduced from 51% to 33.70% and from 49% to 32.91% respectively. Under the Shareholders Agreement, the power of AT&T USA to appoint directors as per the JVA was reduced from four to three to accommodate the directors to be appointed by the Tata Group. All other clauses in the Shareholders Agreement remained the same as in the JVA dated 5th December 1995.

12. The name of BACL after the merger of TCL was changed to Birla Tata AT&T Limited with effect from 6th November 2001. Subsequently, the name of Birla Tata AT&T Limited was once again changed to Idea Cellular Limited ('ICL' for short) with effect from 12th September 2003.

13. In October 2004, Cingular Wireless LLC, USA acquired shares of AT&T Wireless Services Inc, USA from AT&T Corporation, USA and renamed it as New Cingular Wireless Services Inc, USA ('NCWS').

14. On 26th July 2005, NCWS received an irrevocable offer from India Tele Ventures Limited, an unrelated party, to purchase the interest of NCWS in ICL being the entire shareholdings of 74,35,61,480 equity

shares forming 32.91% interest at a price of US\$ 0.4035 per share aggregating to US\$ 300 million.

15. NCWS found the purchase price of equity shares of ICL offered by India Tele Ventures Limited to be reasonable. However, in terms of Article 10.06 of the Shareholders Agreement, NCWS was obliged to offer the shares of ICL first to the other two founders namely, the Birla Group and the Tata Group (as they had the rights of first refusal) and it was only if these two founders refused to purchase the shares of ICL, NCWS could sell those shares to third parties like India Televentures Limited. Accordingly, NCWS by its letter dated 26th July 2005 called upon the Birla Group and the Tata Group to exercise their rights of first refusal in purchasing the shares of ICL owned by NCWS.

16. Grasim Industries Limited, acting on behalf of the Birla Group and Tata Industries Limited acting on behalf of the Tata Group accepted the offer in identically worded letters dated 29th July 2005 and 30th July 2005 respectively and informed NCWS about their willingness to purchase the shares of ICL offered by NCWS. As both the Groups, namely the Birla Group and the Tata Group were interested in purchasing the entire 74,35,61,480 equity shares of ICL offered by NCWS for US\$ 300 million, each Group could get 37,17,80,740 equity shares of ICL on payment of US\$ 150 million.

17. Before entering into an agreement for purchase of 37,17,80,740 equity shares of Idea Cellular Limited (*ICL*) offered by NCWS, Indian Rayon representing the Birla Group applied to the Director of Income Tax (Intl Taxn), Mumbai on 29th August 2005 seeking noobjection certificate under Section 195 of the 1961 Act to remit US\$ 150 million to AT&T Mauritius towards the purchase price of 37,17,80,740 equity shares of ICL. In the said application, it was inter alia stated that they were purchasing ICL shares from AT&T Mauritius and as per the provisions of Article 13 of the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius as also Circular No.682 dated 30th March 1994 and Circular No.789 dated 13th April 2000, capital gains derived by a resident of Mauritius on alienation of shares in an Indian Company shall be taxed only in Mauritius. After considering the application as also the particulars furnished by Indian Rayon and after obtaining approval from DIT (Intl Taxn.), the Assistant Director of Income Tax (Intl. Taxn) by his communication dated 15th September 2005 authorized Indian Rayon to make payment of US\$ 150 million to AT&T Mauritius after deducting income tax at source at the rate 'Nil' therefrom under Section 195(1) of the 1961 Act.

18. Thereupon, Indian Rayon entered into an agreement with AT&T Mauritius & NCWS, USA on 28th September 2005 for purchase of 37,17,80,740 equity shares of ICL for US\$ 150 million. On 29th September 2005, Indian Rayon deposited US\$ 150 million in the bank account of

AT&T Mauritius and on the same day, the AT&T Mauritius paid US\$ 150,000,475 to NCWS, USA.

19. Tata Industries Limited, (*TIL*) however, instead of entering into a similar agreement for purchase of the balance 37,17,80,740 equity shares of ICL for US\$ 150 million, entered into a Sale & Purchase Agreement on the same day i.e. 28th September 2005 for acquiring the entire issued and paid up share capital of AT&T Mauritius for US\$ 150 million from NCWS and MMMH who were holding 100% shares of AT&T Mauritius. As noted earlier, MMMH has subsequently amalgamated with NCWS on 31st December 2006.

20. On 28th March 2008, the Additional Director of Income Tax (Intl Taxn), Mumbai passed an order holding TIL as an assessee in default under Section 201(1) of the 1961 Act since it had failed to deduct tax as required under Section 195 of the 1961 Act, before making payment of US\$ 150 million to NCWS and MMMH. Interest liability under Section 201(1A) was also imposed on TIL. Challenging the said order, TIL has filed an appeal before the first appellate authority and the same is pending. Subsequently, by two orders both dated 2nd March 2009, the DDIT has held that TIL is liable to be assessed as agent of NCWS / MMMH under Section 163 of the 1961 Act and accordingly two notices both dated 3rd March 2009 have been issued under Section 148 of the 1961 Act calling upon TIL as agent of NCWS / MMMH to file return of income in the prescribed form relating to income accrued to NCWS / MMMH on sale of shares under the Sale and Purchase Agreement dated 28th September 2005.

21. In the meantime, on 31st March 2008, the Additional Director of Income Tax (Intl Taxn), Mumbai addressed a letter to the Director of Income Tax (Intl Taxn), Mumbai enclosing a copy of the order dated 28th March 2008 passed by him in the case of TIL under Section 201(1) / (1A) of the 1961 Act. In that letter, it was stated that since the income by way of capital gains is chargeable in the hands of NCWS and MMMH, the Additional Director (Intl Taxn), Range 4, Mumbai may be requested to examine the matter and carry out regular assessment in the hands of the above two US companies.

22. The Deputy Director of Income Tax (Intl Taxn), Mumbai, thereupon, issued a showcause notice dated 8th December 2008 calling upon Indian Rayon to show cause as to why Indian Rayon should not be assessed as a representative – assessee (Agent) of NCWS under Section 163 of the 1961 Act in respect of the gains arising to NCWS pursuant to the transaction under the Sale and Purchase Agreement dated 28th September 2005.

23. Indian Rayon by its reply dated 2nd March 2009 and 17th March 2009 objected to the initiation of proceedings under Section 163 of the 1961 Act inter alia on the ground that : (a) Section 163 cannot be invoked

in the present case, as the income has actually accrued in India and cannot be regarded as deemed to accrue or arise in India so as to assess Indian Rayon as a representative assessee of the US Company; (b) Determination made under Section 195(2) after due application of mind and authorizing Indian Rayon to remit the amount without deduction of tax is binding in nature. As Section 162(2) and Section 195(2) are similarly worded decision under Section 195(2) would apply to proceedings under Section 162(2) of the 1961 Act; (c) As per the DTAA between India and Mauritius as well as Circular No. 682 dated 30th March 1994, Circular No.789 dated 30th April 2000 and the decision of the Supreme Court in the case of *Union of India V/s. Azadi Bachao Andolan* reported in 263 ITR 706, the capital gains arising to AT&T Mauritius cannot be taxed in India; (d) Idea Cellular Limited being an approved Industrial Undertaking under Section 10(23G) of the 1961 Act, any capital gains arising on the sale of shares of Idea Cellular Limited would be exempt from payment of incometax.

24. Rejecting the contention of Indian Rayon, the DDIT passed an order on 25th March 2009 holding that capital gains accrued to NCWS and that Indian Rayon was liable to be assessed as agent of NCWS under Section 163(1) of the 1961 Act. Thereafter, two notices were issued to NCWS and MMMH under Section 148 of the 1961 Act with a view to assess the income chargeable to tax which has allegedly escaped assessment. Challenging the above orders / notices, these four petitions are filed.

25. With these background facts, we may analyse the arguments advanced by the Counsel on both sides in each of the four writ petitions.

Writ Petition No.730/2009

26. Mr.Dastur, learned Senior Advocate appearing on behalf of the petitioner (Indian Rayon) submitted that Indian Rayon cannot be assessed as a representative assessee of NCWS / MMMH for the following reasons:

- A) Indian Rayon has purchased shares of ICL from AT&T Mauritius and the profits arising or accruing to AT&T Mauritius from such sale is not taxable in India because of the IndoMauritius DTAA as discussed elaborately by the Hon'ble Supreme Court in the case of *Union of India V/s. Azadi Bachao Andolan* reported in 263 ITR 706 (S.C.).
- B) Indian Rayon cannot be treated as an agent of NCWS and MMMH under the provisions of Section 160(1)(i) read with Sections 9(1) and 5(2) as interpreted by the Hon'ble Supreme Court in *Eli Lilly and Company (India) P. Limited* reported in 312 ITR 225 (S.C.).
- C) ICL being an approved industrial undertaking under Section 10(23G) of the 1961 Act, capital gains arising on sale of the

shares of ICL to a resident or nonresident would be exempt from payment of tax.

- D) Once certificate under Section 195(2) is issued by the Revenue authorising payment of the sale proceeds for the purchase of Idea Cellular Limited shares without deduction of tax at source and based on such certificate Indian Rayon has remitted the money to the nonresident, the Revenue cannot now go back on the certificate and seek to recover the tax allegedly due by the nonresident, from Indian Rayon as the nonresident's agent.
- E) Having taken steps against NCWS / MMMH for bringing to tax capital gains arising on the transfer of shares of Idea Cellular Limited by (wrongly) piercing the corporate veil, the Revenue cannot continue with the proceedings initiated against Indian Rayon.

(A) Whether Capital gains arising on transfer of shares of Idea Cellular Limited are not taxable in India.

27. According to Mr.Dastur, the capital gains accruing to AT&T Mauritius on sale of ICL shares is taxable only in Mauritius and cannot be brought to tax in India as per Article 13(4) of the DTAA between India and Mauritius. Since AT&T Mauritius is not liable to pay capital gains tax in India on sale of shares of ICL to Indian Rayon, the said tax cannot be recovered from Indian Rayon by treating Indian Rayon as the representative assessee of NCWS (being a 70% shareholder of AT&T Mauritius) and MMMH (being a 30% shareholder of AT&T Mauritius). The argument of Mr.Dastur can be summarised thus:—

- (a) Section 160 to 167 of the 1961 Act are machinery provisions for assessment and recovery of tax on the income of a principal assessee, from a representative assessee. In the present case, the above provisions are not applicable as the income of the principal assessee (AT&T Mauritius) cannot be brought to tax in India in view of the provisions contained in the DTAA. The shares of ICL were acquired by AT&T Mauritius during the period from 7th May 1996 to 18th November 2003 by subscribing directly from ICL and AT&T Mauritius has been holding the said shares until their transfer to Indian Rayon on 28th September 2005. These shares of ICL were issued to AT&T Mauritius after obtaining necessary approval from the RBI as required under Section 19(1)(d) (for issue of equity shares by an Indian Company to a nonresident), Section 29(1)(b) (for acquisition of equity shares of an Indian Company by a nonresident) and Section 19(1)(a) (for export of share certificates to the country of incorporation of the nonresident shareholder) of the FERA. While granting approval, the RBI was fully aware of the fact that AT&T Mauritius was a wholly owned subsidiary

of AT&T USA and thus the RBI has accepted that shares of ICL were acquired and held by AT&T Mauritius.

- (b) Transfer of 37,17,80,740 shares of ICL (being 50% of the shares) in favour of Indian Rayon was effected in India by way of transfer from the depository account of AT&T Mauritius in India into the depository account of Indian Rayon in India. Such transfer of shares gave rise to income by way of capital gains which accrued or arose in India under Section 5(2)(b) of the 1961 Act and hence taxable in India. However, AT&T Mauritius is a resident of Mauritius holding Tax Residence Certificate dated 19th May 1995 issued by the Commissioner of Income Tax in the Republic of Mauritius and the same was valid till the date of transfer of shares as is evident from the certificate issued by the Commissioner of Income Tax, Republic of Mauritius on 18th August 2005. Therefore, capital gains accrued to AT&T Mauritius on transfer of shares of ICL is taxable only in Mauritius and cannot be taxed in India as per Article 13(4) of the DTAA between India and Mauritius.
- (c) Section 90(2) of the 1961 Act provides that when the Central Government enters into an Agreement with the Government of any country outside India for granting relief of tax, then in relation to an assessee, the DTAA would prevail except where the provisions of the 1961 Act are more beneficial to the assessee. This position is also made clear by the Central Board of Direct Taxes ('CBDT' for short) Circular No.333 dated 2nd April 1982 {137 ITR (st) 1} and upheld by the Apex Court in the case of *Commissioner of Income Tax Vs. Azadi Bachao Andolan* reported in 263 ITR 706 (SC). In the present case, Article 13(4) of the DTAA being more beneficial to AT&T Mauritius, the DTAA would apply and not the 1961 Act.
- (d) In the present case, the Revenue has denied the benefit of DTAA on the ground that the real owner of shares ICL was NCWS / MMMH and it is the NCWS / MMMH (resident of USA) who have transferred the shares of ICL and, therefore, the DTAA between India and Mauritius would not apply. The shares of ICL were held by AT&T Mauritius and were transferred by AT&T Mauritius and, therefore, capital gains accrued to AT&T Mauritius to which Article 13(4) of the DTAA between India and Mauritius would apply.
- (e) As per CBDT Circular No.682 dated 30th March 1994 and CBDT Circular No.789 dated 13th April 2000, the capital gains derived by a resident of Mauritius holding Tax Residence Certificate would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAA. In the present case, AT&T Mauritius is a resident of

Mauritius and, therefore, AT&T Mauritius would be the beneficial owner of the shares of ICL and capital gains arising on transfer of those shares would be squarely covered under the DTAA between India and Mauritius.

- (f) The Apex Court in the case of *Azadi Bachao Andolan* (supra), while upholding the validity of the CBDT Circular No.682 dated 30th March 1994 and CBDT Circular No.789 dated 13th April 2000 held that the provisions of DTAA would prevail over the 1961 Act and that the Tax Residence Certificate issued by the Mauritius Tax Authorities constitutes sufficient evidence of the status of residence and beneficial ownership of shares. In view of the above binding decision of the Apex Court, it is contended that in the present case, AT&T Mauritius qualifies as a beneficial owner of the shares of ICL and it is not open to the tax authorities in India to lift the corporate veil to find out as to who are the real owners of the shares held by AT&T Mauritius. The fact that the capital gains accrued to a resident of Mauritius and taxable in Mauritius are exempted under the Mauritian tax law cannot be a ground to tax that capital gains in India. Even assuming whilst denying that AT&T Mauritius was incorporated in Mauritius with a view to obtain benefit of the DTAA, the benefits under the DTAA cannot be denied to AT&T Mauritius because there is no provision in the DTAA / domestic law to deny such benefits.
- (g) Decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra) holds good even today and in fact the Review Petition as well as the Curative Petition filed against the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra) have been dismissed by the Apex Court. Moreover, the decision in the case of *Azadi Bachao Andolan* (supra) has been followed subsequently by the Authority for Advance Ruling (AAR) in the case of *E Trade Mauritius Limited* (324 ITR 1), *Emirates Fertilizers Trading Company* (272 ITR 84) and an unreported judgment of the AAR in the case of D.B. Zwirn Mauritius Trading No.3 Limited.
- (h) The Apex Court in the case of *Carew & Co. Limited Vs. Union of India* reported in 46 Comp. Cases 121 (SC) and *Mrs.Bacha F. Guzdar Vs. Commissioner of Income Tax* reported in 27 ITR 1 (SC) has laid down that the assets held by a wholly owned subsidiary cannot be regarded as the assets of the parent company. As per Section 47(iv) and 47(v) of the 1961 Act, the holding company and its wholly owned subsidiary company are two different entities and the assets owned by a subsidiary cannot be regarded as owned by the holding company.

- (i) Under Section 2(a), 3 and 4 of the Benami Transactions (Prohibition) Act, 1988 it is not open to NCWS (assuming without admitting it is the beneficial shareholder) to assert its beneficial interest in the shares of ICL allegedly held by it in the name of AT&T Mauritius. If the contention of the Revenue is accepted, then absurd situation would arise because under the Benami Transactions Act, NCWS would not have any rights over the shares that stood in the name of AT&T Mauritius but assessable to capital gains under the 1961 Act on sale of shares held by AT&T Mauritius.
- (j) The Apex Court in the case of *Howrah Trading Co. Limited Vs. Commissioner of Income Tax* reported in 36 ITR 216 (SC) has held that the person whose name is entered in the Register of Members is to be regarded as the holder of the said shares. The Revenue has failed to establish as to how NCWS became the owner of the shares of ICL held by AT&T Mauritius. Apparently, the shares are held by AT&T Mauritius and as per the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra) the Revenue cannot go behind the apparent shareholding where the DTAA is applicable.
- (k) RBI while granting its approval under Section 19(1)(a), 19(1)(d) and 29(1)(b) of FERA was fully aware of the fact that AT&T Mauritius was then a wholly owned subsidiary of AT&T, USA. If the Revenue's contention that NCWS is the real owner of ICL shares held by AT&T Mauritius is accepted, then, it would mean that ICL as well as NCWS have violated FERA, when in fact they have not violated any provisions of FERA. Therefore, the proper course is to hold that the shares of ICL were validly held by AT&T Mauritius and that the approvals granted by RBI are legal and valid.
- (l) The fact that AT&T Mauritius was the legal owner of the shares of ICL is not disputed by the Revenue in view of the fact that the RBI has granted requisite approval and in fact the shares also stood in the name of AT&T Mauritius. In the present case, NCWS and MMMH (the shareholders of AT&T Mauritius) have contributed funds by way of a share capital and loan to AT&T Mauritius to acquire the shares of ICL. Under para 4.01 of the Shareholders Agreement the liability to make payment for the uncalled capital was on the shareholder i.e. AT&T Mauritius. For application of the DTAA, it is not necessary that the Company as well as the shareholders of the Company must be resident of Mauritius. Therefore, AT&T Mauritius would be resident of Mauritius even though its shareholders viz. NCWS and MMMH are US residents.

- (m) The argument of the Revenue that they are not lifting the Corporate Veil but simply determining as to who should be regarded as the owner of the shares of ICL is not acceptable, because, while accepting that AT&T Mauritius is the legal owner of the shares of ICL (as a registered shareholder) to find out as to whether NCWS is the real owner of the said shares itself amounts to lifting the corporate veil which is not permissible in view of the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra).
- (n) The transaction of purchasing the shares of ICL from AT&T Mauritius by Indian Rayon in the year 2005 was based on the Share Purchase Agreement dated 28th September 2005 and not on the basis of JVA dated 5th December 1995. Perusal of the Share Purchase Agreement dated 28th September 2005 shows that AT&T Mauritius was the vendor and sole owner of the shares of ICL and AT&T Mauritius was to instruct the depository for transfer of shares of ICL to Indian Rayon. NCWS had become party to the Sale Agreement, because, NCWS had provided certain warranties under the agreement to the effect that the said shares were free from encumbrances. Similarly, purchase price was to be paid by Indian Rayon in the bank account maintained by AT&T Mauritius.
- (o) On execution of the Shareholders Agreement dated 15th December 2000, the JVA dated 5th December 1995 could not and did not survive, because, the founders in both the agreements are different, share holdings in the two agreements are different, the terms to be incorporated in the Articles of Association are different, requirement relating to quorum of board meeting, appointment of Board of Directors, officers etc are different and above all clause 12.07 of the Shareholders Agreement specifically provides that *“This agreement together with all exhibits and attachment hereto represents the entire agreement and understanding between parties with respect to the subject matter of this Agreement and supersedes any prior agreement or understanding, written or oral, that the parties may have had”*. Therefore, there can be no doubt that the 1995 agreement or any terms and conditions contained therein, would not survive after the Agreement dated 15th December 2000 and no reliance can be placed on the 1995 agreement.
- (p) Even if it is accepted that the 1995 agreement prevails after the execution of the Shareholders Agreement and AT&T Corp is to be regarded as owner of the shares of ICL, still it is not shown how NCWS became the owner of the shares of ICL in respect of whom Indian Rayon is sought to be treated as the agent and a representative assessee, especially when NCWS was not even a

party to the 1995 agreement. If according to the Revenue AT&T Corp is the owner of the shares of ICL, then also it is not clear how transfer of shares could take place on 28th September 2005 in favour of Indian Rayon, because AT&T Corp is not a party to the said agreement. Moreover, Indian Rayon has not been treated as the agent of AT&T Corp.

- (q) The fact that the NCWS was a party to the Sale and Purchase Agreement dated 28th September 2005 makes no difference, because, the shares were sold by AT&T Mauritius as vendor and NCWS had agreed to be party to the sale purchase agreement dated 28th September 2005, because, it had given warranties to Indian Rayon to the effect that the shares of ICL held by AT&T Mauritius were free from encumbrances and that India Rayon would acquire good and valid title to the shares upon completion of transfer.
- (r) Filings by AT&T Corp, Cingular Wireless LLC and NCWS before the Securities Exchange Commission (SEC) of USA regarding the receipt of sale proceeds do not support the case of the Revenue because, US law requires the companies to reflect a consolidated position of the group as a whole and AT&T Mauritius being a subsidiary, the sale proceeds realised by AT&T Mauritius on sale of shares of ICL had to be disclosed before the SEC. Therefore, the fact that disclosures have been made before the SEC by NCWS regarding the sale proceeds received by AT&T Mauritius, it cannot be assumed that the said sale proceeds belonged to NCWS.
- (s) The fact that AT&T Mauritius immediately on receipt of the sale proceeds amounting to US\$ 150,000,000 on 29th September 2005 transferred on the same day US\$ 150,000,475 in favour of NCWS, cannot be a ground to infer that the shares of ICL belonged to NCWS and that the NCWS has received the sale proceeds through AT&T Mauritius. From the cash flow statement of AT&T Mauritius furnished by the Revenue, it is seen that the amount of US\$ 150,000,475 paid by AT&T Mauritius to NCWS comprised of dividend amounting to US\$ 43,915,312 distributed by AT&T Mauritius and US\$ 101,685,163 represented repayment of loan. Thus, the sale consideration was received by the owner of ICL shares viz. AT&T Mauritius and utilized for its own purposes. In any event, Indian Rayon is not concerned with the manner in which AT&T Mauritius dealt with the funds received by it upon sale of shares of ICL to Indian Rayon.
- (t) The fact that India Televentures Limited offered to purchase equity shares of ICL directly from NCWS, cannot be a ground to hold that the said shares belonged to NCWS, because NCWS,

Birla Group and Tata Group are parties to the process of offer and acceptance as representative of the founders. The offer was in keeping with the requirement in Article 10.06 dealing with the right of first refusal in the Shareholders Agreement dated 15th December 2000. In any event, while determining the residential status of AT&T Mauritius it is wholly irrelevant as to whom the purchase offer was made.

- (u) The fact that any notice relating to disputes under the Sale and Purchase Agreement dated 28th September 1995 was required to be given to AT&T Wireless Service INC (NCWS being part of it) does not mean that the shares of ICL belonged to NCWS. Requirement of notice to AT&T Wireless Service Inc was necessitated because, after sale of ICL shares by AT&T Mauritius to Indian Rayon, the shares of AT&T Mauritius were to be sold by NCWS / MMMH to TIL and in such a case AT&T Mauritius would not remain a subsidiary of NCWS but would thereafter become a subsidiary of TIL and, therefore, any notice to be given to the Cingular group had to be sent naturally to NCWS. Moreover, NCWS had given certain warranties and if any dispute arises in respect of the sale of shares of ICL by AT&T Mauritius to Indian Rayon, appointment of arbitrator by AT&T Mauritius which thereafter became a Tata group company would not fully protect the interest of the Cingular Group. Therefore, NCWS has been given the authority to appoint arbitrator.

For all the aforesaid reasons, it is submitted by Mr.Dastur that AT&T Mauritius should be regarded as the owner of the shares of ICL and it must be held that the capital gains arising on sale of those shares are not taxable in India in view of Article 13(4) of the DTAA between India and Mauritius.

28. We have carefully considered the above arguments of Mr.Dastur, as also arguments to the contrary advanced by Mr.Parasharan, learned Additional Solicitor General appearing on behalf of the Revenue.

29. In the present case, Indian Rayon pursuant to a Sale and Purchase Agreement dated 28th September, 2005 has purchased 37,17,80,740 equity shares of ICL from AT&T Mauritius and NCWS (USA) for US\$ 150,000,000. The dispute is, whether the ICL shares were owned by AT&T Mauritius or by NCWS (USA). According to the Revenue, the said shares were owned by NCWS (USA) and the capital gains arising or accruing to NCWS (USA) from the above transaction is taxable in India either in the hands of NCWS (USA) or taxable in the hands of Indian Rayon as an agent of NCWS (USA) under Section 163(1) of the Income Tax Act, 1961.

30. Admittedly, the shares of ICL were registered in the name of AT&T Mauritius. However, the Sale and Purchase Agreement was executed jointly by AT&T Mauritius and NCWS on 28th September 2005 and on 29th September, 2005, Indian Rayon paid the sale consideration of US\$ 150,000,000 to AT&T Mauritius. On the same day that is 29th September 2005 itself AT&T Mauritius transmitted an amount of US\$ 150,000,475/to NCWS, USA. The question, therefore, to be considered is, whether the revenue is justified in contending that the beneficial ownership of the shares of ICL transferred jointly by AT&T Mauritius and NCWS to Indian Rayon had vested in NCWS, when admittedly, the said shares stood in the name of AT&T Mauritius. If the beneficial ownership in the ICL shares (before transfer) had vested in AT&T Mauritius then the capital gains would be taxable in the hands of AT&T Mauritius to which the DTAA between India and Mauritius would apply and if the beneficial ownership in those shares had vested in NCWS, USA, then the capital gains arising on transfer of the ICL shares to Indian Rayon would be taxable in the hands of NCWS (USA) to which the DTAA between India and USA would apply.

31. To understand the rival contentions, it would be necessary to refer to the circumstances in which the joint venture company was originally formed and the shares of the JVC were allotted in the name of AT&T Mauritius. Birla Communications Limited now known as Idea Cellular Limited (ICL) was a Joint Venture Company (JVC) formed under the Joint Venture Agreement (JVA) dated 5th December 1995. The joint venture was between AT&T Corp, USA duly executed by AT&T Wireless Services Inc, USA ('AT&T USA') and the Birla Group (which inter alia includes Indian Rayon). In October 2004, Cingular Wireless LLC, USA acquired AT&T Wireless Services Inc, USA and renamed it as New Cingular Wireless Services Inc, USA (NCWS). As a result, the interest of AT&T USA in the JVC stood vested in NCWS which is also a Company incorporated in USA. The joint venture was entered into with a view to facilitate AT&T USA to carry on wireless telecommunication business in India. The joint venture partners (AT&T USA and the Birla Group) were to own 100% equity shares of the JVC as party shareholders. As per the JVA, the joint venture partners were entitled to hold the shares of the JVC in the name of a permitted transferee, however, all right, title and interest attached to the said shares were to vest in the joint venture partners only.

32. As per the JVA, AT&T USA was to subscribe and own 49% equity shares of the JVC as party shareholder and AT&T USA could seek allotment of shares in the name of its permitted transferee. The expression '*party shareholder*' and '*permitted transferee*' were defined in the JVA as follows:—

"Party shareholder" means any owner of Equity Capital who is a party to this Agreement.

“*Permitted Transferee*” has the meaning set forth in Section 12.04(a).

Article 12.04 of the JVA (to the extent relevant) reads thus”

12.04 ‘Permitted Transfers’.

- (a) For purposes of this Article XII, a “Permitted Transferee” is, in the case of shares of Equity Capital owned by a Founder, any corporation of which that Founder directly or indirectly owns all of the shares of voting stock.
- (b) Subject to the provisions of this Section 12.04(b), each Founder shall be entitled, upon prior written notice to the Company and the other Founders, to transfer all but not less than all, of its Shares to any Permitted Transferee. No such transfer shall be or become effective, however, until such Permitted Transferee executes and delivers to the Company a counterpart copy of this Agreement thereby agreeing to be bound by the terms and conditions hereof theretofore applicable to the transferor of such shares. The Founder and the Permitted Transferee shall be jointly and severally liable for all of the obligations of the transferor hereunder. Upon meeting the requirements for transfer under this Section, the Company may, upon formation, at the Closing, or thereafter, issue Equity Capital directly to a Permitted Transferee.
- (c) Each Founder covenants and agrees with the other Founder that (i) it shall retain, directly or indirectly, ownership of all the voting stock of any Permitted Transferee which now holds or hereafter acquires any shares of Equity Capital so long as such Permitted Transferee holds such shares and (ii) it shall not enter into any agreement or otherwise acquiesce to any transaction whereby Equity Capital or voting interest therein fall under the direct or indirect control of a competitor of the Company or a competitor of the other Founder or of the Controlling Shareholder of a competitor of the Company or a competitor of the other Founder.
- (d) Without any any way limiting the provisions of Section 12.04(c), neither the Board of Directors nor the Company shall recognize any direction, instruction or notice from any Person or group of Persons who acquires, directly or indirectly, Control of a Shareholder as a result of a transfer or issuance of securities of such Shareholder or securities or other voting interests of any other Person resulting in a violation of Section 12.04 (c)”.

33. AT&T Mauritius, being a 100% subsidiary of AT&T USA was eligible to hold the shares as a permitted transferee of AT&T USA. As per Article 2.02 of the JVA, liability to subscribe and pay for 49% equity shares of the JVC was on AT&T USA. Accordingly, AT&T USA carried on business in India by subscribing to the equity shares of the JVC by making payments for the equity shares through AT&T Mauritius, a permitted transferee of AT&T USA.

34. From 1996 onwards equity shares of the JVC subscribed to and owned by AT&T USA were allotted from time to time in the name of AT&T Mauritius with the approval of RBI. From 1996 till February 1998, the approval granted by RBI for allotment of shares of the JVC in the name of AT&T Mauritius was to the extent of 43,82,81,480 shares (see page 58 of the petition).

35. Since the equity share amount was paid by AT&T Mauritius and the equity shares were allotted in the name of AT&T Mauritius with the approval of the RBI, it is contended by Indian Rayon, that the beneficial ownership in those shares vested in AT&T Mauritius and not in NCWS. The question, therefore, to be considered is whether, AT&T Mauritius paid the amount for acquiring the equity shares of the JVC in its own name or paid the amount for and on behalf of AT&T USA and whether sale of shares of ICL jointly by AT&T Mauritius and NCWS (successor to AT&T USA) amounts to sale by AT&T Mauritius alone.

36. Apart from the JVA there is no other document on record to show that AT&T Mauritius had independently entered into any transaction for acquiring the equity shares of the JVC. The obligation under the JVA to pay for the equity shares of the JVC was on AT&T USA. 74,35,61,480 equity shares of the JVC allotted in the name of AT&T Mauritius corresponds to the shares subscribed by AT&T USA under the JVA and the Shareholders Agreement. Out of 74,35,61,480 shares allotted to AT&T Mauritius, 43,82,81,480 shares were allotted prior to the execution of the Shareholders Agreement. Obviously, the said 43,82,81,480 equity shares were allotted in the name of AT&T Mauritius in terms of the JVA. Under the JVA, AT&T USA as a founder and party shareholder was entitled to seek allotment of shares in the name of its permitted transferee. Under the JVA the permitted transferee was bound by the JVA and could not independently exercise any of the rights flowing from the shares allotted in its name. Under the JVA all rights in the shares allotted in the name of a permitted transferee (AT&T Mauritius) stood vested in the party shareholder (AT&T USA). In terms of the JVA, AT&T USA was to carry on business in India by subscribing to the shares of the JVC with right to appoint four directors to the board of directors of the JVC and to designate one board member as a 'Principle Founding Member'. Under the JVA, no director appointed by the founder could be removed without the consent of the founding member. The JVA specifically provides that the share certificates of equity capital issued in

the name of a permitted transferee shall carry an endorsement to the effect that the sale of the said shares shall be subject to the JVA and the holder of those shares cannot sell, assign or pledge the shares independent of the terms of the JVA. In these circumstances, in the absence of any document to show that AT&T Mauritius had entered in to any transaction to subscribe to or purchase the shares of JVC in its own name, the prima facie view of the Revenue that the allotment of 43,82,81,480 equity shares of the JVC in the name of AT&T Mauritius was only as a permitted transferee of AT&T USA under the JVA and such allotment of shares in the name of AT&T Mauritius did not confer any beneficial ownership to the AT&T Mauritius as expressly provided under the terms of the JVA, cannot be faulted.

37. The fact that AT&T Mauritius made payments to the JVC towards the equity shares would not make it to be owner of the equity shares, because, firstly, under the JVA, the joint venture partners alone were to subscribe and own 100% equity shares of JVC and admittedly AT&T Mauritius was not a joint venture partner and, therefore, there was no obligation on AT&T Mauritius to pay for the shares. Secondly, it is only because the JVA was implemented by the joint venture partners by subscribing to the shares of the JVC, the shares could be allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA. In other words, it is only because, the joint venture partners viz. AT&T USA and the Birla Group subscribed and owned the shares of the JVC, shares of the JVC were allotted to the joint venture partners or permitted transferee of the joint venture partners. Thirdly, there is no document on record to suggest that the AT&T Mauritius had agreed to subscribe / purchase the shares of JVC. In these circumstances, the payments made by AT&T Mauritius cannot be said to be payments for subscribing / purchasing the shares of the JVC in the name of AT&T Mauritius. Therefore, it is evident that the payments made by AT&T Mauritius to the JVC was obviously for and on behalf of AT&T USA, because, under the JVA, the obligation to subscribe and own the shares of the JVC was on AT&T USA.

38. The payments made by AT&T Mauritius towards the equity shares of the JVC was for and on behalf of the joint venture partner / founder – AT&T USA is further supported by the Shareholders Agreement dated 15th December 2000. It is AT&T USA (not AT&T Mauritius) which has entered into the Shareholders Agreement with the Birla Group and the Tata Group. Admittedly, on the date of the Shareholders Agreement allotment of 43,82,81,480 (see page 58 of the petition) equity shares of the JVC in favour of AT&T Mauritius was approved by RBI. Thus, in spite of the fact that 43,82,81,480 equity shares of the JVC were allotted in the name of AT&T Mauritius, it is AT&T USA which has entered into the Shareholders Agreement as a shareholder of the JVC. Moreover, in the Shareholders Agreement, it is

specifically recorded that AT&T Wireless Services Inc, USA (AT&T USA) is carrying on the telecommunication business in India through its wholly owned subsidiary – AT&T Mauritius. AT&T USA could carry on business in India only in terms of the JVA by subscribing and owning the shares of the JVC to the extent permitted under the JVA. Thus, from the Shareholders Agreement it becomes clear that though the shares were allotted in the name of AT&T Mauritius the said shares were held by AT&T Mauritius as a permitted transferee of the owner of the shares namely, AT&T USA.

39. In the Shareholders Agreement, it is AT&T USA which has agreed to act as a representative of the AT&T Wireless Group and agreed that its obligation to pay for the balance equity shares of the JVC would be discharged by the members of the AT&T Wireless Group. Therefore, the fact that AT&T USA in the Shareholders Agreement agreed that the payment in respect of the balance equity shares would be made by the members of the AT&T Wireless Group, it cannot be said that the ownership of the shares were to vest in the member of the AT&T Wireless Group who paid for the balance equity shares. The Shareholders Agreement neither divests the ownership of the 43,82,81,480 equity shares of the JVC already subscribed and owned by AT&T USA (but allotted in the name of AT&T Mauritius) as per the terms of the JVA nor does it provide that the ownership of the shares to be issued after the Shareholders Agreement shall vest in the member of the AT&T Wireless Group who pays for the equity shares of the JVC. In fact, Article 4.01 of the Shareholders Agreement specifically records that the member of the AT&T Wireless Group in whose name the shares are issued or transferred shall designate AT&T USA as its representative to exercise all the rights and to perform all the obligations attached to the shares except the obligation to pay for the equity shares. Thus, even after the execution of the Shareholders Agreement, ownership of the shares of the JVC to be issued, were to vest in AT&T USA and not with the member of the AT&T Wireless Group who paid for the shares or in whose name the shares were to be issued. In other words, though the Shareholders Agreement partially alters the shareholding and management rights vested in the joint venture partners under the JVA on account of inducting the Tata Group into the joint venture, the Shareholders Agreement does not in any way impair or obliterate the ownership rights in the shares of the JVC vested in the joint venture partners whether allotted prior to or subsequent to the Shareholders Agreement.

40. The argument of Indian Rayon is that since the shares of the JVC purchased by Indian Rayon stood in the name of AT&T Mauritius, the legal owner of the said shares would be AT&T Mauritius and, therefore, on sale of the said shares, capital gains would accrue to AT&T Mauritius which as per DTAA between India and Mauritius cannot be taxed in India and consequently the tax on capital gains arising from the

transfer of shares of JVC cannot be recovered from Indian Rayon as a representative assessee. As noted earlier, out of 74,35,61,480 equity shares of the JVC allotted to AT&T Mauritius, 43,82,81,480 equity shares were allotted to AT&T Mauritius prior to the execution of the Shareholders Agreement. As per the JVA, 100% shares of the JVC were to be subscribed by the joint venture partners, viz. AT&T USA and the Birla Group. AT&T Mauritius was not a joint venture partner under the JVA. AT&T USA as a joint venture partner was to subscribe to 49% shares of the JVC and could hold those shares of the JVC in the name of its permitted transferee. The JVA expressly makes it clear that the permitted transferee shall have no right whatsoever in those shares. Thus, it is evident that 43,82,81,480 equity shares of the JVC were allotted to AT&T Mauritius as a permitted transferee of AT&T USA as per the terms of the JVA. The ownership of the said shares, as per the terms of JVA vested in AT&T USA. Even in respect of the shares of the JVC issued after the execution of the Shareholders Agreement, the ownership in the shares vested in AT&T USA, because, the Shareholders Agreement did not make any departure in the ownership of the shares already issued or to be issued after the Shareholders Agreement. Thus, 74,35,61,480 equity shares allotted in the name of AT&T Mauritius were allotted as per the terms of the JVA and the Shareholders Agreement under which the ownership of the shares were to vest in AT&T USA. That is why NCWS (successor to AT&T USA) offered to sell the shares of ICL to the Birla Group and Indian Rayon representing the Birla Group intimated its acceptance of the offer to NCWS. Moreover, NCWS is a party to the Sale and Purchase Agreement. If AT&T Mauritius was the beneficial owner of the shares, then the Sale and Purchase Agreement would have been solely with AT&T Mauritius and not jointly with AT&T Mauritius and NCWS. Therefore, the argument of India Rayon that since the shares of the JVC stood in the name of AT&T Mauritius, it must be treated as beneficial owner of the shares cannot be accepted. Similarly, the argument that NCWS became a party to the Sale and Purchase Agreement on account of the warranties given by NCWS is without any merit, because, as per the clauses in the JVA and the Shareholders Agreement, shares of the JVC allotted in the name of AT&T Mauritius could not be sold by AT&T Mauritius without the consent of AT&T USA (now NCWS). Thus, sale of ICL shares could be effected by AT&T Mauritius only if NCWS consented to the sale. NCWS could give consent only if it wanted to get out of the joint venture partnership. Therefore, the argument that NCWS was a party to the Sale and Purchase Agreement, because of the warranties given by it cannot be accepted.

41. Even while granting approval for allotment of shares in the name of AT&T Mauritius, the RBI recorded (see page 60 of the petition) that AT&T Mauritius is the wholly owned subsidiary of AT&T USA and that the allotment of equity shares of the JVC in favour of AT&T Mauritius shall not exceed 49% (later on reduced to 32.91% under the Shareholders

Agreement) of the paid up capital of the JVC. These facts noted by RBI clearly suggests that the RBI approval was in terms of the JVA, wherein the ownership of the shares allotted in the name of AT&T Mauritius was to vest in AT&T USA. Thus, the approval granted by RBI for allotment of shares in the name of AT&T Mauritius support the contention of the Revenue that the equity shares of the JVC were issued in the name of AT&T Mauritius under the JVA as a permitted transferee of AT&T USA.

42. Similarly, the approval granted by RBI to the effect that the allotment of shares of the JVC in the name of AT&T Mauritius was in accordance with the provisions of FERA does not make AT&T Mauritius legal owner of the said shares, because, the said approval simply means that according to RBI the allotment of shares in the name of AT&T Mauritius as permitted transferee does not violate the provisions of FERA. The RBI approval does not elevate the status of AT&T Mauritius from that of a permitted transferee to a party shareholder. As noted earlier, out of 74,35,61,480 equity shares, 43,82,81,480 equity shares were allotted prior to the execution of the Shareholders Agreement and the remaining shares were allotted after the execution of the Shareholders Agreement. RBI approval does not make any distinction between the shares of the JVC allotted in the name of AT&T Mauritius prior to the Shareholders Agreement and subsequent to the Shareholders Agreement. In other words, RBI has merely approved allotment of shares of the JVC in the name of AT&T Mauritius prior to and subsequent to the Shareholders Agreement as a permitted transferee of AT&T USA. Therefore, the fact that the allotment of shares in the name of AT&T Mauritius were in accordance with the provisions of FERA does not support the argument of Indian Rayon that AT&T Mauritius held the shares of the JVC as a party shareholder.

43. AT&T USA as a joint venture partner under the JVA, had subscribed to the shares of the JVC is evident from the fact that AT&T USA was a party to the Shareholders Agreement as a shareholder of the JVC. Even in the Shareholders Agreement, it is recorded that AT&T USA is carrying on business in India through its subsidiary AT&T Mauritius. Indian Rayon and TIL Were parties to the Shareholders Agreement. Therefore, Indian Rayon (Birla Group), TIL (Tata Group) and NCWS (successor to AT&T USA) cannot contend that AT&T Mauritius was the owner of the ICL, especially when they were the joint venture partners of the JVC and the ICL shares were allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA, as per the terms of the JVA / Shareholders Agreement. The fact that in the Shareholders Agreement it is recorded that AT&T USA represents the AT&T Wireless Group and that the Shareholders Agreement permits AT&T Mauritius as a member of the AT&T Wireless Group to pay for the balance equity shares of the JVC, does not in any way alter the ownership rights over

the shares of ICL subscribed to by AT&T USA and allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA.

44. The argument that the JVA comes to an end on the execution of the Shareholders Agreement is also without any merit. No doubt, clause 12.07 of the Shareholders Agreement dated 15th December 2000 records that the understanding arrived at between the three parties therein in respect of the subject matter of the Shareholders Agreement shall be final and any understanding to the contrary under any other agreement between the parties shall stand superseded. Obviously, clause 12.07 of the Shareholders Agreement seeks to supersede the terms of the JVA to the extent they are in conflict with the Shareholders Agreement. The Shareholders Agreement does not deal with the rights vested in AT&T USA in respect of the 43,82,81,480 equity shares of JVC already subscribed and owned by AT&T USA but allotted in the name of the permitted transferee – AT&T Mauritius. The Shareholders Agreement does not envisage that the ownership of the shares of the JVC to be issued after the Shareholders Agreement shall vest in the member of the AT&T Wireless Group who is authorized to pay for the equity shares of the JVC. In fact, the Shareholders Agreement makes it clear that AT&T USA shall continue to exercise all rights flowing from the shares of the JVC already issued under the JVA or to be issued after the Shareholders Agreement. Therefore, the argument of Indian Rayon that the Shareholders Agreement supersedes the JVA in its entirety cannot be accepted.

45. Relying on the CBDT circulars No.682 and 789 as also the Apex Court decision in the case of case of *Azadi Bachao Andolan* (supra) wherein the above CBDT circulars have been held to be legal and binding, it is argued on behalf of India Rayon that once Tax Residence Certificate is issued to AT&T Mauritius by the Republic of Mauritius, then it would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying DTAA between India and Mauritius and it would not be open to the tax authorities to go behind the Tax Residence Certificate and find out as to who are the beneficial owners of the shares of the JVC.

46. In our opinion, the CBDT circulars explaining the DTAA between India and Mauritius as also the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra) have no relevance to the facts of the present case for the following reasons:-

- a) The CBDT circulars relied upon by Indian Rayon were issued in the context of extending the benefits of the DTAA between India and Mauritius to the investments made in India by the entities incorporated in Mauritius. The said circulars would not apply where the investments are made in India by entities other than the entities incorporated in Mauritius. In the present case, the investments in India are made by AT&T USA under the JVA

dated 5th December 1995 (as modified by the Shareholders Agreement) and not by a company incorporated in Mauritius. As noted earlier, it is AT&T USA which carried on the business in India by subscribing and owning the shares of the JVC. The fact that AT&T USA discharged its obligation to pay for the equity shares through AT&T Mauritius and the fact that AT&T USA as a joint venture partner of the JVC got the shares in the name of its permitted transferee – AT&T Mauritius, it cannot be said that the investments in India are made by AT&T Mauritius. In other words, in the present case, AT&T USA carried on business in India by entering into a JVA with the Birla Group and by investing funds in India by subscribing to the shares of the JVC. The fact that AT&T USA paid the amount towards equity shares through AT&T Mauritius and got allotted the shares of the JVC in the name of AT&T Mauritius as a permitted transferee, it cannot be said that the investments in India were made by the permitted transferee viz. AT&T Mauritius. In these circumstances, in the present case since the investments in India were made by AT&T USA and not by AT&T Mauritius, neither, the CBDT circulars nor the DTAA between India and Mauritius are applicable to the facts of the present case.

- (b) In the case of *Azadi Bachao Andolan* (supra), investments in India were admittedly made by the Companies incorporated in Mauritius. Income accrued to those Mauritian Companies were governed by the DTAA between India and Mauritius. However, in many cases, the tax authorities sought to treat the shareholders of the Mauritian entities as the real owners and deny the benefit of DTAA between India and Mauritius to the Mauritian entities. In that context, CBDT circulars were issued to the effect that where investments are made by Mauritian entities having tax residence certificate, then the tax authorities cannot go behind the tax residence certificate and deny the benefit of DTAA. Validity of the CBDT circulars were challenged before the Delhi High Court and the Delhi High Court quashed the CBDT circulars. On appeal filed by the Union of India, the Apex Court while setting aside the decision of the Delhi High Court and upholding the CBDT circulars held that where investments are made by a Company incorporated in Mauritius and that company holds valid Tax Residence Certificate, then it is not open to the tax authorities to go behind the Tax Residence Certificate and try to find out as to who are the real owners of the shares of the Indian company and seek to recover tax from them. In the present case, it is AT&T USA which has entered in to the JVA for the purpose of carrying on business in India. It is AT&T USA which has subscribed to and owned 49% equity shares (later on reduced to 32.91%) of the JVC under the JVA. It

is at the instance of AT&T USA the shares subscribed were issued in the name of its 100% subsidiary as a permitted transferee. It is AT&T USA as a shareholder of the JVC, entered into a Shareholders Agreement wherein the shareholding was reduced with the induction of the Tata Group. It is AT&T USA which has agreed with the other joint venture partner that irrespective of issuance of the shares in the name of a permitted transferee, all rights relating to those shares including the right to sell the shares shall vest in AT&T USA. Therefore, in the facts of the present case, where the investments are made by AT&T USA and not by AT&T Mauritius, the ratio laid down by the Apex court in the case of *Azadi Bachao Andolan* (supra) would not apply.

47. Once it is prima facie established that the investments in the shares of the JVC were made by AT&T USA and the allotment of shares in the name of AT&T Mauritius was as a permitted transferee of AT&T USA, then the fact that AT&T Mauritius held a Tax Residence Certificate issued by the Republic of Mauritius and that certificate was valid on the date of sale of ICL shares would become wholly irrelevant. Since the shares of the JVC were subscribed and owned by AT&T USA as a joint venture partner and AT&T USA had agreed to sell the shares of ICL along with AT&T Mauritius to Indian Rayon by a Sale and Purchase Agreement dated 28th September 2005, the amount of sale consideration received by AT&T USA through AT&T Mauritius would be taxable in the hands of the AT&T USA (now represented by NCWS). The argument that the amount received by NCWS was not the sale proceeds but represented the dividend income and return of loan advanced by NCWS to AT&T Mauritius cannot prima facie be accepted, because, under the JVA the liability to pay for the equity shares was on AT&T USA and if AT&T USA discharges that liability by a device of advancing loan to AT&T Mauritius and paying through AT&T Mauritius, then it is open to the assessing officer to discard the device and take into consideration the real transaction between the parties.

48. Strong reliance was placed by the Counsel for Indian Rayon on the decision of the Apex Court in the case of *Carew & Company Limited* (supra) and *Mrs. Bacha F. Guzdar* (supra), wherein it is held that the assets belonging to a wholly owned subsidiary cannot be regarded as belonging to the parent company and the person whose name is entered in the Register of Members is to be regarded as the holder of the said shares. In our opinion, those decisions are distinguishable on facts. In the case of *Mrs. Bacha F. Guzdar* (supra), the assessee was a shareholder in certain tea companies. 60% income of those tea Companies were exempt from tax as agricultural income. The assessee claimed that 60% of the dividend income received by her on account of holding shares in those tea companies would also be exempt from tax as agricultural income.

Rejecting the contention of the assessee, the Apex Court held that a shareholder who buys shares of a Company does not buy any interest in the property of that Company. It was held that declaration of dividend by the company is not the source of the dividend income and, therefore, the dividend income could not be treated as agricultural income in the hands of the shareholder. In the present case, there is no dispute that the capital gains accrued on transfer of the shares, but the dispute is whether the capital gains has accrued to AT&T USA which as a joint venture partner had subscribed and owned the shares of the JVC, or whether capital gains has accrued to AT&T Mauritius which had paid for the equity shares of the JVC for and on behalf of AT&T USA (by taking loan from AT&T USA) and held the shares of the JVC as a permitted transferee of AT&T USA. Thus, the issue in the present case being totally different, the decision of the Apex Court in the case of *Mrs. Bacha F. Guzdar* (supra) would have no relevance to the present case. Similarly the decision of the Apex Court in the case of *Carew & Company Limited* (supra) is distinguishable on facts. In that case, it was held that purchasing 100% shares of a company may inure control and the right of management of the company but it does not follow that while the company is a going concern, the shareholders are the owners of its assets. Thus, in the case before the Apex Court, the dispute was whether the shareholders of a running company own the assets of the Company. In the present case, AT&T USA has entered into a joint venture in India, AT&T USA has agreed to invest in India by subscribing and owning the shares of the JVC and AT&T USA has obtained shares in the name of AT&T Mauritius as its permitted transferee with all rights in the said shares vested in AT&T USA. In the present case, income in the hands of NCWS is being assessed not as a shareholder of AT&T Mauritius but, because, on sale of shares income has accrued to NCWS on account of investments made in India by the predecessor of NCWS. In these circumstances, in our opinion, the decision of the Apex Court in the case of *Carew & Co.* (supra) is wholly distinguishable on facts and has no application in the present case.

49. Reliance was also placed by the Counsel for Indian Rayon on the decision of the Apex Court in the case of *Howrah Trading Company Limited* (supra). In that case, the assessee had purchased shares in a company under a blank transfer, but his name was not registered in the books of the company. The question was whether the assessee was entitled to the dividend income on the said shares purchased by the assessee therein. In that context, it was held by the Apex Court that the person in whose name the shares are registered in the books of the company would be the shareholder and not the purchaser of the shares who may have equitable right to the dividend on account of purchasing the shares. In the present case, no doubt that the shares are registered in the name of AT&T Mauritius and, hence, it would be holder of the said shares. However, holding of the said shares by AT&T Mauritius itself

was as a permitted transferee of AT&T USA, with all rights including the right to sell the said shares vested in AT&T USA. In the case before the Apex Court, the purchase of shares was not complete till the shares were actually transferred in the name of the assessee therein. In the present case, acquisition of shares of the JVC by AT&T USA was complete on allotment of shares in the name of AT&T Mauritius as a permitted transferee of AT&T USA. Therefore, the decision of the Apex Court in the case of *Hourah Trading Company Limited* (supra) does not support the case of Indian Rayon.

50. It was contended that having accepted AT&T Mauritius as the legal owner of the shares of JVC it is not open to the Revenue to find out as to whether NCWS is the real owner of the shares as it amounts to lifting the corporate veil which is not permissible in view of the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra). In our opinion, the fact that the shares of the JVC stood in the name of AT&T Mauritius did not make AT&T Mauritius the legal owner of the shares because in the present case, allotment of shares of the JVC was to the joint venture partner, receipt of the shares of ICL by AT&T Mauritius was on behalf of the joint venture partner and sale of the said shares was from one joint venture partner to another joint venture partner under the JVA / Shareholders Agreement. In fact, shares were offered for sale by NCWS (successor to AT&T USA) as a joint venture partner and Indian Rayon agreed to purchase the shares of ICL in its capacity as a representative of the joint venture partner under the JVA / Shareholders Agreement. It is not in dispute that 43,82,81,480 equity shares were allotted during the period from 10th April 1996 to 24th February 1998. Obviously the said allotments were under the JVA, wherein it was expressly stated that the allotment of shares in the name of a permitted transferee (AT&T Mauritius) would be on behalf of the party shareholder (AT&T USA) and that the ownership of the shares shall vest in the party shareholder. Therefore, in the facts of the present case, the fact that the shares of ICL were allotted in the name of AT&T Mauritius as a permitted transferee and the fact that AT&T Mauritius was a party to the sale transaction did not make AT&T Mauritius as the legal owner of the shares of ICL. Thus, in the facts of the present case, the capital gains is sought to be taxed in the hands of NCWS (successor to AT&T USA) not as a shareholder of AT&T Mauritius but on account of the direct investment in India made by AT&T USA as a joint venture partner under the JVA. In these circumstances, it cannot be said that the Revenue is trying to lift the corporate veil to find out the real owners of the shares but the Revenue is seeking to tax NCWS, because investment in the shares of the JVC made by the predecessor of NCWS viz. AT&T USA by subscribing to the shares of the JVC under the JVA and on sale of the said shares, capital gains have accrued to NCWS.

51. It was contended that if the argument of the Revenue is accepted, then absurd situation would arise, because, under the Benami Transactions (Prohibition) Act, 1988, the US Company would not have any right over the shares that stood in the name of AT&T Mauritius but assessable to capital gains tax under the 1961 Act. There is no merit in the above contention, because under the Benami Transactions Act, 1988, a transaction is considered to be a benami transaction, in which the property is transferred to one person for a consideration paid or provided by another person. In the present case, the shares of the JVC subscribed to and owned by AT&T USA are allotted in the name of AT&T Mauritius as a permitted transferee with all rights attached to those shares vested in AT&T USA. In other words, in the present case, there was only a limited transfer of shares of ICL in the name of AT&T Mauritius, because, the allotment itself was subject to the condition that all rights under the said shares including the right to sell the said shares shall vest in the joint venture partner of the JVC, viz. AT&T USA who had subscribed to those shares under the JVA. Thus, in the facts of the present case, shares of ICL were not held by AT&T Mauritius as benami, but were held as a permitted transferee of AT&T USA (joint venture partner of the JVC) as per the terms of the JVA on the specific condition that all rights and obligation thereunder shall vest in the owner of the shares namely AT&T USA and, therefore, the provisions of the Benami Transactions Act would not apply to the facts of the present case.

52. The argument that NCWS and MMMH (the shareholders of AT&T Mauritius) have contributed funds by way of share capital and loan to AT&T Mauritius to acquire the shares of the JVC is of no consequence, because, under the JVA the obligation to pay for the shares of the JVC was on the joint venture partner who had subscribed to those shares and that obligation has been discharged by AT&T USA through AT&T Mauritius. It is not in dispute that the JVA was implemented and AT&T USA carried on business in India as a joint venture partner of the JVC. AT&T USA could carry on business in India only by subscribing and owning the shares of the JVC. Therefore, the fact that AT&T USA paid for the shares of the JVC through AT&T Mauritius by advancing loans to AT&T Mauritius does not mean that AT&T USA did not own the shares allotted to it in the name of its permitted transferee viz. AT&T Mauritius.

(B) Whether Indian Rayon cannot be treated as an Agent of NCWS & MMMH under Section 160(1)(i) read with Section 9(1) and 5(2) in the light of Supreme Court decision in the case of *Eli Lilly Co. P. Limited* (supra).

53. In the case of a nonresident, Section 5(2)(a) and (b) of the Act provides that all income which is received or is deemed to be received in India or accrues or arises or is deemed to accrue or arise in India to such nonresident shall be included in the total income of the nonresident. Under Section 160(1)(i) of the Act, a person including a person treated as

an agent under Section 163 can be regarded as a representative assessee in respect of the income of a nonresident covered under subsection (1) of section 9. Subsection (1) of section 9 enumerates certain categories of income accruing or arising in India which are deemed to accrue or arise in India. One such category of income set out in Section 9(1)(i) is, the income accruing or arising through the transfer of a capital asset situate in India.

54. The argument of Indian Rayon is that in the present case, the Revenue has admitted that on sale of shares of ICL, income has accrued in India and income is received in India. Once it is accepted that income has accrued or is received in India, then the said income cannot be said to be deemed to accrue or arise in India as contemplated under Section 9 of the Act. Reliance is placed on the decision of the Apex Court in the case of *Eli Lilly & Co (India) P. Limited* (supra) wherein it is held that Section 9 would not apply in respect of income which actually accrues in India. In the present case, since it is admitted by the Revenue that income has accrued and arisen in India, Section 9 would not apply and consequently the question of recovering tax on the basis of deemed income from Indian Rayon as a representative assessee of the nonresident does not arise at all. It is contended that one has to first consider whether the income can be regarded as accruing or arising in India and if so, one is not required to go to the deeming provisions, in which case Section 160 does not come into picture.

55. We see no merit in the above argument advanced on behalf of Indian Rayon. The Apex Court on analysis of Section 5 and Section 9 in the case of *Eli Lilly & Co.* (Supra) held thus:—

“..... Under Section 5, all residents and nonresidents are chargeable in respect of income which accrues or is deemed to accrue in India or is received in India. Nonresidents who are not assessable in respect of income accruing and received abroad are rendered chargeable under section 5(2)(b) in respect of income deemed by section 9 to accrue in India. Section 9 which deems certain categories / heads of income to accrue in India has no application in cases where income actually accrues in India. Likewise, section 9 does not apply in cases where income is received in India. Therefore, if the income is not received in India, a nonresident would not be chargeable to tax upon it unless it accrues or is deemed to accrue in India. Thus, a general charge of incometax is imposed by sections 4 and 5, and that general charge is given a particular application in respect of nonresidents by section 9 which enlarges the ambit of taxation by deeming income to arise in India in certain circumstances. Under section 9(1), income is deemed to accrue in India if it accrues directly or indirectly under the five circumstances mentioned therein. To give an example of as to

how the 1961 Act is an integrated code we may state that section 9(1) explains the meaning of the words “deemed to accrue or arise in India” in Section 5(2)(b). Section 9(1)(i) performs two functions :

- I. It deems the above five categories of income to accrue in India. The deeming provisions of this clause
 - (a) apply to residents and nonresidents alike;
 - (b) have no application where income actually accrues in India or is received in India.

Both these points have been noted above in dealing with this section generally.

- II. It specifies the categories of income in respect of which a vicarious liability is imposed by sections 160 and 161 on an agent to be assessed in respect of a nonresident’s income. In performing this function, the clause
 - (a) applies to the income of nonresidents alone;
 - (b) specifies the categories of income in respect of which the agent is vicariously liable even if the income actually accrues in India or is received in India.”

(emphasis supplied)

Thus, the Apex Court in the case of *Eli Lilly & Co.* (supra) has held that any income which accrues in India or is received in India within the meaning of Section 5 of the Act would be income deemed to accrue or arise in India if such income falls within the categories of income specified under Section 9(1) of the Act. Similarly, this Court in the case of *Vodafone International Holdings B.V. Vs. Union of India* reported in (2010) 329 ITR 326 (Bom) after construing Section 5 and Section 9 of the Act has held that where an asset or source of income is situated in India, all income which accrues or arises directly or indirectly through or from it shall be treated as income which is deemed to accrue or arise in India. In the present case, transfer of ICL shares constitutes transfer of a capital asset situate in India and income from such transfer of capital asset even if accrues or is received in India within the meaning of Section 5 of the Act, such income being specifically enumerated under Section 9 of the Act, would be income deemed to accrue or arise in India.

56. Under Section 163 of the Act, a resident may be regarded as an agent of the nonresident if the resident has acquired by means of a transfer, a capital asset in India from the nonresident. In the present case, Indian Rayon has acquired shares of ICL, a Company incorporated in India, from the nonresident. Income from such sale of shares if accrues or is received in India by the nonresident, then such income would be taxable in the hands of the nonresident under Section 5(2) of the Act or may be taxed in the hands of Indian Rayon under Section 163 read with

Section 9(1) of the Act, because, the income accrued to the nonresident falls within the categories of income specified under Section 9(1) of the Act. As held by the Apex Court in the case of *Eli Lilly & Co.* (supra), Section 9 is a typical example of a combination of a machinery provision which also provides for chargeability. Therefore, in the present case, the capital gains accruing or arising to the nonresident on transfer of a capital asset situate in India apart from being taxed in the hands of nonresident, can be taxed in the hands of the agent of the nonresident under Section 163 read with Section 9 of the Act, because the income in question accrued to the nonresident falls within the category of deemed income specified in Section 9 of the Act.

57. Once the Apex Court on analysis of Section 5, 9, 160 to 163 of the Act has ruled that the agent is vicariously liable in respect of specific categories of income of a nonresident even if the income actually accrues in India or is received in India, it is not necessary for us to deal with various arguments advanced by the Counsel for Indian Rayon in support of the contention that income has accrued or arisen in India to the nonresident.

58. Thus, the ratio laid down by the Apex Court in the case of *Eli Lilly & Co.* (supra), in our opinion, supports the contention of the Revenue that the income accruing or arising in India to AT&T USA (now NCWS) on transfer of a capital asset situate in India, (sale of shares of ICL to Indian Rayon) would be income deemed to accrue or arise in India to NCWS and can be assessed in the hands of the US Company or in the hands of Indian Rayon as agent of the nonresident under Section 163 of the Act.

(C) Exemption under Section 10(23G)

59. The argument that the capital gains arising on transfer of ICL shares are exempt under Section 10(23G) of the Act was raised by Indian Rayon in the proceedings initiated under Section 163 of the Act.

60. However, the Assessing Officer while holding that Indian Rayon is liable to be assessed as a representative assessee, observed that the question of exemption under Section 10(23G) would be considered in the assessment proceedings. Even before us, it is contended on behalf of the Revenue that the exemption issue can be considered only after the question as to whether the investee company had the necessary approval for grant of benefit under Section 10(23G) is investigated in the assessment proceedings. In these circumstances, we do not consider it proper to dwell upon an issue which is not adjudicated by the assessing officer and leave it for Indian Rayon to agitate the applicability of Section 10(23G) in the assessment proceedings.

D) Impact of Certificate issued under Section 195(2)

61. It is the contention of Indian Rayon that once a Certificate under Section 195(2) of the Act is issued after due application of mind and

payments to the nonresident have been made without deducting tax at source on the basis of the Certificate issued, it is not open to the tax authorities to recover the tax allegedly payable by the nonresident from Indian Rayon by initiating proceedings under Section 163 of the Act.

62. In the application dated 29th August, 2005 made to the Assistant Director of Incometax (International Taxation) seeking NOC under Section 195 of the Act for remitting US\$ 150,000,000 to AT&T Mauritius, Indian Rayon had stated as follows:-

- a) Indian Rayon has agreed to purchase 37,17,80,740 equity shares of ICL from AT&T Mauritius;
- b) AT&T Mauritius is a Private Limited company incorporated in Mauritius since 1995 and is a tax resident of Mauritius;
- c) As per Article 13 of the DTAA between India and Mauritius and Circular No.682 dated 30th March 1994 and Circular No.789 dated 13th April, 2000, the capital gain derived by a resident of Mauritius by way of alienation of shares shall be taxed only in Mauritius;
- d) thus, the capital gains, if any, is not liable to be taxed in India;
- e) NOC under Section 195(2) of the Act be granted for remittance of US\$ 150,000,000 without withholding tax.

63. On receipt of the above application, the Assistant Director of Incometax by his letter dated 6th September 2005 called for various documents including 'J.V. Agreement'. In reply, Indian Rayon by its letter dated 8th September 2005 inter alia stated thus:

- “1. We would like to submit as these shares were directly allotted by the Idea Cellular Limited to the AT&T Cellular Pvt. Limited, Mauritius, there is no specific agreement relating to purchase of shares.”
5. The latest Joint Venture Agreement between the parties is enclosed herewith.”

What was forwarded as latest joint venture agreement was the Shareholders Agreement.

64. On the basis of the above particulars furnished by Indian Rayon, issuance of certificate under Section 195(1) without deducting tax at source was approved by D.I.T. and accordingly, a certificate was issued on 15th September 2005 authorizing payment of US\$ 150,000,000 to AT&T Mauritius without deduction of tax at source.

65. Facts revealed subsequent to the issuance of the Certificate under Section 195 of the Act clearly show that the statement made in the application that Indian Rayon intended to purchase 37,17,80,740 shares of ICL from AT&T Mauritius was itself not an entirely correct statement, because, Indian Rayon was purchasing the said shares as a

representative of the Birla Group in exercise of the rights of first option which NCWS (successor to AT&T USA) had called upon the Birla Group to exercise. In fact, Grasim Industries Limited representing the Birla Group by its letter dated 29th July 2005 (see page 690 of the Petition) informed NCWS (successor to AT&T USA) that the Birla Group intends to purchase the shares of ICL subscribed to by AT&T USA (now NCWS). These facts were suppressed by Indian Rayon in the application seeking Certificate under Section 195 of the Act.

66. Indian Rayon, which represents the Birla Group cannot be said to be an innocent purchaser so as to be unaware of the circumstances under which the shares of the JVC (ICL) were issued in the name of AT&T Mauritius. The JVC (now known as ICL) was formed under the JVA between AT&T USA and the Birla Group. The JVA specifically records that the Birla Group inter alia consists of Indian Rayon and in fact Indian Rayon is a signatory to the JVA. As per the JVA, 100% shares of the JVC were to be held by the joint venture partners viz. AT&T USA and the Birla Group. The JVA permitted the joint venture partners to seek allotment of shares the name of a permitted transferee. Accordingly, shares of the JVC (ICL) owned by AT&T USA were allotted in the name of AT&T Mauritius from timetotime. It is not in dispute that in implementation of the JVA (before the execution of the Shareholders Agreement), admittedly 43,82,81,480 equity shares of the JVC were allotted in the name of AT&T Mauritius. These shares were allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA as provided under the JVA. Indian Rayon being a group concern of the Birla Group, having signed the JVA, cannot be said to be unaware of these facts. In spite of the above, Indian Rayon represented to ADIT that the shares were directly allotted by ICL to AT&T Mauritius and that there was no specific agreement relating to the allotment of shares of ICL. Whether the representation made by Indian Rayon was a bona fide representation is the question. Having obtained a Certificate under Section 195 of the Act by making representation which is incorrect to the knowledge of Indian Rayon, it is not open to the Indian Rayon to contend that Certificate under Section 195 of the Act has been validly issued.

67. The Revenue could have taken steps to cancel the Certificate issued under Section 195 of the Act on the ground that the said Certificate was obtained by suppressing material facts and misrepresentation. However, since the period of the Certificate has already expired and the remittances have already been made without deduction of tax, the Revenue has chosen to initiate proceedings under Section 163 of the Act. The question, therefore, to be considered is, whether the Revenue is justified in initiating the proceedings under Section 163 of the 1961 Act in spite of the Certificate issued under Section 195 of the Act ?

68. In the present case, Certificate under Section 195 of the Act was issued by relying on the statements made by Indian Rayon to the effect that the shares it had agreed to purchase belonged to AT&T Mauritius. The specific case put forth by Indian Rayon was that AT&T Mauritius had purchased the shares directly from ICL and that there was no specific agreement relating to the purchase of shares. In the absence of any material to the contrary, the assessing officer was bound to issue Certificate under Section 195 of the Act, because, as per the DTAA between India and Mauritius, income accrued to AT&T Mauritius on sale of the shares of ICL to Indian Rayon could not be brought to tax in India and consequently recovering the tax on the said income accrued to AT&T Mauritius from Indian Rayon as agent of AT&T Mauritius did not arise. Once the statement that income has accrued to AT&T Mauritius was accepted, there was no scope for considering the applicability of Section 163 of the Act, because, if the income by way of capital gains accrued to AT&T Mauritius was not taxable in India, there was no question of recovering tax from Indian Rayon as agent of AT&T Mauritius under Section 163 of the Act.

69. According to the learned ASG, the proceedings under Sections 163 and 195 of the Act operate in completely different fields and, therefore, Certificate issued under Section 195 of the Act does not preclude the assessing officer from initiating proceedings under Section 163 of the Act, for the following reasons:—

- “(a) Section 195 casts a statutory obligation to deduct tax on the payer. Section 195(2) is a protection against the consequences that may follow out of non deduction, if any. On the other hand, Section 162 grants rights to the representative assessee to recover taxes paid on behalf of the principal.
- (b) The statutory obligation u/s.195 gets triggered the moment payer pays any chargeable sum to the non resident. Provisions of Section 162(2) get triggered when there is a dispute between the representative assessee and the principal with regard to the amount of money to be retained.
- (c) A certificate u/s.195 (2) grants immunity to the payer from being treated as an assessee in default u/s.201 for non deduction of tax. The order u/s.162(2) settles the amount to be recovered from the representative assessee.
- (d) The order u/s.195(2) is tentative in nature and does not have any effect beyond providing immunity u/s.201 and the immunity stops at that stage and does not preclude the assessing officer to either reexamine the chargeability of income in regular assessment proceedings or to recover the taxes from the payer in his representative capacity. On the other hand, the order u/s.

162(2) is final and limits the amount to be recovered from the representative assessee.

- (e) Neither the words used in the statute nor by any reasonable interpretation, it can be inferred that once the certificate u/s. 195(2) is issued, the assessing officer is precluded from proceeding against the payer in his representative capacity.
- (f) Liability of an assessee under Section 195 is in his capacity as a payer, whereas, the liability under Section 163 is as a representative assessee of the nonresident with all attendant rights and obligation as per the provisions contained in Section 161. A representative – assessee cannot escape liability on the ground that the assessee as a payer was not required to deduct tax at source as per the Certificate granted under Section 195(2) of the Act.
- (g) Moreover, in the present case, when the assessing officer issued a certificate under Section 195(2) he was not having the benefit of following vital documents.
 - (1) Joint Venture Agreement of 1995.
 - (2) Offer and acceptance documents.
 - (3) Share purchase agreement with Tatas.
 - (4) Share purchase agreement with Birlas.
 - (5) Declaration made by NCWS before SEC in USA.
 - (6) Bank details of AT&T Mauritius showing transfer of sale consideration.

In the absence of the above vital documents, the assessing officer could not have come to the conclusion that the income arose to NCWS and that the applicable DTAA was IndoUS DTAA and not IndoMauritius DTAA.”

We find merit in the above arguments advanced on behalf of the Revenue. Accordingly, we hold that in the facts of the present case, initiation of proceedings under Section 163 of the Act cannot be faulted.

70. Relying on a decision of the Karnataka High Court in the case of *Anusuya Alva Vs. DCIT* reported in 278 ITR 206 (Karn), it was contended on behalf of Indian Rayon that while discharging the obligation to deduct tax at source, the payer (in the present case Indian Rayon) acts as agent of the Government. It was contended that as per the directions given by the Government of India contained in the Certificate issued under Section 195(2) of the Act, Indian Rayon had made remittances to the nonresident without deduction of tax at source. It was further contended that having induced Indian Rayon to make the remittance without deduction of tax at source, it was not open to the Revenue subsequently to allege that the transaction of sale of shares by AT&T Mauritius to Indian

Rayon gave rise to capital gains chargeable to tax in India on which Indian Rayon should pay tax on behalf of the nonresident as a representative assessee. We see no merit in the above contention because it is Indian Rayon which has prima facie suppressed material facts and induced the assessing officer to issue certificate under Section 195(2) of the Act. As noted earlier, Indian Rayon belonging to the Birla Group was a party to the JVA under which AT&T USA became the joint venture partner of the JVC (now known as ICL) and as per the JVA, shares of the JVC owned by AT&T USA were allotted from 1996 onwards in the name of AT&T Mauritius as a permitted transferee of AT&T USA. This fact was not disclosed to the assessing officer. Not only, Indian Rayon failed to disclose the material facts but wrongly represented to the assessing officer that the shares were directly allotted by ICL to AT&T Mauritius and that there was no specific agreement relating to purchase of shares, knowing fully well that the shares were allotted in terms of the JVA to which the Birla Group (including Indian Rayon) was a party. Thus, it is Indian Rayon which has failed to disclose material facts and wrongly represented to the assessing officer that the shares were purchased by AT&T, Mauritius directly from ICL and thereby induced the assessing officer to issue certificate under Section 195(2) to make remittances without deduction of tax at source. If correct facts were disclosed, it would have revealed that the investments in India were made by AT&T USA and not by AT&T Mauritius. Having wrongly represented to the assessing officer, it is not open to Indian Rayon to contend that the assessing officer is precluded from taking corrective steps as is permissible in law.

71. Strong reliance was placed by the Counsel for Indian Rayon on the decision of the Rajasthan High Court in the case of *Jaipur Udyog Limited Vs. Commissioner of Income Tax* reported in 155 ITR 476. In that case, the Rajasthan High Court has held that once a Certificate under Section 197(3) (omitted with effect from 1st April 1987) of the Act is issued, then no action can be taken on the ground that certain material facts were not placed before the assessing officer and that the Certificate was issued under an error in law. The aforesaid decision of the Rajasthan High Court is distinguishable on facts, because in that case, though the assessee therein while seeking Certificate under Section 197(3) did not mention the profit for the relevant previous year in its letter dated 17th July 1962, the assessee had enclosed a statement along with the said letter which indicated the profits earned in the previous year and the same was considered by the Income Tax Officer while issuing the Certificate. In that context, it was held by the Rajasthan High Court that the failure to mention the profit in the letter would not be a very material difference so as to invalidate the Certificate. In the present case, the basic facts disclosed in the application itself was inaccurate, if not false and the same was compounded by making incorrect statement to the effect that the shares were purchased by AT&T Mauritius directly from ICL.

Neither before the assessing officer nor before us, it is contended by Indian Rayon that the JVA was not acted upon or implemented. If the JVA was implemented, then there was no question of issuing the shares of the JVC to AT&T Mauritius, because, as per the JVA 100% shares of the JVC were to be owned by the joint venture partners only. Admittedly, AT&T Mauritius was not the joint venture partner and, therefore, issuing the shares of the JVC directly to AT&T Mauritius did not arise at all. Thus, the decision of the Rajasthan High Court do not support the case of Indian Rayon.

72. In the result, we hold that in the facts of the present case, the Certificate obtained by Indian Rayon by furnishing incorrect facts and by making misleading statements would not preclude the Revenue from initiating proceedings under Section 163 of the 1961 Act, because, the facts discovered subsequent to the Certificate prima facie reveal that it is AT&T USA (now NCWS) which had subscribed to the shares of the JVC and that the said shares were owned by AT&T USA and not by AT&T Mauritius. Consequently, on sale of the shares, capital gains accrued to AT&T USA (now NCWS) could be recovered from Indian Rayon as agent of NCWS. Since the proceedings under Section 163 and 195 operate in different fields and in the present case, there is no material on record to suggest that the Certificate under Section 195(2) was issued after considering the applicability of Section 163, in our opinion, initiation of proceedings under Section 163 of the Act cannot be faulted.

(E) Assessment proceedings simultaneously against the resident and the nonresident.

73. The alternative argument advanced on behalf of Indian Rayon is that once the assessing officer has exercised his option under Section 166 of the Act to assess the nonresident NCWS USA directly by issuing notice under Section 148 of the Act, the proceedings initiated to assess Indian Rayon as a representative assessee of the NCWS must come to an end. The submission is that once the assessing officer chooses to assess the nonresident, it means that the assessing officer has given up his right to make an assessment on the representative assessee and, therefore, the assessing officer cannot continue the proceedings against the representative assessee. In support of the above contention, reliance is placed on the decision of the Apex Court in the case of *Mrs. Arundhati Balkrishna Shri Ambica Mills Premises Vs. Commissioner of Income Tax* reported in 1989 Supp (1) SCC 278 and a decision of the Calcutta High Court in the case of *Commissioner of Income Tax Vs. Alfred Herbert (India) Private Limited* reported in 159 ITR 583 (Cal.).

74. Section 166 of the Act overrides the provisions contained in Sections 160 to 165 of the Act and confers powers on the assessing officer to assess either the representative assessee or the principal assessee to whom the income has accrued. Thus, Section 166 provides that initiation of proceedings to assess the income deemed to accrue or arise in India to

a nonresident in the hands of a representative assessee shall not bar direct assessment in the hands of the nonresident. Though the Section contemplates one assessment either in the hands of the nonresident or in the hands of the representative assessee, the Section does not provide any clue to the effect that once the assessment proceedings are initiated against the nonresident, the proceedings initiated to assess the income of the nonresident in the hands of the representative assessee must be dropped. In other words, there is nothing in Section 166 or any other provision of the Act to suggest that the option to assess either in the hands of the representative assessee or in the hands of the nonresident must be exercised at the threshold itself and not at the end of the assessment proceedings.

75. In our opinion, the observations made by the Apex Court in the case of *Mrs. Arundhati Balkrishna* (supra) does not support the arguments advanced on behalf of Indian Rayon. The question as to whether the assessment proceedings initiated to assess the income accrued to the non resident in the hands of the representative assessee must come to an end if the assessing officer issues notice under Section 148 of the Act to assess the income directly in the hands of nonresident, was not a question specifically raised in the aforesaid case before the Apex Court. Moreover, the observations made by the Apex Court to the effect that the Income Tax Officer has the option to proceed either against the Trustee or against the beneficiary, would mean that the Income Tax Officer can proceed to pass assessment order against the Trustee or the beneficiary. Therefore, in our opinion it cannot be said that the Apex Court in the case of *Mrs. Arundhati Balkrishna* (supra) lays down any proposition of law that the assessing officer has to exercise the option at the threshold and not at the end of the assessment proceedings. Though the decision of the Calcutta High Court in the case of *Alfred Herbert* (supra) supports the contention of Indian Rayon, we find it difficult to subscribe to that view, because, in our opinion there is nothing in the provisions of Section 166 which would indicate that the choice to assess either the representative assessee or the nonresident has to be exercised at the threshold and not at the completion of assessment proceedings.

76. We are aware that continuing the assessment proceeding against the representative assessee as well as the nonresident simultaneously would operate harshly against the representative assessee, because, if the Revenue can assess and collect the tax directly from the nonresident, there is no reason as to why the assessment and collection of tax should be made in the hands of the representative assessee and leave the representative assessee to collect the said amount from the nonresident. The very object of assessing the income of the nonresident in the hands of the representative assessee is, on account of the fact that it is quite often difficult to recover the tax from the nonresident. In the present case, remittances to the nonresident were made by Indian Rayon by obtaining

Section 195(2) certificate based on incorrect statement. In these circumstances, in our opinion, it would be just and proper to hold that ordinarily the assessing officer must not proceed against the representative assessee once the assessment proceedings are initiated against the nonresident but in exceptional cases like the present one, where complex issues are involved relating to the computation of capital gains and the assessing officer is unable to make up his mind on account of suppression of material facts, then, it would be open to the assessing officer to continue with the assessment proceedings against the representative assessee and the nonresident simultaneously till he decides to assess either of them.

77. In the present case, AT&T Corp / AT&T Wireless Services Inc (AT&T USA) carried on business in India as a joint venture partner of JVC by subscribing to and owning the shares of JVC. Admittedly in October 2004 Cingular Wireless LLC USA acquired AT&T Wireless Services Inc, USA (AT&T USA) and renamed it as New Cingular Wireless Services Inc, USA (NCWS). Thus, from October 2004, NCWS stepped in to the shoes of AT&T USA and all rights and obligations of AT&T USA vested in NCWS. It is neither the case of Indian Rayon nor the case of NCWS that after October 2004 any of the rights and obligations of AT&T USA in the joint venture business continued to vest in AT&T USA. Therefore, it is evident that after October 2004 the joint venture business in the JVC was carried on by NCWS as a successor of AT&T USA and by selling the shares of ICL to Indian Rayon (Birla Group) and TIL (Tata Group), NCWS made exit from the joint venture business in India. Thus, the sale transaction not merely involved transfer of shares but involved relinquishment of bundle of rights conferred upon AT&T USA (now NCWS) under the JVA and Shareholders Agreement. In these circumstances, the prima facie opinion of the Revenue that from the transaction in question, capital gains has accrued to NCWS cannot be faulted. Consequently, the impugned order passed on 25th March 2009 under Section 163 of the Act and notices issued under Section 148 of the 1961 Act to assess Indian Rayon as agent of NCWS cannot be faulted.

WRIT PETITION NO.345 OF 2010

78. This Writ Petition is filed by Indian Rayon to challenge the order dated 22nd January 2010, whereby it is held that Indian Rayon is liable to be assessed as agent of NCWS as successor of MMMH LLC (which later on merged with NCWS) on account of gains arising to MMMH LLC under the Sale and Purchase Agreement dated 28th September 2005. Indian Rayon has also challenged the notice dated 12th February 2010 issued under Section 148 of the Act to assess the capital gains accrued to NCWS as successor of MMMH LLC (which later on merged with NCWS) on account of gains arising to MMMH LLC on transaction under the Sale and Purchase Agreement dated 28th September 2005.

79. As regards the validity of the notice dated 12th February 2010 is concerned, the learned ASG during the course of arguments fairly stated that the impugned notice dated 12th February 2010 is issued beyond the time prescribed under the Act. If the notice issued under Section 148 of the Act is barred by limitation, then assessing the income accrued to NCWS as successor of MMMH, LLC in the hands of India Rayon as an agent of NCWS does not arise. In such a case, challenge to the validity of the order dated 22nd January 2010 becomes academic. Hence, without going into the merits of the order dated 22nd January 2010, we set aside the notice dated 12th February 2010 issued under Section 148 of the Act as time barred.

WRIT PETITION NO.1837 OF 2009

80. This Writ Petition is filed by NCWS to challenge two notices issued under Section 148 of the Act both dated 31st March 2009, whereby NCWS and the erstwhile MMM Holdings LLC (which has merged with NCWS with effect from 31st December 2006) are called upon to file return of income for assessment year 200607 so as to assess the income which according to the assessing officer has escaped assessment in the said assessment year.

81. The argument of Mr.Chinoy, learned Senior Advocate appearing on behalf of NCWS can be summed up as follows:

- a) Once proceedings are initiated to assess the income allegedly accrued to the nonresident in the hands of the representative – assessee, notice under Section 148 cannot be issued so as to assess the very same income in the hands of the nonresident (NCWS)
- b) NCWS is a company incorporated in USA and has no presence whatsoever in India. NCWS does not have a representative or liaison office in India nor does it have even a branch or subsidiary in India and, therefore, NCWS cannot be taxed in India.
- c) the transaction referred to in the reasons recorded for reopening of the assessment do not amount to transfer of capital asset situated in India and, therefore, not covered under Section 9(1)(i) of the Act.
- d) Sale of 50% shares of ICL held by AT&T Mauritius to Indian Rayon may give rise to capital gains in the hands of AT&T Mauritius. However, as per the DTAA between India and Mauritius, circulars issued by the CBDT and in view of the decision of the Apex court in the case of *Azadi Bachao Andolan* (supra), capital gains accruing to a Mauritian Company holding Tax Residence Certificate from the Republic of Mauritius cannot be taxed in India. Any enquiry by the Incometax authorities as to who are the shareholders of the Mauritian Company and any

enquiry regarding the source of funds which enabled AT&T Mauritius to make investment in India is foreclosed. Even RBI has considered that the shares of ICL belonged to the Mauritian Company and not to AT&T USA (predecessor of NCWS).

- e) Admittedly, payments for acquisition of shares of ICL were made by AT&T Mauritius and shares of ICL have been allotted in the name of AT&T Mauritius. Similarly, shares of ICL have been sold by AT&T Mauritius and payments in respect thereof have been received by AT&T Mauritius. In these circumstances, it is futile for the Revenue to contend that the legal ownership of the shares of ICL has vested in NCWS. The fact that predecessor of NCWS had financed loans to AT&T Mauritius to facilitate them to invest funds in India by acquiring shares of ICL and the fact that AT&T Mauritius immediately on receipt of the sale proceeds received on sale of shares of ICL, repaid the loan with dividend to NCWS, it cannot be inferred that the investments in ICL shares were made by the predecessor of NCWS.
- f) NCWS was a party to the Sale and Purchase Agreement not because the ICL shares belonged to NCWS, but because NCWS had given certain warranties which had to be discharged before finalizing the deal. Thus, neither the shares of ICL were acquired by NCWS nor NCWS has sold the shares of ICL, nor NCWS has received any amount by way of sale consideration. Accordingly, no income has accrued or arisen in India to NCWS on account of sale of shares of ICL by AT&T Mauritius, which can be assessed in the hands of NCWS.
- g) Amounts received by NCWS and MMMH from TIL on account of transfer of shares of AT&T Mauritius cannot be considered as sale of a capital asset situated in India, as the Company (AT&T Mauritius) as well as the shareholders (NCWS & MMMH) of the Company are situate outside India. Even after the purchase of the shares of AT&T Mauritius by TIL, the Company (AT&T Mauritius) continues to exist at Mauritius and TIL became shareholder of AT&T Mauritius situate at Mauritius. Therefore, acquisition of shares of AT&T Mauritius by TIL from NCWS and MMMH cannot constitute transfer of a capital asset situate in India and consequently NCWS and MMMH cannot be held liable to pay tax in India on any gains accruing or arising from the above transaction. In support of the above contention, reliance was placed on two decisions of the Delhi High Court in the case of *Carrasco Investments Limited Vs. Special Director, Enforcement Directorate* reported in 79 Comp. Cases 631 (Del) & *Commissioner of Income Tax Vs. Quantas Airways Limited* reported in 256 ITR 84 (Del), and a decision of this Court in the

case of *Commissioner of Income Tax Vs. Framji* reported in 54 ITR 588.

82. We have carefully considered the arguments advanced by the Counsel for NCWS.

83. The basic question to be considered in this Writ Petition is, whether initiation of proceedings under Section 148 of the Act is in accordance with law or not. From the reasons recorded for reopening of the assessment it is evident that the said proceedings have been initiated on the ground that the transactions under two Sale and Purchase Agreements both dated 28th September 2005 entered into by NCWS and AT&T Mauritius with Indian Rayon and TIL respectively are for sale of 74,35,61,480 equity shares of ICL belonging to NCWS for a consideration of US\$ 150,000,000 each (total US\$ 300,000,000) and the capital gains accruing or arising to NCWS from the above transactions are liable to be taxed in India.

84. The reasons recorded for reopening of the assessment indicate that the predecessor of NCWS, viz., AT&T Corporation representing AT&T Wireless Services Inc., USA (AT&T USA) had entered in to a Joint Venture Agreement (JVA) with Birla Group (which includes Indian Rayon) to form a Joint Venture Company (JVC) known as Birla Communications Limited (presently known as Idea Cellular Limited) on 5th December 1995 under which AT&T USA was to subscribe and own 49% equity shares of the JVC. Under the JVA, the obligation to pay for the equity shares of the JVC was on AT&T USA, and AT&T USA could own the shares of JVC by seeking allotment of shares in the name of a permitted transferee who is a 100% subsidiary of AT&T USA. Under the JVA, all rights including the right to sell the shares of the JVC owned by AT&T USA but allotted in the name of a permitted transferee were to vest in AT&T USA and the permitted transferee was bound by the terms and conditions of the JVA.

85. The reasons recorded for reopening of the assessment as also the argument advanced by the Counsel for the Revenue, to the effect that the shares of ICL sold to Indian Rayon belonged to NCWS (successor to AT&T USA) and the capital gains accrued to NCWS from the above transaction is taxable in India may be summed up as follows:

- (a) AT&T USA carried on the telecommunication business in India as a Joint Venture Partner of the JVC (ICL) by subscribing to and owning the shares of JVC to the extent permitted under the JVA.
- (b) The fact that AT&T USA paid the share subscription amount through its 100% subsidiary – AT&T Mauritius and got the shares allotted in the name of AT&T Mauritius as a permitted transferee does not divest the ownership rights in the said shares vested in AT&T USA.

- (c) AT&T Mauritius has not entered into any agreement with the JVC (ICL) to subscribe / purchase shares of the JVC and the shares allotted to AT&T Mauritius were as a permitted transferee of AT&T USA.
- (d) Prior to the execution of the Shareholders Agreement dated 15th December 2000, the JVC, as per the JVA had allotted 43,82,81,480 shares in the name of AT&T Mauritius, as a permitted transferee of AT&T USA.
- (e) The Shareholders Agreement for all the practical purposes was a reconstitution of the Joint Venture which was originally between AT&T USA and the Birla Group and after the Shareholders Agreement the joint venture was between AT&T USA, Birla Group and the Tata Group. As per the JVA, 100% shares of JVC were to be held by and between AT&T USA and the Birla Group. After the Shareholders Agreement, 100% of the shares of the JVC were to be held by and between AT&T USA, Birla Group and the Tata Group.
- (f) In the Shareholders Agreement, it is recorded that AT&T USA represents the AT&T Wireless Group and that the payments for the balance equity shares would be paid by the members of the AT&T Wireless Group (which includes AT&T Mauritius). However, all rights in the equity shares of the JVC to be issued after the Shareholders Agreement were to vest in AT&T USA. Thus, the rights in respect of the shares of the JVC allotted to AT&T Mauritius prior to and subsequent to the Shareholders Agreement continued to vest in AT&T USA.
- (g) In October 2004, M/s.Cingular Wireless, a Company incorporated in USA, acquired AT&T Wireless Services Inc., USA and renamed it as New Cingular Wireless Services Inc., USA (NCWS). Thus, NCWS stepped into the shoes of AT&T Wireless Services Inc., USA and as a result whereof all rights and obligations in respect of the shares of the JVC issued prior to and subsequent to the Shareholders Agreement stood vested in NCWS.
- (h) M/s.India Televentures Limited offered to purchase from NCWS its entire shareholding of 74,35,61,480 equity shares at US\$ 300,000,000. As per the JVA as also under the Shareholders Agreement, NCWS could sell the shares of the JVC owned by it, by first offering it to the other two joint venture partners viz., the Birla Group and the Tata Group (rights of first refusal) and if they declined to purchase the shares, then only the shares of the JVC could be sold by NCWS to third parties. Accordingly, NCWS gave option to the Birla Group and the Tata Group to

purchase the shares of the JVC owned by NCWS as a joint venture partner.

- (i) The Birla Group as also the Tata Group agreed to purchase from NCWS the entire shares of the JVC owned by AT&T USA (now NCWS).
- (j) Indian Rayon representing the Birla Group made an application seeking Certificate under Section 195(2) of the Act. In the application, it was stated that Indian Rayon was purchasing shares of ICL from AT&T Mauritius. It was further represented that AT&T Mauritius directly purchased the shares from the JVC. On the basis of the above representation made, Indian Rayon was permitted to transmit US\$ 150 million to AT&T Mauritius without deduction of tax at source.
- (k) Indian Rayon representing the Birla Group entered into a Sale and Purchase Agreement on 28th September 2005 with NCWS and AT&T Mauritius for purchase of 37,17,80,740 (50% of the shares of the JVC allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA for US\$ 150,000,000. On 29th September 2005, Indian Rayon remitted US\$ 150,000,000 to AT&T Mauritius and on the same day US\$ 150,000,475 was remitted by AT&T Mauritius to NCWS. According to the Revenue, out of US\$ 150,000,475 the amount of US\$ 150,000,000 represented the sale proceeds of the ICL shares received by AT&T Mauritius as a permitted transferee of the AT&T USA (now NCWS).
- (l) As regards the balance 50% shares of ICL held by NCWS i.e. 37,17,80,740 equity shares of ICL, TIL was entitled to purchase the same (in exercise of the rights of first refusal) from NCWS on payment of US\$ 150,000,000/. However, TIL instead of purchasing balance 50% shares of ICL held by NCWS for US\$ 150,000,000/sought to purchase 100% shares of AT&T Mauritius owned by NCWS and MMMH (belonging to the AT&T Group) for US\$ 150,000,000/. NCWS & MMMH held 70% and 30% shares of AT&T Mauritius respectively. Accordingly, a Sale and Purchase Agreement was entered into on 28th September 2005 between TIL on the one hand and NCWS and MMMH on the other hand, wherein it is recorded that TIL would purchase entire shares of AT&T Mauritius held by NCWS and MMMH for US\$ 150,000,000. The said agreement records that AT&T Mauritius holds 74,35,61,480 shares of ICL and that AT&T Mauritius has agreed to sell 37,17,80,740 shares of ICL to Indian Rayon out of the total 74,35,61,480 shares and that the sale of the shares of AT&T Mauritius to TIL would take place only after the sale transaction between AT&T Mauritius and Indian Rayon is completed.

- (m) Thereafter, TIL paid US\$ 105 million to NCWS and US\$ 45 million to MMMH (total US\$ 150 million) towards the purchase price of the entire share capital of AT&T Mauritius held by NCWS and MMMH in the ratio of 70% and 30% respectively.
- (n) By an order dated 28th March 2008 ADIT (Intl. Taxn.) held that the payment of US\$ 150 million by TIL to NCWS and MMMH was in fact for acquisition of the balance 37,17,80,740 equity shares of ICL remaining with NCWS (after selling 37,17,80,740 equity shares of ICL to Indian Rayon) and since payment was made to NCWS and MMMH without deducting tax at source, TIL is liable to be treated as an assessee in default under Section 201(1)/201 (1A) of the 1961 Act. By two orders both dated 2nd May 2009 passed under Section 163 of the Act, it was held that TIL was liable to be assessed as an agent of NCWS and MMMH.
- (o) By two notices both dated 31st March 2009 issued under Section 148 of the 1961 Act, NCWS and MMMH LLC were called upon to file return of income, as income accrued to NCWS and MMMH on account of sale and purchase transaction with TIL was a transaction relating to the sale and purchase of shares of ICL which is taxable in India and that income has escaped assessment.

86. From the aforesaid facts on record, in our opinion, the prima facie belief formed by the assessing officer that the Sale and Purchase Agreement dated 28th September 2005 entered into by Indian Rayon with AT&T Mauritius and NCWS as also the Sale and Purchase Agreement dated 28th September 2005 entered in to by TIL with NCWS and MMMH were in fact transactions for transfer of the right, title and interest of NCWS in the JVC as a joint venture partner together including the shares of ICL owned by NCWS cannot be said to be without any substance especially when Indian Rayon and TIL in exercise of their rights of first refusal had agreed to purchase equity of ICL from NCWS for US\$ 300 million.

87. NCWS being successor to AT&T USA, it could make exit as a joint venture partner of the JVC (now ICL) by not only selling all the shares it held in ICL, but also by relinquishing all right, title and interest vested in it under the JVA / Shareholders Agreement. Accordingly, NCWS as a joint venture partner offered to sell and Indian Rayon / TIL representing the other two joint venture partners accepted the offer to purchase all the shares of ICL in exercise of their right of first refusal under the Shareholders Agreement. As noted earlier, even before the execution of the Shareholders Agreement 43,82,81,480 equity shares of ICL were allotted to AT&T Mauritius as a permitted transferee of AT&T USA with all rights vested in AT&T USA. Thus, shares issued under JVA and thereafter under the Shareholders Agreement could be divested by

NCWS by not merely transferring the shares of the JVC but also by relinquishing all rights conferred under the JVA / Shareholders Agreement. By the two Sale and Purchase Agreements, though NCWS has ceased to be the joint venture partner of ICL, it is the contention of NCWS that the amounts received thereunder do not represent the consideration received on relinquishment of right, title and interest including the shares of ICL held by NCWS.

88. It is an admitted fact that the value of 74,35,61,480 equity shares of ICL offered by NCWS to the Birla Group and the Tata Group was US \$ 300 million. It is an admitted fact that the Birla Group and the Tata Group had agreed to purchase the said shares of ICL from NCWS for US\$ 300 million. It is an admitted fact that on completion of transaction under the two Sale and Purchase Agreements both dated 28th September 2005, NCWS has ceased to be joint venture partner of the JVC and ceased to have any interest in the said shares of the JVC. Indian Rayon as well as TIL have paid US\$ 150 million each (total US\$ 300 million) under the two Sale and Purchase Agreements both dated 28th September 2005, as a result whereof NCWS has ceased to be the joint venture partner of the JVC. In these circumstances, whether NCWS relinquished its right, title and interest in ICL (as a joint venture partner) under the two Sale and Purchase Agreements both dated 28th September, 2005, without receiving any consideration or whether the consideration of US\$ 300 million paid by Indian Rayon and TIL under the said Agreements were the consideration paid to NCWS for relinquishing its right, title and interest in ICL is the question raised by the Revenue, which cannot be said to be without any merit and it cannot be said that initiation of assessment proceedings are without jurisdiction. Accordingly, the prima facie view formed by the assessing officer to the effect that the transaction in question was in fact, a transaction for transfer of a capital asset situate in India (sale of shares of ICL) and the income accrued to NCWS / MMMH from the above transaction are taxable in India cannot be faulted. It would be open to NCWS to prove to the contrary by placing all material facts in the assessment proceedings. Therefore, without going into the merits of the case, we hold that prima facie case is made out for invoking jurisdiction to initiate assessment proceedings against NCWS / MMMH and it is not a fit case for exercising the writ jurisdiction.

WRIT PETITION NO.38 OF 2010.

89. TIL has filed this Petition to challenge the order dated 28th March 2008 passed under Section 201(1) / 201(1A) of the 1961 Act, two orders both dated 2nd March 2009 passed under Section 163 of the 1961 Act and two notices both dated 31st March 2009 issued under Section 148 of the 1961 Act.

90. As regards the challenge to the order dated 28th March 2008 passed under Section 201(1) / 201(1A) is concerned, TIL has already filed an appeal against the said order and the said appeal is pending. Hence,

we do not consider it proper to decide the said issue in the present Writ Petition.

91. The challenge to the orders dated 2nd March 2009 passed under Section 163 of the Act is on the ground that TIL had purchased 100% shares of AT&T Mauritius from NCWS and MMMH for US\$ 150 million and the capital gains arising from the above transaction is not taxable in India. In the ordinary course, income accrued to a nonresident on account of sale of shares of a foreign Company would not taxable in India. However, in the present case, the argument of the Revenue is that the transaction between TIL and NCWS / MMMH is really a transaction for purchase of 37,17,80,740 equity shares of ICL subscribed and owned by NCWS (successor to AT&T USA) as a joint venture partner of JVC in India and, therefore, income accrued to NCWS and MMMH would be taxable in India.

92. Mr.Dada, learned Senior Advocate appearing on behalf of TIL vehemently contended that the case of TIL cannot be compared with the case of Indian Rayon, because, Indian Rayon has purchased shares of ICL from AT&T Mauritius, whereas TIL has purchased the shares of AT&T Mauritius from NCWS and MMMH. According to Mr.Dada, acquisition of shares of AT&T Mauritius does not mean acquisition of shares of ICL held by AT&T Mauritius. Shares of ICL continued to belong to AT&T Mauritius even after the shares of AT&T Mauritius were acquired by TIL from NCWS and MMMH. A person who acquires the shares of a Company becomes the shareholder of that Company. Such a shareholder does not proportionately or otherwise own the assets belonging to the Company. Therefore, in the present case, the fact that TIL has acquired the shares of AT&T Mauritius, it does not mean that TIL becomes owner of assets belonging to AT&T Mauritius.

93. It is further contended by the Counsel for TIL that in the present case NCWS and MMMH have not transferred any capital asset situate in India and no income accrue or arise or deemed to accrue or arise in India to NCWS and MMMH which can be taxed in India and consequently recovering any tax from TIL as agent of NCWS and MMMH does not arise at all.

94. Referring to various documents annexed to the Writ Petition, as also the compilation of documents furnished, Mr.Dada submitted that in the present case genuineness of the transaction were considered in detail by the Reserve Bank of India and it is only after the genuineness of the transaction was established, TIL was permitted to make remittances to the shareholders of AT&T Mauritius, viz. NCWS and MMMH. It was argued that TIL acquired the shares of AT&T Mauritius with a view to set up its wholly owned subsidiary for exploiting future telecom acquisition opportunities globally. It was further contended that Reserve Bank of India has allotted the identification number to TIL to set up / acquire AT&T Mauritius i.e. the Wholly Owned Subsidiary (WOS) in

Mauritius subject to the condition that the WOS would not make any further investment in India without prior permission of Reserve Bank of India and, accordingly, no investments have been made in India. In these circumstances, it was argued that the incometax authorities cannot go into the genuineness of the transaction once again and, therefore, the proceedings initiated against TIL be dropped and the amount of Rs.45.40 crores paid by TIL under protest towards the tax liability of NCWS and MMMH be refunded to TIL.

95. We have carefully considered the above arguments advanced on behalf of TIL. In the present case, TIL in exercise of its right of first refusal contained in the Shareholders Agreement had agreed to purchase 37,17,80,740 equity shares of ICL from NCWS for US\$ 150 million. However, instead of purchasing the said shares of ICL, by a Sale and Purchase Agreement entered into with NCWS and MMMH, TIL agreed to purchase the entire shares of AT&T Mauritius for US\$ 150 million. Once we find merit in the contention of the Revenue that prima facie the ICL shares held by AT&T Mauritius belonged to NCWS and the value of the ICL shares remaining with AT&T Mauritius (after selling shares to Indian Rayon) was US\$ 150 million, then the question to be considered is, whether TIL paid US\$ 150 million for the shares of ICL or for the shares of AT&T Mauritius which had no assets other than ICL shares. These questions would have to be gone into in the assessment proceedings.

96. TIL cannot be said to be unaware of the fact that the shares of ICL held by AT&T Mauritius did not belong to AT&T Mauritius because TIL was party to the Shareholders Agreement, wherein all rights in respect of the shares of JVC to be issued after the Shareholders Agreement was to vest in AT&T USA and not with AT&T Mauritius. In the Share Purchase Agreement, it is recorded that the sale of shares of AT&T Mauritius in favour of TIL would take place only after the sale of shares of ICL in favour of Indian Rayon takes place so that on the date of transfer of shares of AT&T Mauritius, only 50% of the ICL shares remain in the name of AT&T Mauritius. Therefore, the prima facie opinion of the Revenue that the transaction between TIL and NCWS / MMMH for sale and purchase of shares of AT&T Mauritius was a colourable transaction and in fact the transaction was for sale and purchase of ICL shares by NCWS to TIL cannot be said to be devoid of any merit.

97. In this view of the matter, we do not see any infirmity on the part of the assessing officer in initiating assessment proceedings against TIL and it would be open to the TIL to establish that the income accrued to NCWS and MMMH was not taxable in India and consequently no amount can be recovered from TIL as agent of NCWS / MMMH.

98. In the result, we find it difficult to accept the arguments advanced by the Counsel for Indian Rayon, NCWS and TIL as, in our opinion, prima facie, the transactions under the two Sale and Purchase Agreements both dated 28th May 2005 were basically transactions to

transfer the entire right, title and interest in ICL by one joint venture partner namely NCWS (successor to AT&T USA) to the remaining two joint venture partners namely the Birla Group (represented by Indian Rayon) and the Tata Group (represented by TIL). There is voluminous evidence on record to support the above prima facie view. Therefore, in the facts of the present case, prima-facie case is made out by the Revenue for initiating proceedings under Section 148 as also under Section 148 read with Section 163 of the Act. The assessing officer is directed to complete the assessment proceedings as expeditiously as possible. All contentions of both the parties are kept open.

99. For all the aforesaid reasons, Writ Petition No.730 of 2009 filed by Aditya Birla Nuvo Limited (formerly known as Indian Rayon & Industries Limited), Writ Petition No.1837 of 2009 filed by NCWS and Writ Petition No. 38 of 2010 filed by Tata Industries Limited are dismissed. Writ Petition No. 345 of 2010 filed by Aditya Birla Nuvo Limited is partly allowed by setting aside the notice dated 12th February 2010 issued under Section 148 of the 1961 Act as timebarred. All the Writ Petitions are accordingly disposed off with no order as to costs.

100. At the request of the Counsel for the petitioners in Writ Petition No.1837 of 2009 and Writ Petition No.38 of 2010 {Writ Petition (L) No.2423 of 2009}, interim reliefs granted in the respective petitions on 1st December 2009 are continued for a further period of six weeks from today.

2011 PTR 1854 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "H" BENCH, DELHI

Rajpal Yadav, Judicial Member and
K.D. Ranjan, Accountant Member

FACTS/HELD

1. from supply of 'shrink-wrapped' software assessable as 'royalty'. A tax-treaty can be unilaterally overridden
2. Till 31.12.1998, **Microsoft Corporation** directly entered into agreements with Indian distributors for sale of Microsoft products being "off the shelf"/ "shrink wrapped" software, on principal to principal basis. The Indian Distributors, in turn, sold these Microsoft products to re-sellers/consumers. The business model was changed w.e.f. 1.1.1999. **Microsoft Corp**

granted an exclusive license to its 100% subsidiary **Gracemac Corp**, USA, to manufacture and distribute in the territory the MS retail software products. **Gracemac** in turn, entered into a license agreement with **Microsoft Operations Pte Ltd**, Singapore (“MO”), under which it granted the latter a license to manufacture and distribute (reproduce) Microsoft software in Singapore in consideration of a royalty ranging from 30% to 40% of the selling price (in India). MO in turn entered into a distribution agreement with **Microsoft Regional Sales Corporation**, USA (“MRSC”), appointing the latter as distributor for selling the Microsoft software which were manufactured by **MO**. **MRSC**, in turn, entered into agreements with various distributors in various countries including India. The distributors distributed copies of software in their respective countries. **MO** sold the software copies to **MRSC** in Singapore. The Microsoft software copies are delivered by **MRSC** to the Indian Distributors “ex-warehouse” in Singapore. The distributor sold the products to re-sellers in India who, in turn, sold them to end users. **Microsoft Corp** entered into agreements with end users to use the software products licenced to them as per terms of agreement.

3. In the case of **Microsoft Corp** (till the change), the assessee accepted that income from licensing software to OEMs was “royalty” though it argued that income from licensing software to distributors was “sale of a copyrighted article” and not assessable in India for want of a PE. In the case of **Gracemac** (after the change), it was argued that as the royalty was received from a Singapore company (**MO**), the source of the royalty (though based on sales in India) was not in India and consequently not assessable in India. In the case of **MRSC**, it was argued that revenue was derived from sales of software to independent distributors and not from licensing and the revenue was not assessable to tax in India for want of a PE. The AO & CIT (A) took the view that the revenue received by all three parties was assessable as “royalty” under s. 9(1)(vi) as well as Article 12 of the India-USA DTAA. On appeal to the Tribunal, HELD:

- (i) **The income received for supply of software is assessable as “royalty” under s. 9(1)(vi) as a copyright subsists in a computer programme and it**

is also a literary as also a scientific work. A computer programme is also a patent, invention or process. As end-users have made payment for transfer of rights (including the granting of a license) in respect of copyright, patent, invention, process, literary or scientific work, the payment would be in the nature of royalty. Under the Explanation to s. 9 (1) inserted by FA 2010 w.r.e.f 1.6.1976, income u/s 9(1)(vi) is deemed to accrue or arise in India even if the non-resident does not have a place of business in India;

- (ii) As regards **Article 12(3) of the India-USA DTAA, the definition of the term “royalty” is identical that in s. 9(1)(vi)** and there is no conflict. Under both, royalties are deemed to arise in the State in which the payer is situated;
- (iii) Assuming there was a conflict between the Act and the DTAA, **the proposition that the DTAA will prevail over the Act is not infallible.** Later domestic tax legislation can over-ride treaty provisions if there is an irreconcilable conflict (**Gramophone Company of India AIR 1984 SC 667** followed). **As the India-USA DTAA was entered on 20.12.1990, the subsequent retrospective amendment to s. 9 which provides that royalties will be deemed to accrue or arise in India even if the non-resident has no place of business in India will apply irrespective of any contrary provision in the India-USA DTAA;**
- (iv) Though the **OECD Commentary** provides that **software supply profits are not assessable as “royalty”, the same merely contains the views of the authors and cannot be equated with the court decisions or law.** Further, several Countries have expressed **reservations** in following the OECD commentary and there is also a **cleavage of opinion** in the OECD on whether a copyrighted article has copyright in it;
- (v) The judgement of the Supreme Court in **Tata Consultancy Services vs. State of AP 271 ITR 401** where a distinction was drawn between a “copyright” and a “copyrighted article” is **not applicable** as the Court was

concerned with the provisions of the sales-tax act and was not concerned with the issue whether the transfer of a copyrighted software can give rise to “royalty”. Similarly, in **Motorola** 95 ITD 269 (SB) the Special Bench was concerned with a case where the software licensed to the cellular operator was a **part of the hardware and had no independent use**;

- (vi) As the assessee has itself filed suits in Indian courts alleging copyright-infringement when pirated/unlicensed software is used, it cannot “blow hot & cold” in the same breath on the same issue;
- (vii) Accordingly, the **payments received by Microsoft Corporation from end users through distributors in respect of sale of computer software is taxable as royalty u/s 9(1)(vi)**;
- (viii) As regards Gracemac, the argument that since EULA has been signed between end users and Microsoft Corp, no license was granted by Gracemac and consequently royalty payments are not chargeable to tax in the hands of Gracemac is not acceptable because the agreements are a “camouflage”. **As end users have made payments for grant of license in respect of copyright in computer programmes, the consideration is taxable as “royalty” in the hands of Gracemac**;
- (ix) However, as regards MRSC, **the income ought to have been assessed as business income u/s 9(1)(i) as it had a “business connection” with distributors in India** and not as “royalty” as the royalty for grant of rights has already been assessed in the hands of Gracemac and there will be double taxation.
- (x) The assesseees (though non-residents) are **liable to pay interest u/s 234A to 234C** in view of **Anjum Ghaswala** 252 ITR 1 where the levy of interest was held mandatory in nature.

Order accordingly.

Income Tax Appeal Nos. 1331, 1332, 1333, 1334, 1335 & 1336 (Del) of 2008. Assessment Years: 1999–2000, 2000–01, 2001–02, 2002–03, 2003–04 & 2004–05, 1392 (Del) of 2005. Assessment Years : 1996–97

and 1393, 1394 & 1395 (Del) of 2005. Assessment Years: 1999-2000, 2000-01 & 2001-02.

Decided on: 26th October, 2010.

Present at hearing: N. Venkataraman, Sr. Advocate, Rajan Vohra, C.A., Salil Kapoor, Advocate. Muhammad Shafiq, Sushant Mehta, C.A.; and Manju, Advocate, for Appellant. S.G. Srivastava, Standing Counsel; and L. M. Pandey [CIT] – D.R., for Respondent.

JUDGMENT

Per K.D. Ranjan:- (Accountant Member)

These group of appeals by three different assessee arise out of separate orders of the Id. CIT (Appeals)–XXIX, New Delhi. These appeals were heard together and, for the sake of convenience, are being disposed, of by this consolidated order.

2. The appeal for assessment year 1996-97 of M/s. Microsoft Corporation in ITA No 1392 (Del) of 2005 and three appeals in ITA Nos. 1393/Del/2005 to 1395/Del/2005 for Assessment Years 1999-00 to 2001-02 of Microsoft Regional Sales Corporation(MRSC) were heard together and thereafter 6 appeals of Gracemac Corporation in I. T. Appeal Nos. 1331, 1332, 1333, 1334, 1335 & 1336 (Del) of 2008 for assessment years 1999-00 to 2004-05 were also heard. The issues involved in the appeals are common and both assessee and Revenue have requested that the arguments and submissions for all the appeals should be considered together.

3. Microsoft Corporation (MS Corp) in its return filed for AY 1996-97 offered its income from licensing of software to Original Equipment Manufacturers (OEM) to tax and did not offer to tax its income from sale of Microsoft software products to Indian Distributors. The assessing officer, however, taxed the payments received from Indian Distributors as 'royalty' under section 9(1)(vi) of Income Tax Act, 1961 and Indo-US DTAA. Against the said order MS Corp filed appeal before CIT(A) and while passing an order CIT(A) also confirmed the addition made to the income of MS Corp. Against this order assessee is in appeal before this Tribunal.

4. For AY 1999-00 to 2001-02 in case of MRSC, the payments received from Indian distributors on sale of Microsoft software products were not offered to tax as royalty. However, the assessing officer assessed the entire payments in the hands of MRSC as royalty income on the ground that payments have been received towards licensing of Microsoft software products which amounts to grant of right in Intellectual property Rights (IPRs). On appeal against the order of assessing officer, Id CIT(A) has considered that the software is being licensed and not sold and accordingly the consideration received for supply of software should

be taxed as royalty. Against this order the assessee is in appeal before this Tribunal.

5. In case of Gracemac for assessment years 1999-2000 to 2004-05, the assessing officer had taxed the payments made by MO Singapore to Gracemac, USA @ 35%/40% of net sales consideration received by MRSC from Indian distributors in India under Section 9(1)(vi)(c) of the Act and Article 12(7) (b) of the Indo- US Double Taxation Avoidance Agreement (DTAA) on the ground that Gracemac's source of royalty is MO which distributes Microsoft software products in India through MRSC and accordingly, Gracemac is getting royalty out of the licensing of Microsoft software products carried out in India. The assessing officer also held that the royalty received from MO is taxable under Article 12(7)(b) of the India US DTAA as the payment to Gracemac is based on the number of users of intellectual property rights in India. Ld CIT(A), however enhanced the assessment by bringing the entire consideration received by MRSC from Indian distributors on the contention that MRSC and MO are legal façade. To this extent, the same revenue is being taxed in case of MRSC and Gracemac for the Assessment Years 1999-00 to 20001-02 and this according to assessee has resulted in double taxation for these Assessment Years.

6. For sake of convenience as identical issue is involved in these cases, we will take up appeal filed by assessee in the case of Gracemac Corporation in I. T. Appeal Nos. 1331 to 1336 (Del) of 2008 for Assessment years 1999-2000 to 2004-05. The grounds of appeal raised by the assessee are as under:—

“ On the facts and in the circumstances of the case, the ld. Commissioner of Income-tax (Appeals),XXIX, Delhi [“ld. CIT (A)] has :

- 1. Erred in law in determining the income of Gracemac Corporation (the Appellant”) for the subject year at USD 58,764,099 completely ignoring the fact that the actual income of the Appellant from licensing of manufacturing and distribution rights to Microsoft Operations Pte Ltd. (“MO”) pertaining to India was only USD 22,668,737 during the subject Assessment Year;*
- 2. Erred in holding that revenue earned and received from sale of software by a group company of the Appellant – Microsoft Regional Sales Corporation, USA (“MRSC”), a distributor of Microsoft products to Indian distributors amounting to USD 58,764,099 is taxable in India in the hands of the Appellant under the provisions of the Income-tax Act, 1961 (“the Act”) and the double taxation avoidance agreement between India and US (“India-US tax treaty”);*

3. *Erred in observing that the Appellant has granted license to end users in India to use the Microsoft software in respect of which it earns royalty income. The Id. CIT (A) has completely ignored the fact that the Appellant only earns 'royalty' income from MO for grant of manufacturing and distribution rights in Microsoft products (which are exercised in Singapore) and which is not taxable in India under the Act or India-US tax treaty as the same is not sourced in India;*

Without prejudice to the above grounds that the Appellant has not earned income from licensing of software to end-users in India, the Appellant submits the following grounds of appeal with respect to the income from sale of software;

4. *Erred in passing the order under section 250 of the Act and taxing such income in the hands of Appellant which is otherwise also not taxable in India. In doing so the Id. CIT (A) has disregarded the decisions of the Honourable Income Tax Appellate Tribunals ("ITAT") that are squarely applicable with respect to the income for which the Appellant has been assessed and ignoring the Doctrine of Binding Precedents;*
5. *Erred on the facts and circumstances of the case and in law in concluding that the CBDT Circular No. 621/1991 and 588/1991 exempting royalty payments received in respect of 'system software' supplied along with computer hardware signifies that by implication, consideration for use of software products in all scenario except where the specific exemption has been granted, will be liable to tax as royalty income under section 9(1)(vi) of the Act;*
6. *Erred in law in concluding that the provisions of section 115A of the Act, characterizes the income from sale of software (deemed to be income of Appellant) as 'royalty' under the Act without appreciating that section 115A of the Act applies to royalty payments as defined under section 9(1)(vi) of the Act and in the instant case, as the revenue does not amount to 'royalty' under the provisions of section 9(1)(vi) of the Act, there is no basis to rely on the provisions of section 115A of the Act;*
7. *Failed to appreciate that the sale of software is sale of 'Copyrighted Article' and not 'Copyright' in Microsoft software and accordingly, the revenue from sale of software is in the nature of business income not taxable under Article 7 of the India US tax treaty in the absence of a 'Permanent Establishment' of the Appellant in India;*

8. *Failed to comprehend the facts and has erred in law and on facts in arriving at the following conclusion :*
- (a) *That the Appellant has licensed software copyright to end users in India;*
 - (b) *That the source of revenue derived by the Appellant is from licensing of software and utilization / exploitation of the license granted to the users in India, completely disregarding the fact that such revenue is from sale of Microsoft products and is not in the nature of licensing revenues;*
 - (c) *That the consideration received from Indian distributors for sale of computer software is towards use of 'scientific knowledge, invention, secret formula, process and scientific work' developed by the Appellant and hence the same is taxable as royalty under the Act;*
 - (d) *That the sale of software to Indian distributors under Volume Purchase Product ("VPP") model is akin to licensing of copyright in computer software to Original Equipment Manufactures. Accordingly, consideration received from sale of software under VPP model is taxable as royalty;*
 - (e) *That the consideration received from sale of software under Full Packaged Product ("FPP") model is taxable as royalty since the same involves granting of limited right to end users to copy the software on the hard drive of the computer.*
9. *Erred on the facts and circumstances of the case and in law in holding the draft report issued by High Powered Committee ("HPC") as India's position on e-commerce transaction thereby ignoring that the said report has not been accepted by the Government of India and accordingly does not have any bearing in characterization of the transaction of sale of software by the Appellant;*
10. *Erred in holding that the rationale laid down by the Hon'ble Supreme Court in the decision of Tata Consultancy Services Ltd. 271 ITR 401 (SC) is not applicable in the instant case;*
11. *Erred on the facts and circumstances of the case and in law in confirming the interest under section 234-A and 234-B of the Act while completely disregarding the provisions of the Act and the judicial precedents issued by the Hon'ble ITAT(s) and Hon'ble High Court."*

7. The key issue involved in all these appeals and is raised for adjudication before this Tribunal is as to whether the sale of "off the shelf

software product” by US based non-resident companies to independent Indian distributors is taxable in the hands of such non-resident companies as royalties within the meaning of Explanation 2 to section 9(1)(vi) of the Act as well as under Article 12 of Double Taxation Avoidance Agreement between India and US.

8. The facts of the case stated in brief are that upto 31.12.1998 Microsoft Corporation (MS Corp) had directly entered into agreements with various Indian Distributors for sale of Microsoft products being “off the shelf”/ “shrink wrapped” software, on principal to principal basis. The Indian Distributors, in turn, sold these Microsoft products to re-sellers/consumers. The above business model was changed w.e.f. 1.1.1999, whereby the Microsoft products were sold by Microsoft Regional Sales Corporation [MRSC], USA, to Indian distributors, through its branch office in Singapore. The business model w.e.f. 1.1.1999 onwards in case of MRSC and Gracemac is as follows:-

- i) Microsoft Corporation entered into agreement on 1/01/1999 with Gracemac Corporation, USA, a hundred per cent subsidiary, to grant an exclusive license in exchange of all shares to manufacture in the retail territory the MS retail software products including all updates as developed from time to time and to distribute such MS retail software products manufactured by its subsidiary or so manufactured by a sub-licensee or sub-contractor of subsidiary, in accordance with terms of the license agreement or the previous licenses. MS Corp also granted subsidiary, an exclusive right to license any third party in the retail territory to grant directly to customers the right to reproduce the software portion of MS retail products for internal use. The agreement also provided that all master copies provided by MS Corp to subsidiary shall at all times remain the sole property of MS Corp as shall the packaging and documentation related materials provided by MS Corp. Subsidiary also agreed not to make any copies of the master copies except as provided in the agreement and agreed to return to MS Corp. the master copies and any other materials supplied by MS Corp. immediately upon termination of the agreement. All the licenses were granted in exchange for issuance of 20 shares of subsidiary common stocks with par value of \$0.01; provided that subsidiary may issue additional stock subsequent to the effective date of this agreement in exchange for any license granted under the agreement with respect of MS retail software products including updates designated by MS Corp after such date. The agreement further provided that subsidiary shall owe no other royalty or payment for any license granted under the agreement.

- ii) Gracemac in turn, entered into a license agreement with Microsoft Operations Pte Ltd (“MO”), Singapore, under which MO, was granted non-exclusive license to manufacture (reproduce) Microsoft software in Singapore; non exclusive license to distribute the software products so manufactured to retailers or to MS Corp or to subsidiaries of MS Corp and non-exclusive right to license or sub-license the right to reproduce Microsoft software to certain end users (large account customers) for their internal use. In consideration to this, MO pays royalty to Gracemac for each MS retail software copy. The royalty amount ranges from 35% to 40% of net selling price received by MRSC from the distributors for the Indian Territory.
- iii) MO has in turn entered into a non-exclusive distribution and inter-company services agreement (distribution agreement) with MRSC for appointing MRSC as a distributor for selling the copies of Microsoft software which are reproduced / manufactured by MO.
- iv) MO sells all the software copies to MRSC in Singapore. MRSC, in turn, has entered into agreements with various distributors in various countries including India. The distributors have a right to distribute the copies of software in their respective countries.
- v) The Microsoft software copies are delivered by MRSC to the Indian Distributors “Ex-warehouse” in Singapore. The distributor sells the products to the re-sellers in India which, in turn, sells them to the end users.
- vi) The Microsoft Corp. entered into agreement with end users to use the software products licenced to them as per terms of agreement.

9. The modus operandi of distribution models for supply of software to Indian distributors is as under:—

- (a) The first model known as Fully Packaged Product (FPP) model is meant for small customers. In this model, MO, Singapore, produces the copy of software program by embedding the software in a media and sells the media containing the software through the supply chain i.e MRSC and distributors in India to the end users.
- (b) The other category of sale of products is called the Volume Purchased Products (VPP) model, which is for large customers like corporate customers. In this model, instead of selling individual software copies in media, the end user gets/buys one set of media containing the software and can make as many copies for internal use as is prescribed in the license. The end

user is required to pay based on the number of copies which can be made for internal use.

- (c) MS Corp being the registered owner of intellectual property in Microsoft software products, entered into an 'End User License Agreement (EULA)' with the end users in India.

10.1 During the course of assessment proceedings the assessing officer noted that on 1/01/1999 Microsoft Corporation granted M/s. Gracemac Corporation, the assessee, a hundred per cent subsidiary of Microsoft Corporation, licence to manufacture and distribute all MS retail software products. Subsequently on the same date the assessee entered into another licence agreement with Microsoft Operations, a Corporation created under the laws of Singapore to manufacture and distribute Microsoft softwares in various countries including India. As per the terms of agreement the royalty was to be paid on the basis of number of copies distributed / licenced in various countries including India. Before the assessing officer there was no dispute between the Department and the assessee that the payment was covered under the term 'royalty' both as per Income-tax Act as well as Indo-US DTAA. The only objection which the assessee could raise was that income was not taxable in India as per Indo-US treaty. Further the assessing officer noted that Microsoft Operations Pte Ltd. entered into service agreement with Microsoft Sales Regional Corporation, a company registered in US an another subsidiary of Microsoft Corporation. The assessing officer noted that as per the agreement the assessee was to receive royalty of 35 to 40 per cent. Since the payment was flowing from India the assessing officer was of the view that the payments made by the end-users was in respect of royalty. The assessing officer dealt with the terms of agreement entered into between the parties. The assessing officer further noted that the assessee had granted the right to Microsoft Operations for manufacture and distribution of software in India. The assessee's source is Microsoft Operations which is distributing software in India through another group concern i.e. Microsoft Regional Sales Corporation. The agreement clearly stated that the assessee was getting royalty out of licensing of software carried out in India. The assessing officer referring to provisions of Article 12(3) of Indo-US treaty has noted that royalty and fee for included services shall be deem to arise in a contracting State when payer is a resident of that State. The assessing officer was of the view that the payment was for the right to use the copyright in the programme i.e. the software and not for manufacturing of tangible products. According to the assessing officer there was no dispute to the fact that as per Article 12(2) the royalty was to be taxed in India if it was arising in India. Since the payment of royalty was directly related to source in India and, therefore, the assessing officer treated the sale as taxable in India. As regards the contention of the assessee that commercial exploitation of right to manufacture the software was outside

i.e. in Singapore, was rejected on the ground that in case of volume licences one hard disc is sent in India to customer and is granted a number of licences depending upon his requirement and he makes copies of the software in India and loads it on its computers. Therefore, the payment is related to grant of licence and the number of users of that intellectual property right for which licence has been granted. The assessing officer accordingly treated the payment as royalty arising out of licensing of the computer software. He placed reliance on the decision of Authority for Advance Ruling P. No. 13 of 1995, 228 ITR 487.

10.2 In the case of Microsoft Corporation the source of Revenue for assessment year 1996-97 was from licensing of computer software to Original Equipment Manufacture (OEM) amounting to US \$ 27,16,592 and licensing of computer software to independent distributors in India amounting to US \$ 1,06,11,033. The assessee accepted income from licensing of computer software to OEM as taxable, but the taxability of its income derived from licensing of software was denied. The main contention of the assessee was that what was being used in India was copyrighted article and not copyright. This contention of the assessee was rejected on the ground that software is licenced and not sold. The assessing officer referring to the Copyright Act, 1957 observed that in the case of computer programme the Copyright Act recognizes as doing or authorizing the doing of any of the acts in respect of a work or any substantial part thereof i.e. to sell or give on commercial rental or offer for sale or for commercial rental any copy of computer programme. Therefore, the assessing officer concluded that the assessee has authorized to use the copyright to Indian distributors in India. During the course of assessment the assessee placed reliance on OECD commentary. Since the assessing officer was of the view that the assessee had right over the Intellectual Property Rights [IPRs] of the software which was licenced for distribution to the end users in India the payment made for the same was in the nature of royalty. He accordingly treated the revenues from licence as income of the assessee under section 9(1)(vi) of the Act.

10.3 In the case of Microsoft Regional Sales Corporation [MRSC] the Microsoft Operations granted MRSC the right to appoint non-exclusive distributors in Asia for distribution of Microsoft software. In pursuance of such rights MRSC entered into agreements with independent distributors in India, Nepal and Bhutan for distribution of Microsoft products. It was submitted that the end users had merely been permitted to use the software and, therefore, cannot be said that he has acquired the copyright or the right to use copyright in software supplied. The end user had simply used the right to use a copyrighted article. It was also submitted that MRSC derives only sales revenue from the independent distributors and not licensing revenue. The products are delivered by MRSC to Indian distributors outside India and not taxable in India. The Revenues

received by MRSC may be taxed as business profit under Article 7 of the tax treaty in the event MRSC carried on business in India through a permanent establishment [PE] in India. Since MRSC did not have PE in India its income was not taxable under Article 7 of the tax treaty. However, the assessing officer treated the payment received by MRSC by Indian distributors as royalty within the meaning of section 9(1)(vi) of the Act.

11. On appeal Id. CIT (Appeals) upheld the stand taken by the assessing officer by observing as under:-

- (a) that the consideration received by the assesseees in appeal is for right to use copyright in computer software as defined under section 14 of Copyright Act, 1957.
- (b) that the computer software can also be covered under other Intellectual Property Rights (IPR) categories such as Patent, Process, Equipment as provided in Explanation 2 to section 9(1)(vi) and therefore by supplying software to end users, the end users have a right to use such IPRs.
- (c) Computer software is separately and independently covered in the definition of 'royalty' as provided in Explanation 2 to section 9(1)(vi) of the Act. Therefore, the license of computer software is also covered under the definition of royalty.

12. Before us Sh. N Venkataraman, the Ld counsel for the assessee has submitted that clause (v) of Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 defines the royalty as the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films. It has been contended that the expressions "*copyright, literary, artistic or scientific work including films*" have neither been defined under the Income Tax Act 1961 nor the applicability of Copyright Act, 1957 has been excluded in the Income Tax Act. He has, therefore, submitted that the word "copyright" should be followed by word "*of*". Thus the expressions "*copyright, literary, artistic or scientific work including films**etc.*" should be read as "*copyright of literary, artistic or scientific work including films**ect.*". Without adding the expression "*of*", after the expression 'copyright', the subsequent expressions, appearing after the expression 'copyright' viz 'literary, artistic or scientific work including films and video tapes ...' would be rendered superfluous or redundant. However, by adding the expression "*of*" after the expression 'copyright' in Explanation 2 to section 9(1)(vi) of Act, will thus avoid redundancy and absurdity and the real purport of the legislation, in the absence of independent definitions under the Act, can be brought out. In order to support his contention that

expression “copyright” should be followed by word “of” he referred to provisions of section 180 of the Act wherein the Parliament has employed the expression “of” while dealing with a similar provision on royalties or copyright fees for literary or artistic work. He placed reliance on the decision of constitutional Bench of Hon’ble Supreme Court in the case of Padmasundara Rao Vs State of Tamil Nadu, [2002] 255 ITR 147 wherein at page 155 it has been held that in order to avoid absurdity, provisions should be so read which results into bringing out of the correct intention of the legislation and produce a rational construction.

13. It has further been contended by ld counsel for the assessee that the contention of the ld CIT(A) that software programme should be considered as patent or invention also does not hold good. Since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer programme to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the Indian Copyright Act, 1957 and not under any other category of intellectual property right laws. Ld counsel for the assessee placed reliance on the decision of Bangalore Bench in the case of *Sonata Software Ltd. vs. DCIT* in 103 ITD 324 for the proposition that since computer programme has been defined under the Copyright Act, 1957, it is incorrect to say that computer programme can also be considered as ‘patent’ / ‘invention’ / ‘process’.

14. The next contention of the ld counsel for the assessee is that there is a difference between a “copyright” and a “copyrighted article” and in the context of software the Constitutional Bench of the Hon’ble Supreme Court in the case of *Tata Consultancy Services vs. State of Andhra Pradesh* (2004) 271 ITR 401 has brought out very clearly that a software programme may consist of various commands which enable the computer to perform a designated task. The copyright in the programme may remain with the originator of the programme but the moment, copies are made and marketed, it becomes ‘goods’ which are susceptible to sales tax. Therefore the consideration received by MRSC / MS Corp from Indian distributors is towards sale of Microsoft software products, being copyrighted articles. The end users have not been granted any right in copyright in such software and therefore, such consideration is not taxable as royalty under section 9(1)(vi) of the Act.

15. He has further submitted that the Special Bench in the case of *Motorola Inc. vs.. DCIT*, Non-resident circle (2005) 95 ITD 269 had also recognized the distinction between a “copyright” and a “copyrighted article”. It has been observed by the Special Bench that if the payment is for copyright, it should be classified as royalty both under the Income Tax Act and under the DTAA and it would be taxable in the hands of the assessee on that basis. On the other hand if the payment is for a copyrighted article, then it only represents the purchase price of the

article and therefore cannot be royalty either under the Act or under the DTAA. He placed reliance on the decision of Bangalore Bench of ITAT in the case of *Sonata Information Technology Limited vs. Addl. CIT* 103 ITD 324. It has further been clarified that M/s Sonata Information Technology Limited is one of the distributors of Microsoft software products in India and purchases these products from MRSC for further distribution to end users. It has been held that software products distributed by MRSC were in the nature of copyrighted article and not the right to use copyright. The OECD commentary to Model Tax Convention had also approved the distinction between a “copyright” and a “copyrighted article”. In view of above submissions Ld Counsel for the assessee has submitted that the end user purchasing either a Fully Packaged Products, (FPP) or a Volume Purchase Products (VPP) has only purchased copyrighted articles and has not acquired any copyright. Consequently the sale proceeds cannot be subjected to royalty. He also placed reliance on the following judgments wherein it has been held that computer software is product/goods and therefore a sale of copyrighted article gives rise to business income

- *Motorola Inc. vs. DCIT*, Non-resident circle (2005) (95 ITD 269) (SB Delhi)
- *Infrasoft Limited vs. ACIT*, Circle 2(2) (ITA No 847 Delhi 2008) (Delhi)
- *Lucent Technologies International Inc. vs. DCIT* (120 TTJ 929) (Delhi)
- *Lotus Development Asia Pacific Limited Corporation* (ITA No. 564 to 566/Del/05) (Delhi)
- *Sonata Information Technology Ltd. vs. DCIT* (2006) (7 SOT 465)(Mum.)
- *Sonata Software Ltd. vs. ITO* (Int. Tax) (2006) (6 SOT 700)(Bang)
- *Samsung Electronics Co. Ltd vs. ITO* (TDS-1)(2005) (93 TTJ 65) (Bang)
- *Hewlett – Packard (India) (P) Lt.d vs. ITO* (2006) (5 SOT 660)(Bang)
- *M/S Metpath Software International Limited* (ITA No 179) (Delhi)

16. Further ld CIT(A) has held that the assessee has received consideration under the software license agreement for transfer of ‘some rights’ including the granting of license in respect of copyright in software. Further the rights which have been transferred include the right to copy software on computer hardware on a definite location and right to use software for business purpose. In case of VPP model the end user has a right to reproduce copies of software and accordingly, it is Revenue’s case that the end user is granted right in copyright in software

and therefore the consideration is liable to be taxed as 'royalty'. The Ld Commissioner in the order for Gracemac has noted that the Copyright Act, 1957 defines the term "copyright" to include inter-alia, the right to reproduce the work in any material form including the storing of it in any medium {section 14(a)(i) } and/ or to sell or give on commercial rental a copy of the computer programme {section 14(b)(ii)}. Ld counsel for the assessee to counter the contention of ld CIT(A) submitted that the assesses have not given any right to end users under the Copyright Act, 1957. As regards the conclusion of the ld. CIT(A) that the end user, has been granted right to reproduce a copy of software resulting in grant of the "right" covered under section 14(a)(i) of the Copyright Act, 1957 it has been submitted that making copies for back up purposes under FPP model and making copies for internal use in VPP model, would not result in exercise of the "right to reproduce" as envisaged under section 14(a)(i) of the Copyright Act, 1957 since no right of commercial exploitation has been given to the end user. In the case of FPP, the EULA permits the right to install, use and make back-up copies. A copyright is a negative right which protects the owner/author of copyright against commercial exploitation by an unauthorized person. Section 52(1)(aa) of the Copyright Act makes it clear that making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copies, in order to utilize the computer programme for the purpose for which it was supplied or to make backup copies, purely as a temporary protection against loss, destruction or damage, will not tantamount to 'infringement' of a copyright. In other words, installation, use, access, back-up copies will not constitute 'infringement' of a copyright. He placed reliance on the decision of Hon'ble Delhi High Court in the case of *Time Warner Entertainment Company vs. RPG Netcom* 2007 (34) PTC 668 (Del) (DB) wherein High Court while concluding that Copyright is a negative right has held that the object of copyright law is to prevent copying of physical material and form in the field of literature and art. It is essentially a negative right given to the author, in the sense that the Act does not confer the owner with a right to publish its work, but the right to prevent third parties from doing that which the owner is solely allowed to do under the Act. Accordingly, since the end user can only use the copy/copies of software for internal use, there is no right in copyright in software is granted to end user.

17. In short, it has been submitted that copyright is a negative right and also a bundle of rights. It deals with the right against third parties or consumers or end users. Consequently, if a statute, through a provision of law, makes it clear that the performance of any of the enumerated activities under section 52 of the Copyright Act will not constitute an infringement of a copyright, it would only mean that the third parties or customers or end users do not need a copyright to perform the enumerated activity. The force of law, through a statutory provision, protects the interest of such third parties/customers/end users. It is not a

right flowing out of a contract. It is a protection flowing out of provision of law. He placed reliance on the decision of Special Bench, in the case of *Motorola vs. DCIT* (Supra) for the proposition that the performance of enumerated activities under section 52(1)(aa) of the Copyright Act do not result in “infringement of a copyright” and results only in the acquisition of “copyrighted articles”. In view of the above, it has been submitted that assessee has only sold “copyrighted article” and has not granted any right in copyright in software to the end users.

18. Ld CIT(A) further observed that the expression “computer software” is independently covered in Explanation 2 to section 9(1)(vi) which is based on a conjoint reading of second proviso to section 9(1)(vi) of the Act, CBDT Circular No 588 and section 115A of the Act. According to him these provisions are a pointer to the legislative “intent” of first bringing software under “royalty provision” and then granting “conditional exemption” wherever necessary. Ld Commissioner (Appeals) has further held that the assessee had not sold software but has only licensed the software to the customers in India to use the same in a particular way in lieu of a consideration being licensee fee. The Ld CIT(A) has also observed that even after obtaining a copy of software, in lieu of license fee the end user further requires a permission from the assessee, to activate software on a specified machine to use the same. In view of the activation requirement, the CIT(A) had concluded that the payment made by end user is towards license to use copyright in software and not for sale of software.

19. In this regard, the ld counsel for the assessee submits that second proviso to section 9(1)(vi) of the Act should not be read, so as to bring to charge, that transaction, which is in the first place not covered by the provisions of section 9(1)(vi) of the Act. It has also been submitted that provisos are incorporated to establish that what is stipulated in the proviso will remain excluded from the main clause and are being highlighted more as an abundant caution. He has placed reliance on the decision of larger Bench of Hon'ble Supreme Court in the case of *Commissioner of Income Tax vs. Madurai Mills Co. Ltd* (1973) 89 ITR 45 wherein it has been held that it is well settled that considerations stemming from legislative history must not be allowed to override the plain words of a statute. A proviso cannot be construed an enlarging the scope of an enactment when it can be fairly and properly construed without attributing to it that effect. Further, if the language of the enacting part of the statute is plain and unambiguous and does not contain the provisions which are said to occur in it, one cannot derive those provisions by implication from a proviso. In other words, it is well settled principle that if the language of the enacting part of the statute is plain and unambiguous and does not contain the provisions which are set to occur in it, one cannot derive those provisions by implication based on the proviso. In fact, wherever needed and whenever intended, the

Parliament has employed the expression “computer software” in various places vide sections 10A and 80HHE of the Income Tax Act, 1961. The parliament could have made the intention clear by explicitly referring the term ‘computer software’ in clause (v) of Explanation 2 to Section 9(1)(vi) of the Income Tax Act, 1961 if intended.

20. He has further submitted that the Govt. of India, between 1996 and 2000 entered into double taxation avoidance agreements with Turkmenistan, Russia, Morocco, Trinidad and Tobago, wherein the expression “computer software” was employed independently in each of the agreements in the definition of royalty. Further in case of Double Taxation Avoidance Agreements with countries including Kyrgyz Republic entered during the period from 2001 to 2003, the term software/computer software programme has been employed in the definition of royalty. In other words, both under the Income Tax Act 1961 and in the Double Taxation Agreements entered into with various States, whenever felt appropriate the Parliament/Government has chosen to incorporate the expression “computer software” specifically. When the same is conspicuous by its absence under Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 and under Article 12(3) of the Indo - US DTAA, the same cannot be read into them by implication.

21. The provisions contained under section 115A of the Act cannot provide any aid to interpret computer software independent of ‘copyright’. As section 115A is a machinery provision it cannot create charge and expression ‘copyright’ used in the sub-section 1(A) of section 115A is necessarily to be read with the term ‘computer software’. Further, the opening phrase of sub section (1A) of section 115A refers back to sub section (1) of section 115A and therefore by default, one has to fall back on Explanation (c) of section 115A (1) which again refers back to Section 9(1)(vi) read with explanation 2 to section 9(1)(vi) of the Act. It is only where a transaction is held liable to be taxable as royalty one can proceed to prescribe the rates of taxes and where the transaction is being questioned as to whether taxable or not, reliance cannot be placed upon a machinery provision to create charge.

22. Referring to End User License Agreement (EULA) and Activation, the Id counsel for the assessee has submitted that the objective of EULA is to ensure protection against misuse, abuse or piracy of software and is nothing but a set of instructions or conditions, imposed by a copyright holder on an end user of a copyrighted article. It mandates an end user to be cautious in using the product or the copyrighted article in a manner governed by the local territory’s statutory laws alongwith contractual limitations and conditions. It is similar to the restrictions and limitations imposed by a copyright owner in a book published and sold at a time when a buyer buys the book for his use. In the case of a book, the conditions and limitations form part of the published book. In the case of a copyrighted article in the nature of computer programme/software, the

EULA may form part of the product or may be given as a separate printed document, along with the sale of the products.

23. Further, clause 19 of the EULA makes clear distinction between owning the copyright and selling copyrighted articles. It clearly provides that product is protected by copyright and the other intellectual property laws and treaties, and that Microsoft (or its suppliers of software code, if any) own the title, copyright and other intellectual property rights in the product. The expression '*the product is licensed not sold*' is nothing but a standard clause in the EULA and cannot vitiate or alter the status of the transaction which had happened through an entire supply-distribution channel at an arms' length. Clause 19 reasserts that copyright is never sold or handed over and the end user at no point of time should assume owning any copyright. Further the term 'Activation' is a technological mechanism meant to prevent illegal copying of the copyrighted article and consideration paid by the end user is towards acquiring the copyrighted article and not directly or indirectly for the activation. Microsoft U.S.A, the sole registered owner of the copyright in the software, does not deal or sell copyrighted products outside the US and supply chain dealing with the copyrighted articles has nothing to do with the rights available to the owner of copyright in the software.

24. Under EULA, the end user has perpetual possession and only in case of violation of the terms of the agreement, software needs to be destroyed/returned back to MS Corp and cause 6 of the EULA makes it abundantly clear which provides that "*Pursuant to this clause, the end user has a perpetual possession of the Microsoft software product which it has legally acquired and only in a situation of violation of the terms that the end user is contractually required to destroy the product*". EULA entered between MS Corp and End users, which is more like a legal agreement/notice enlisting the terms of the usage of the software programme by the End user upon sale.

25. To conclude that since EULA states that product is licensed and not sold and there is restriction of activation of the software before the user can copy and start using the software, consideration has been received for grant of right of copyright in the software is misplaced. To understand the terms of EULA, reference can be made to notice given by a copyright owner in a book published. In case of a book, copyright owner makes a declaration that copyright in respect of the book is with the author and no part of the book to be reproduced without prior permission by the copyright owner. At a time when buyer purchases book for his use, he agrees to abide by such terms as enumerated therein. In the case of a software programme also, notice in form of EULA is given along with the software programme by the owner of the IPR wherein certain restrictions and limitation are imposed on use of software within the boundaries defined by the international laws governing such IPR's. Accordingly, user is paying for getting a copy of the software and not certain limited rights

in software, which rests with the copyright owner of the software programme.

26. Ld counsel for the assessee referring the contention of the Assessing Officer/CIT(A) that the transaction should be examined under every sub-clause of Explanation 2 to section 9 (1) (vi) of the Income Tax Act, 1961 to see whether the transaction could be assessed as royalty, submits that the Assessing Officer / CIT(A) has not provided any credible basis in support of his contention and has not placed on record as to which of the sub-clauses could be invoked against the assessee to tax the impugned transaction as royalty. Even where it is accepted for argument sake that the transaction involved in the present appeals is that of licensing of the software programme to end user and only in a situation where any IPR (being copyright) is given to the end user, the transaction can be considered as falling in the definition of royalty. Computer software qualifies as a copyrighted article and the granting of license in a product does not itself qualify the transaction as amounting to royalty.

27. Referring to the contention of the ld CIT(A) that software programme should be considered as patent or invention, ld counsel for the assessee submits that such an argument does not hold good. Since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer programme to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the Indian copyright Act, 1957 and not under any other category of intellectual property right laws. The consideration received from end users/distributors is for sale of Microsoft products being copyrighted articles and no right in copyright has been granted to the end user and accordingly, the consideration received is in the nature of sales giving rise to 'business income' and not 'royalty' under section 9(1)(vi) of the Income Tax Act or Article 12 of Indo-US DTAA. Further, the business income is not taxable as the assessee is a nonresident and does not have Permanent Establishment in India. Ld counsel for the assessee placed reliance on the decision of Bangalore Bench in the case of Sonata Software Ltd. Vs DCIT in 103 ITD 324 for the proposition that since computer programme has been defined under the Copyright Act, 1957, it is incorrect to say that computer programme can also be considered as 'patent' / 'invention' / 'process'.

28. Coming to the provisions of India US DTAA, it has been submitted by ld AR of the assessee that the definition of royalty given under Article 12 should also be interpreted with reference to domestic tax laws. This is also clear from the provisions of Article 3(2) of India US DTAA which provides that for those expressions not defined under the treaty, resort can be made to the domestic laws. Further, every judicial precedent dealing with the issue involved in the present appeals has also placed reliance upon the copyright Act, 1957 to interpret the provisions of

DTAA. It is also pertinent to note at this point that before the Indo-US DTAA was entered in 1990, the Copyright Act, 1957 was amended in 1984 to include within its scope “computer programme” under the definition of “literary work”.

29. It is also not the case of the Revenue that pursuant to the observations of revised OECD commentary distinguishing “*copyright*” from “*copyrighted article*”, that the Government of India has chosen to incorporate the expression “Computer Software” explicitly in DTAA signed with countries post amendment in OECD commentary. For example in the case of India Saudi Arabia DTAA entered into in the year 2006, the expression “Computer Software” is conspicuous by its absence in Article 12(3) of the treaty. There is a list of other countries namely Armenia, Hungary, Ireland, Portugal, Slovenia, Sudan, Uganda, UAE where tax treaties with India were entered or revised in recent years without incorporating the expression “Computer Software” in the definition of ‘royalty’. Thus there is no expressed / implied intention / policy of India to include ‘computer software’ in the definition of royalty.

30. On merits it has been submitted that for the years under appeal ie AY 1999-00 to 2004-05, Gracemac Corporation was assessed for the royalty income received from MO which is based on 35%-40% of the revenue received from Indian distributors on the ground that the royalty received from MO is arising out of a ‘source’ in India. However, for the same years, it was subsequently held that the assessee (Gracemac) should be liable to be taxed for 100% of the revenue received by MRSC from sale of software and therefore the assessee’s income was enhanced from 35%-40% to 100%. The learned CIT(A) has in the case of Gracemac examined in detail the structure followed by MS Corp for distribution of its software products in India both pre and post 1st January 1999. In his impugned order, the learned CIT(A) has concluded that after lifting the corporate veil, all the transactions between the entities involved in the distribution channel has been designed to reduce the quantum of taxable royalty. In view of Id. CIT (A) MO and MRSC being sham entities should be disregarded. Accordingly, it is a clear case of double taxation of same income as CIT(A) has on one hand has said that the Gracemac is taxable in respect of the entire payments made by end user in respect of grant of license to copy of software programme since (MRSC) is a sham entity and there is arbitrary allocation of payments made by these entities involved in the transaction. Whereas on the other hand MRSC has also been taxed for the years under appeal (i.e. A.Ys. 1999-00 to 2001-02) considering the same to be a separate independent legal entity.

31. As regards the supplies made through the supply chain Id. Counsel for the assessee has submitted that MO, Singapore, acquired the right to manufacture software products (otherwise called as ‘copyrighted articles’) which are sold within Singapore to MRSC and MRSC, in turn, sells them to the Indian Distributors and the Indian Distributors, in turn,

sell them to the end users in India. It is also clear from the agreement that the sale by MRSC to the Indian Distributor is ex-warehouse, Singapore and the title to the property passes at Singapore. The Appellants have submitted the tax resident certificate of MRSC and MO, Singapore and a statement issued by the Ministry of trade and industry, Republic of Singapore granting certain statutory exemptions to MO. Gracemac has received 35%/40% of the payments received by MRSC, from MO, Singapore and the payments made by MO represents consideration paid towards exercise of manufacturing and distribution rights by MO in Singapore. By treating MO and MRSC as sham entity, the Revenue is contending that there is no commercial justification for their legal existence. Thus to say that these companies are legal façade is completely extra territorial and contrary to the documents mentioned above. It, therefore, goes to prove conclusively the independent legal existence of each of the entities. Reliance has been placed on the decision of Hon'ble Gujarat High Court in the case of Arabian Express 212 ITR 31 wherein it was held that when a Sovereign State recognizes the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other Sovereign State including India to recognize the same and it is not open to Revenue to declare these entities as façade without any basis. This judgment support the proposition that MO and MRSC which are incorporated under the laws of Singapore and US having the tax residency certificate issued by authorities of their respective countries cannot be considered as fictitious entities without any legal basis. It is pertinent to note here that Revenue has never contended that the sale of software programme sold through a distribution channel have not been undertaken at arm's length price nor has challenged that transaction is a principal-principal relationship. It seems that Revenue itself is taking contradictory view to justify the taxability of Gracemac and MRSC without any valid justification for the same.

32. Revenue has argued that without prejudice to its main contention regarding taxability of payments made by end user for use the software programme as royalty, payment made by MO (35%/40%) to Gracemac is deemed to accrue or arise under the provisions of section 9(1)(vi) of the Act and under Article 12 of India US tax treaty. It has been submitted by Id counsel for the assessee that the provisions of section 9(1)(vi)(c) of the Act may be invoked on Gracemac, only if "royalty" is payable either in respect of a right used by MO for the purposes of a business carried on by MO in India or for the purposes of making or earning any income from any source in India. It has been further submitted that the royalty received from MO is not taxable in India under section 9(1)(vi)(c) of the Act for the following reasons:

- (a) The issue of 'source' becomes academic or insignificant if the principle issue ie whether sale of software gives rise to royalty is decided in favour of the assessee. If the transactions are not

liable to royalty, the question of source of taxation would not arise at all.

- (b) The counsel for the assessee sought to argue that source of income can be at a place where either the sale takes place or the business is conducted or any income generating activity is undertaken. In the present case, since none of these activities have taken place in India, income cannot be taxed.

As in case of MO sales take place outside India the title to the products passes to MRSC outside India and MO's business of manufacturing and distribution activities are being carried out in Singapore, the payments made by MO to Gracemac are not in respect of a right used for the purposes of making or earning any income from any 'source' in India. Accordingly, the provisions of section 9(1)(vi)(c) of the Act are not attracted in this case and hence, the assessee is not taxable in India under the Act.

33. It has been also submitted that the royalty received from MO is also not taxable in India under Article 12(7)(b) of Indo-US DTAA on the ground that for taxability of royalty what is essential under Article 12(7)(b) is that the "copyright" itself should be used in India. It has already been argued at length that there is no use of 'copyright' in India by the end user and the transaction in India is in the nature of 'sale' of Copyrighted Article. Alternatively, the Revenue is entitled to invoke Article 12(7) (b) of Indo-US DTAA for imposition of tax only if MO Singapore instead of manufacturing and distributing the products (which tantamount to use of copyright) in Singapore, chooses to do so from India, in which case by virtue of the expression "use" in India would get the domain power to tax. The fact pattern clearly shows that in the assessee's case, the "use of copyright" is the "right to copy" the master copy (sublicensed by the assessee to MO). This "right to copy" the master copy is exercised by MO in Singapore and hence, "copyright" is not used in India. Consequently, Article 12(7)(b) is not attracted.

34. At the outset Id counsel for the Revenue Sh. G.C. Shrivastava has submitted that the thrust of assessee's argument is that it is a sale of copyrighted article and not the transfer of any rights in the copyright and hence the income would not fall within the meaning of royalty under the Income tax Act, 1961 or the Double Taxation Avoidance Treaty (DTAA) between India and USA. He has further submitted that the issue has to be decided in terms of the provisions of the IT Act, 1961 and under Indo-US DTAA and not under the Indian Copyright Act. The purpose of the two enactments is different – one taxes incomes and the other protects rights of the authors. Therefore, any reference to Indian Copyright Act 1957 has to be made for the limited purpose of finding out the meaning of the word 'copyright' and that too for the reason that the term 'copyright' is not defined in the Income tax Act or the DTAA. He has placed reliance on the decision of Hon'ble Supreme Court in the case of Jagatram Ahuja 2011

reported in 246 ITR 609 (SC) for the proposition that the interpretation in one statute cannot be made applicable to another statute. Paragraph 2 of Article 3 of DTAA between USA and India, to which reference was made by the Id. Counsel assessee also stipulates the limited reference to other enactments i.e. where the terms used in the DTAA are not defined in the agreement, help can be sought from other domestic enactments.

35. He has further submitted that the term “copyrighted article” is nowhere used either in the IT Act, 1961 or the Copyright Act. The term finds its origin in U.S. Regulations and then found its way later in the OECD commentary. As recognized in the Income Tax Act as also under the Copyright Act, there are basic differences between a book or music CD and a computer programme. There is a definite rationale for keeping such a distinction. The differences can be summarized;

- (i) One major attribute of a literary work is that it can be received by mind through audiovisual senses. Software, though classified as a literary work, cannot be read being in machine language. Software has to be integrated with hardware before it can be put to any use.
- (ii) Book need not be copied before being used. Software cannot be put to use unless it is copied on the hard disk.
- (iii) Book does not act as a process to achieve some results whereas *software* does primarily act as a process.
- (iv) After acquiring a book, no further permission from the author is needed for putting it to any use (except for making copies or adaptations etc) including resale of the book but after acquiring a CD containing a software, authorizations are specifically needed for lending it to third parties and for copying it even for personal use.

Thus the term “Copyrighted Article” may be aptly used for a book or music CD but it is a misnomer in the case of computer programme (software) where one or more rights in copyright have necessarily to be transferred to make it workable. A dumb CD without right of reproduction on the hard disk is of no value to the end-user unlike a book or a music-CD.

36. The Id. Counsel for the Revenue further submits that the moot point for consideration is what the end-user is paying for? Is the payment for the material on which the programme is written or is it for the programme, which is an intellectual property? The payment is definitely for obtaining the right to copy the programme on to the hard disk and to use it. What is being used is not the CD but the programme contained in the CD, which is protected by copyright and right to copy the programme has to be exercised before it can be put to use. The nomenclature given to a transaction or to a right or a property is not decisive of the nature of the transaction or of the rights or of the property. Whether we call it a

copyrighted article or a copy right, it makes no difference so long as the consideration paid or payable by the licensee is in respect of exercising the rights in a copyright. He placed reliance on the decision of Hon'ble Gujarat High Court in the case of *Ahmedabad Mfg and Calico Printing Co* 139 ITR 806.

37. Ld AR for the Revenue continues his submissions by saying that the Income tax Act, 1961 maintains a clear distinction between an article and computer software. The provisions contained in Section 10A provide for deduction of such profits and gains as are derived from the export of articles or things or computer software'. The use of the word "computer software" as distinguished from articles or things is clearly suggestive of the fact that computer software is not the same as an article, whether copyrighted or not. The argument of the learned counsel for the assessee that 'computer software' was added in Section 10A to include IT enabled services is misconceived because if that were the reason the word "article" or "thing" could have been defined to include IT enabled services. If computer software were to be regarded as articles or things which essentially mean goods or merchandise, there was no need to enact a separate Section 80HHE for granting export benefits to computer software. The deduction would have been available under Section 80HHC itself.

38. Ld. counsel for the Revenue has also submitted that the word "copyrighted" has been defined under Law Lexicon which states that a copyright when registered becomes copyrighted. Hence, whether a computer programme is registered under the Copyright Act or not, it remains a copyright and cannot be given any other character by the mere change of noun into adjective.

39. The other limb of the assessee's argument is that it is a sale of goods. In this regard ld. Counsel for the Revenue has submitted that sale postulates transfer of ownership. When only the use or the right to use a property is given under a license there cannot be any element of sale in the transaction. EULA clearly states that product is licensed and not sold. There are limitations on the rights granted to licensees as the programme are to be returned or destroyed on expiry of the license. Hence in the case of the assessee it cannot be considered as sale.

40. The ld counsel for the Revenue further submits that computer software, particularly Microsoft software, also falls within the ambit and scope of an "invention" and a "patent". MS Software are patented in USA. These softwares are held to be original inventions. The assessee has himself asserted in their agreements that what is being distributed by MRSC is patented software. EULA refers that the product is protected by copyright and other intellectual property rights. The arguments of the learned counsel for the assessee that computer programme are not patentable, emanates from Section 3(K) of Indian Patent Act which provides that computer programme per se or algorithms are not

patentable inventions. However, as held in the case of Microsoft by US courts, some of the softwares may not be computer programmes per se but may be the original inventions and hence patentable.

41. Ld Counsel for the Revenue has further submitted that assuming for a while that computer programmes are not patentable, still these would fall in the category of inventions. There can be overlap between copyright and patent but it does not mean that both are mutually exclusive. A property may be protected both as a copyright and as a patent. In fact MS Softwares enjoy this dual protection. MS Software is also a process to achieve a certain result. Process is defined in the context of Section 9(1)(vi) to mean a series of steps to achieve a certain result. These programmes are designed to provide a certain result to the end-user. The end-user gets the right to use the process contained in the programme to achieve a desired result. The CIT (A) has relied upon the order of his predecessor in this regard. The assessee has given the right to use the patent, invention or process (each as alternative contention of the Revenue) and the consideration therefore would fall within sub-clause (iii) of Explanation 2. The expression 'use' or 'right to use' has not been defined either in the Act or in the treaty. However, this aspect has been discussed in detail in the order of the ITAT in the case of Asia Satellite Communications Ltd and the nature of the use given in the present case squarely falls within the scope so defined. There is yet another alternative contention. If the computer software is regarded as a tangible property as contended by the assessee though Revenue is not making any such assertion, the software would still fall within the meaning of "Equipment" as appearing in sub-clause (iva) of Explanation 2 and license to use the same would still attract royalty with effect from A.Y 2002-03. He placed reliance on the decision of ITAT in the case of Frontline Soft Ltd —2008- TIOL-422 ITAT Hyderabad and West Asia Maritime 297 ITR 202. Therefore, it has been submitted whether we consider it under the domestic law or under the treaty, the license fee paid by the customers in India for the transfer of rights in copyright of software or for the use of the computer programmes being patent/invention/process/equipment would fall within the definition of Royalty and would be liable to tax in India.

42. He further submits that the term 'royalty' has been defined in the Explanation 2 to section 9(1)(vi) and means to include the consideration for transfer of either one or more of intellectual property rights mentioned therein. The argument of ld counsel for the assessee that sale of computer software is outside the ambit of the said Explanation is totally misplaced. Whether there is a transfer of any rights in a copyright or in other intellectual properties or not, will depend upon facts of each case and there can be no general proposition that computer software is out of purview of the said Explanation. The provisions of the Act have to be read as a whole. A composite reading of

clause (vi) of Section 9(1) including second proviso to Explanation 2 leaves no room for doubt that computer software is fully covered within the meaning of 'royalty' as defined in the Explanation 2. Second proviso to section 9(1) (vi) provides for an exception from the fiction of income deemed to accrue or arise in India in respect of a computer software which is an integral part of a hardware supplied under a defined policy of the Govt. There is no reference to copyright in the proviso but only to rights in respect of computer software. A proviso can carve out exception out of a subject matter covered in the main section. The argument of the Id. counsel for the assessee that the proviso cannot create a charge is well taken. However, in this case, there is nothing to suggest that computer software is one such intellectual property as is not covered in the Explanation. It is only by a strenuous argument of the assessee viz, that right of reproduction of one single copy in the case of FPP or of a number of copies in the case of VPP for personal or noncommercial use is not a copyright. This argument of the Id counsel for the assessee is obviously against the plain and literal meaning of the words used in Section 14(a)(i) of the Indian Copyright Act. A meaning is sought to be given to the Explanation 2 that the computer software is not covered within its scope. Such an argument suffers from different fallacies — (i) the second proviso is redundant (ii) Parliament enacted the Proviso in ignorance of what is the true scope of the Explanation-2. In the case of *CIT Madras vs. Ajax Products Ltd* 55 ITR 741 (SC) a 3 judge Bench of the Hon'ble Supreme Court has held that the Proviso must be construed harmoniously with the main enactment. There is another aspect of the matter. Not only the second Proviso to Section 9(1)(vi) but Section 115(1A) also refers to royalty from computer software. No rate of tax could be provided in Section 115A unless computer software gives rise to royalty income.

43. Explanation 2 defines intellectual properties in broad terms. There is nothing to suggest that if a property falls into one sub-clause, it would not fall into the other. To illustrate, an invention when registered under the Patents Act becomes a patent or else it remains only an invention. A process, when patented, becomes a patent (Process Patent), so is the case with design. Hence a property may be patent as also an invention. In the case of the assessee, the terms of the agreement clearly stipulate that the software is protected both by copyright and patent laws. The argument of the learned counsel that since computer software is specifically covered under the Copyright Act, it would not fall in any other category is fallacious. Neither the Income Tax Act nor the Copyright Act stipulates any such compartmentalization. Besides, how the rights of the authors or inventors are protected under IP protection laws is wholly irrelevant for the purposes of deciding the issue under the IT Act. Hence, the argument of the Ld. Counsel for the assessee that Parliament has categorized 'computer software' as a literary work is of no consequence because such categorization is for IPR protection. Even unprotected IPRs are nonetheless IPRs. Computer software may have

2011 Tax Review

been categorized as a literary work for the purpose of copyright protection but the Income tax Act keeps a clear distinction between copyrights in a literary work like books etc and the computer software. This distinction has also been maintained under the Copyright Act by excluding computer programme from section 14(a) and enacting a separate sub-section therefore in section 14(b).

44. Section 14(a)(i) of Indian Copyright Act, 1957 defines the term “copyright” to include, inter alia, the right to reproduce the work in any material form including the storing of it in any medium. Section 14(b)(ii) takes into its ambit the activity to sell or give on commercial rental a copy of the computer programme within copyright. The meaning of the word “reproduction” used in section 14(a)(i) is explained in Govt. of India Publication “Handbook of Copyright Law” to mean the right to make “one or more copies”. There is no contemplation that reproduction will arise only if mass copies are produced or only if these are produced for sale or commercial exploitation. The arguments to that effect do not get any support from the language employed in the enactment. It is a settled rule of interpretation that in finding out the meaning of the section, the provision should be read in its plain grammatical meaning. Nothing more is to be read. There is no room for any such intendment. Thus there being no ambiguity in the language employed in the provisions of section 14 of the Copyright Act, import of such qualifications or limitations to the rights contemplated therein is wholly unnecessary and unjustified.

45. He has further submitted that treaties are not legislative enactments. These do not flow as acts of Parliament. Being an executive function, the words and phrases used in the treaty are obviously the outcome of negotiations between the officials of the two contracting states. The choice of the words in the treaty are dependent upon the domestic laws of the respective countries, their understanding of the definitions appearing in Model conventions (OECD, UN, US etc), the respective commentaries and the Judicial pronouncements in their countries and elsewhere. In Indian scenario, the word “computer software” has been added at the insistence of the other parties to the negotiation, which is evident from the treaties entered into with other countries. A number of such examples were cited at the time of hearing by the Id. Counsel for the assessee. In his rejoinder, the Ld. Counsel for the appellant referred to certain treaties which Russia has entered into with other countries where computer software is not included. That position is not disputed. Some Russian treaties were cited by the Revenue only as examples to show that words in the treaty may be employed at the insistence of one or the other party and such differences should not be taken to mean change in the official position of either state by reference to what was negotiated with a third state. The treaties where Russia or any other country chose not to include computer software cannot be a

guide to decide what transpired between Russia and India. The omission by Russia could be at the insistence of the third party.

46. It has further been submitted that one provision of the Act should be construed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The inconsistency or repugnancy either within a section or between two different sections or provisions of the same statute has to be avoided. This proposition gets further fortified by provisions of Section 115A(1A) which provides a rate of tax for different incomes of non residents and refers to royalty from “*copyright in any book*” or “*in respect of any computer software*”. This is a clear indication that (i) computer software is very much covered under the definition of “*royalty*” as appearing in the Act and (ii) the law treats computer software as different from copyright in any book. The suggestion of the assessee that Section 115A is only a machinery section is totally misconceived as a section which provides the rate of tax cannot be a machinery provision. Once again a ridiculous proposition is sought to be advanced that Parliament prescribed rate of tax for an item of income not covered in the charging section (9)(1)(vi).

47. Referring to the arguments raised by Id Counsel for the assessee that EULA is signed between the end-user and Microsoft and not with the assessee, Id. Counsel for the Revenue Sh. G.C. Srivastava has submitted that Microsoft has entered into an agreement with the assessee to grant exclusive right to licence the computer softwares to customers in India and elsewhere. The said agreement, however, stipulates that while granting the license, the assessee will use the standard format and log etc. as made available by the Microsoft. Thus the terms of the agreement bind the assessee to execute the agreement with the customers in the name of Microsoft yet for all intent or purpose the right to grant license rests with the assessee and not with Microsoft. In that event the license fee received by the assessee would also not belong to Microsoft. It would only arise to assessee. The learned counsel for the assessee referred to the chart showing distribution model and sought to argue that source of none of the activities in the chain like manufacturing or marketing is in India or gives rise to income from royalty in India. This aspect may be dealt with in the case of MRSC. Revenue seeks to assert in this case that income arises not from distribution of a dumb CD, but from the grant of license in the absence of which licensee cannot reproduce copy the programme and use the same. The license has directly flowed from the assessee to the end-user in India. The consideration paid is for getting the license to copy and use the programme. Thus income from royalty arises in India.

48. The EULA being in the name of Microsoft is a consequence of agreement between Microsoft and the assessee. They have agreed not to change the format of the license agreement (EULA) or the name in which it is to be signed. The right to grant license to the customers is given to

the assessee under clause 2.1(b) of the said agreement. As stated in earlier paragraphs, the CD distributed to the customers in India is a dumb CD. It gets activated by a centralized activation system. Unless activated, it does not open. Even when the CD is activated, a license agreement has to be entered into by which the licensee gets the right to copy the programme on his hard disk and to use it. The consideration paid by the licensee is not for the medium through which the programme reaches him but for the right to have access to the programme and to use it. Thus the source of income is in India where the licence agreement is entered into. The property is being used in India to derive income from licences in India. It would, thus, squarely fall within 9(1) (vi) of the Act and Article 12(7) of Indo-US DTAA.

49. Replying to the arguments advanced by the Id. Counsel for the assessee that Article 12(7) (b) of DTAA is also not applicable for the reason that no copyright is being used in India and since the product is sold in Singapore and not in India and there is no transfer of any right in a copyright, the Id. Counsel for the Revenue has submitted that the contention with regard to the sale being in the source country or the business being conducted in the source country may be valid arguments for income under the head 'business or profession'. Income from royalty is taxable under provisions of section 9(1)(vi) of the I. T. Act and the said provision deems certain income to accrue or arise in India (which otherwise may not accrue or arise or be received in India). In the case of income from royalty u/s 9(1)(vi)(b), it accrues in India if the royalty is payable by a resident except where such payment is in respect of a right or property or information used or services utilized for the purposes of business outside India or for earning income outside India. Under section (9)(1)(vi)(c) the income from royalty will also be deemed to arise in India if it is paid by a non resident, if the right to property is used for business in India or for earning of any income from any source in India. Thus, the taxability of royalty income is directly linked to the payer and the place of utilization of the right or property. It is not in dispute that the assessing officer taxed income from royalty in respect of rights which are transferred to Indian licensees and which are being used for earning income from sources in India. He has further submitted that the assessee transferred manufacturing, distribution and licensing rights for large account customers to Microsoft Operations for which they received royalty at the 40% of the net selling price to Indian end users. The AO taxed this amount of royalty on gross basis as provided for in section 115A of the Act and Article 12 of the Indo-US DTAA. Id. CIT(A), however, took the view that not merely 40% of royalty but the consideration from the end users in India is liable to tax as royalty on gross basis for reason that the consideration flows from the end users for the transfer of rights to them under the agreement and the gross basis of taxation cannot be converted into net basis creating intermediate entities and reducing expenses incurred or the profits earned by them. He, therefore, enhanced the income. The AO

assessed royalty income under section 9(l)(vi)(c) being the payment made by one non-resident to another non-resident while the CIT(A) has upheld and enhanced the income from royalty by invoking section 9(l)(vi)(b) the payment being from resident Indian end users. The entire consideration flows from a person who is a resident of India hence the conditions stipulated in clause(b) of Sec. 9(1)(vi) is clearly applicable. The exception clause contained in Section 9(1)(vi)(b) is obviously not relevant. Without prejudice, the payment of 40% royalty made by MO to the assessee is also covered under clause-(c) of Sec. 9(1)(vi) and the necessary condition that the payer of such royalty should utilize the right or property for earning income from sources in India also stands fulfilled. Thus, looked from any perspective, the income from royalty is liable to tax in India both under the Income Tax Act and also the DTAA. Article 12(7) grants the rights of taxation to the source country when the payer is a resident of that country or where the right or property is used in that country.

50. The assessee is dealing in two kinds of products i.e. FPP and VPP. The volume Purchase Product (VPP) entails transfer of rights to the large enterprise customers for making a number of copies and not merely copies for archival purposes. The right of reproduction envisaged in Section 14(a)(i) has to be transferred to the licensees in both kinds of products. It is wholly fallacious to say that none of the copyright rights are being transferred. It is really strange that the ld counsel for the assessee seeks to argue that in the case of VPP as well as FPP, there is no transfer of copyright right. The fact of the matter is that in the case of VPP, the licensee is allowed to make several copies depending upon the number agreed to from one copy supplied by the assessee. The right u/s 14(a)(i) are necessarily exercised in such a situation. The argument that consideration is paid for each number of copy made is totally irrelevant. It is a settled proposition of law that mode of payment and the basis of payment of consideration will not determine the nature of royalty income. He has further submitted that in the case of OEM, Microsoft Corporation had offered income from royalty to tax in India in earlier years. The moot point for consideration is not whether the licensor puts the copy of the software on the hardware and sells the hardware or not. The issue to be decided is whether the assessee has transferred any rights in the copyright as defined in Section 14 and whether has received any consideration for the same. Both such necessary ingredients are satisfied in the case of the assessee. There is no exclusivity in granting the rights to OEMs as Microsoft had granted such rights to several such manufacturers and still the income was returned as one from royalty. In fact, in the periods thereafter, a new entity of the group which is assigning such rights to OEMs in India is returning income from royalty on that basis. It is, therefore, not open to argue by drawings an artificial distinction between OEMs and other licensee (VPP & FPP) that income from the latter entities does not have the character of royalty income since the basic nature of rights transferred in either case remains the same.

51. The rights provided for in Section 14 (which protects the rights of the author) cannot be limited by the provisions of Section 52 (which protects the rights of the consumer). On the other hand, Section 52 only reinforces the view that the right of reproduction even for personal use is a copyright' or else there was no need to carve out an exception to protect the consumer. Therefore, the reference to the Copyright Act has to be made for the limited purpose for getting the meaning of the word "copyright". Reference to other sections of the Copyright Act are wholly unnecessary and beyond the scope since the issue to be decided is not when the copyright would get violated. In the present case, the end users have neither violated the copyright nor are there any occasion for invoking the protection given under Section 52. In fact, the end-users have been granted license, as contemplated under Section 30 of the Indian Copyright Act, by an agreement to make copies. If the contentions of the assessee were correct, the agreement granting such rights was wholly unnecessary or redundant. Neither the tax laws nor the laws protecting intellectual property envisage the manner or the purpose for which these rights are to be used/ exploited. The provisions in the Income tax Act talk of transfer of rights or the use of the property but not nature of use to which the property may be put to. The use of any right in intellectual property for captive use is nonetheless a business/commercial use. In any case, the use of the property will not and cannot determine the nature and character of the rights enjoyed by the end-users or alters the nature of payment made to the licensor. Where any one of the rights mentioned in Section 14 of the Copyright Act get transferred to the licensee the payment therefor would be in the nature of royalty within the meaning of provisions of 9(1)(vi) of IT Act.

52. It has further been submitted that right of reproduction given under the license is an element of copyright and not of sale. Referring to page 438 of assessee's paper book it has been submitted that the agreement itself states that 'grant of IPR is set forth in the agreement'. Reliance on the OECD commentary or on the IRS regulations in support of the proposition that it is a sale of copyrighted article is not valid in view of India's reservations on the OECD commentary. Reservations on the commentary imply that the views given in the commentary are not the views of Govt. of India. These reservations assume importance for the fact that OECD seeks to bring the changes in concepts of taxation by bringing changes in the commentary and not in the text of the Articles which can be done only by bilateral negotiations. The commentaries thus become ambulatory. It is not the case that when India signed the treaty with USA such views existed in the OECD commentary or that both contracting states had agreed to such a view. In that event, reservations would not be needed but when a contracting state feels that the revised view in the commentary is not in tune with their stated original position with different contracting states, it does offer its reservation to the commentary There is neither any contradiction nor any change in the

stand of Govt. of India. Though, India is not a member of OECD, yet it has chosen to state its position to remove all doubts in this regard.

53. Ld. Counsel for the Revenue further has submitted that the fallacy in the arguments of the ld. Counsel for the assessee is evident if one views his arguments in the light of provisions of section 90 of the I. T. Act. On the one hand, the Ld. counsel for the assessee seeks to argue that computer software does not give rise to royalty income as there is no transfer of rights in a copyright, while on the other he suggests India intended to tax royalty from computer software only in respect of countries where the treaty specifically stated so. Treaties are meant to grant relief from domestic taxation. If Income from a certain source is not liable to tax under domestic laws, it cannot be brought to tax by the terms of treaty. He has therefore submitted that computer software is covered under the definition of 'royalty' both under the domestic law as also the DTAA under the broad categories of IPRs like copyright, patent, invention, process or equipment. Specific items of intellectual property do not find mention either under Explanation 2 of the Act or under the definition given in Indo-US DTAA. It is submitted that when the language employed in Indo-US DTAA is not ambiguous, any reference to other treaties is wholly unnecessary. In any case, an interpretative inference by reference to comparative analysis of two different agreements is wholly unwarranted in regard to negotiated agreements. In any case, the outcome of negotiation with one country cannot lead to the presumption that similar issue was under negotiation with the other country and a contrary view has finally emerged. Such an approach would not be valid for interpreting a negotiated bilateral agreement. India US treaty was negotiated before 1990 when such views as are now expressed in the OECD commentary or elsewhere were not there. Both sides went by what was meant by the "royalty" under the law as then existing. It cannot be inferred that computer software was meant to be excluded. Thus, going by the peculiar facts of the present case, there was a definite transfer of rights in a copyright under a license and this would give rise to income from royalty.

54. Ld. counsel for the Revenue further submitted that none of the cases relied upon by the assessee are applicable to the appeals pending before the Tribunal or have a binding precedence. To buttress his arguments it has been submitted that the Hon'ble Supreme Court in the case of CIT v/s Sun Engg. Works (P) 198 ITR 297(SC), has held that a decision of a court takes its colour from the questions involved in the case in which it is rendered and while applying the decision, the courts must carefully try to ascertain the true principles laid down by the decision and not to pick out words or sentences from the judgment, divorced from the context, to support the reasoning. It is in the above backdrop that CIT (A) has discussed the principles of sub-silentio and per in curium in his order as regards the binding nature of the decisions. The decision of a

coordinate Bench or a Special Bench will not have a binding precedence unless the Bench comes to the conclusion that if the new facts brought out in the present case or the new legal submissions (not raised before or considered by earlier Benches) were before those Benches, the decisions would still not have been different. It has further been submitted that some of very vital facts and legal submissions as were not raised and/or considered by coordinate Benches in the other decisions are: (a) The clauses in the agreements, which clearly stipulate transfer of intellectual property rights. (b) The clauses in the agreements stipulating retaining of ownership in the property with the assessee and only licensing of limited rights to the licensees. (c) Effect of second proviso to section 9(1)(vi) and of section 115A. (d) Effect of distinction between 'article' and 'computer software' maintained under the IT Act. (e) India's reservations on the OECD Commentary.

55. The decision in the case of *Tata Consultancy Services 271 ITR 401* was rendered under the A.P. General Sales Tax Act relying upon very broad definitions of "goods" and "sale" appearing in the said enactment. Reference to Article 366 of the Constitution of India is also made in the same context as the Article 366 defines various terms used in the Constitution and sub-Article (12) thereof defines "goods" to "include all materials, commodities and articles". It was in the backdrop of these definitions that the Hon'ble Supreme Court held that the software, though it may contain intellectual property, would still be regarded as goods for the purposes of the said enactment. Reference made to the decision of *Associated Cement Companies 4 SCC 593* was also in the same backdrop as the Customs Act also defined "goods" to include all kinds of movable property. Legislative Schemes of Sales Tax law or the Customs Act and the Income Tax Act are different. Software may be regarded as goods for the former enactments but it cannot and would not suggest that licensing of software would not give rise to income from royalty under the later enactment if transfer of rights in or use of intellectual properties is indicated. The basic difference is that while passing of rights in intellectual property is not regarded as a taxable event under the sales tax or Customs Act, it is a taxable event under the Income Tax Act. The decision in *TCS* itself states that the Copyright Act and the Sales Tax Act are not statutes in para materia and as such the definition contained in the former should not be applied in the latter. It was on the strength of this reasoning that the arguments of Mr. Sorabjee regarding transfer of intellectual property were rejected. By analogy, where the issue relates to the Copyright Act or the IT Act, such arguments regarding transfer of IP will assume significance. The argument of the learned counsel that these were the observations of the concurring judge, Hon'ble Justice Sinha, makes no difference to the point at issue. The AAR had the occasion to examine the decision in the context of Explanation 2 in the case of *(Airports Authority of India — 304 ITR 216)* and it has been held that the said decision will have no applicability

in deciding the taxability of royalty income u/s 9(i)(vi) of the Act. The ld counsel for the Revenue has pointed out that the assessee seeks to rely on this decision for the proposition that there is difference between copyright and copy righted article. He submits that the decision of the Apex Court will have to be read in the context in which it was rendered. The Hon'ble Court observed "but the moment, copies are made and marketed, it becomes goods which are susceptible to sales tax". The factor of marketability or the copies of software being regarded as goods are the observations which have to be read by the qualifying words appearing at the end of the sentence viz "which are susceptible to sales tax".

56. He has further submitted that in the case of Motorola Inc (supra) the special bench has discussed the issue in Para 151 and the critical observations appear in Para 155 to the effect that the crux of the issue is whether the payments are for a 'copyright' or for a 'copyrighted article'. The final conclusion is reached in Para 104 to hold that the software supplied was a copyrighted article and not a copyright right. After analyzing the agreement, the Hon'ble Bench observes on page 426 that the "*cellular operator has been denied the right to make copies of the software except for archival back up purposes*". However in the present case, the licensee has been given the right to make copies not only for archival purposes but also for installation of the programme on the hard disk. Para 161 records the finding that the "*software is actually a part of the hardware and it has no use or value independent of it*". This is the vital factual distinction. In the present case, the software (computer programme) itself is licensed with the right of reproduction though for limited use. The reference to the OECD commentary in Para 165 and to IRS regulations in paras 166 to 171 will no longer be relevant in view of India's clear reservations on the OECD commentary. Even some member Countries of the OECD have also expressed their reservations on such views in the commentary. Hon'ble Bench goes on to hold, by analysis and case laws referred to in Paras 175 to 180, that the price paid for cannot be split between that for the hardware and for the software. The material facts in the present case do not call for such determination. There being no supply of hardware, the entire consideration is for the software which is an intellectual property. He, therefore submitted that the decision of the Special Bench in the case of Motorola would not apply in the light of following distinguishing features of the present case:

- (a) On facts, the present case concerns the licensing of software and not of hardware embedded with software. There is no composite price paid / payable for hardware and software as in that case;
- (b) On Facts, the following features of the present case were either non-existent or not raised and/or considered by the Special Bench:
 - (i) Clauses in the agreement clearly stipulate the transfer of rights in the intellectual property.

- (ii) Clauses in the agreement retaining ownership with the assessee and only licensing of limited rights to the licensees.
- (iii) End-user license agreement, which makes specific transfer of rights in a copyright.
- (c) On law, the following aspects were not raised and/or considered by the Special Bench:
 - (i) Effect of second proviso to Section 9(1)(vi) and of Section 115(1A).
 - (ii) Effect of distinction between computer software and article maintained under the IT Act.
 - (iii) India's reservation on the OECD commentary.
 - (iv) The submission that reference to the Copyright Act has to be for the limited purpose of finding out the definition of "copyright".
 - (v) The submission that the rights u/s 14(a)(i) do not cease to be rights by reference to Section 52 particularly when in the present case, there is no breach of copyright by the licensee so as to attract Section 52. In fact, all such rights are specifically given under the license.
 - (vi) The submission that rights u/s 14(a)(i) are not qualified or limited by the nature of the use of such rights by the licensee.
 - (vii) In view of the above, it has been submitted that the decision of the Special Bench would not be applicable to the facts of present case before the Tribunal and in view of the submissions not raised before and / or considered by the Special Bench.

57. In the case of *Lotus Development Pt Ltd* (supra) the reliance has been placed by ITAT on the decision in the case of *TCS & Motorola*. The Bench has also placed reliance on OECD commentary in Para 25, which is not warranted in the present case in the light of India's reservations.

58. In the case of *Samsung Electronics* (supra) ITAT has placed reliance on the decision of TCS. It has been held that what was being transferred was a copyrighted article whereas the copyright remained with the owner. Hence, the decision is not applicable to the facts of the present case, as discussed in respect of *Motorola*.

59. In the case of *M/s. Infrasoftware Limited* (supra), the ITAT has placed reliance on the decision in the case of *Motorola* and in the case of *Samsung Electronics*. No other reasons have been given in this case by the ITAT to arrive at the finding. Hence, the decision is not applicable in the present case.

60. In the case of Sonata Information Technology (supra) the admitted position was that the issue was covered by the earlier decision of the ITAT. This is not so in the present case. The Bench has critically observed that the agreement with the Indian distributor did not grant any right of reproduction or distribution to the distributor. M/s. MRSC had given distribution right to the distributor was “in consequence of the exercise of the right u/s 14(b)(ii) and not a transfer of right u/s 14(b)(ii)”. He has further submitted that the decision in the case of Sonata Information Technology (supra) is not applicable for the reason that: (a) This was a case of tax deduction at source u/s 195 by Indian distributor who was the last entity in the distribution chain before the end user and the ITAT reached a finding that the distributor did not pay for any rights in the copyright. (b) The ITAT held that the payment made by the distributor was not for any rights in the copyright. The case of the Revenue in the present appeal is that since the end user is paying for rights to copy and use the software under a license directly granted by the assessee, the rights in the copyright are being transferred by the assessee. The thrust in the present case is not on the right of distribution or who enjoys that right but on the license to copy the programme (right to reproduce). The connected appeal in the case of MRSC proceeds on the basis of right of distribution (sale). In that case, the question to be considered would be whether Indian distributor is making payment for getting the right to sell the software, as contemplated under section 14(b)(ii). The fact of Microsoft Software being patented in USA and also the fact that various agreements between Microsoft and the Gracemac; Gracemac and MO and MRSC and distributors and Microsoft and EULA clearly stipulating that the programs are protected both under copyright as also patent was not brought to the notice of the Tribunal. In the light of these agreements, and the products enjoying patent protection, it is not open to argue that because of the observation of the ITAT in the case of Sonata, computer software cannot be treated as patent, invention or process etc.

61. The other decisions of the ITAT relied upon by the appellant are also distinguishable and not a binding precedence for similar reasons as these decisions primarily rely on Motorola.

62. In rejoinder the ld. counsel for the assessee clarified the position by making reference to various amendments to the Copyright Act, 1957 that the expression 'computer programme' has been granted protection under Copyright Act since 1984 and it was never intended to be covered under other IPRs. Therefore, it is incorrect on the part of the Revenue to say that the computer programme was not granted protection under Copyright Act on or before 1994. Accordingly the contention of the Revenue that computer software is independently covered in the definition of royalty deserves to be rejected.

63. As regards the contention of the Revenue that computer programme is distinct from goods or article the ld. counsel for the assessee submitted that the Parliament has employed expression “computer software” in various places vide sections 10A and 80HHC of the Act whenever it was found necessary to incorporate it specifically and not with the intention to make distinction between “computer software” and “goods” or “article”. Therefore, the contention of the Revenue that expression computer software in section 10-A was never part of expressions “article” or “things” is completely misplaced and incorrect as prior to Amendment by the Finance Act, 1993 Explanation to section 10A defined produce as including word computer programme. He also submitted that the clauses of treaty should be interpreted on the plain language used and not based on what to be the intention. If the intention was to tax supply of computer software as royalty this could be done through amending Explanation 2 to section 9(1)(vi). He also submitted that the OECD Model commentary and UN model also demarcate between a “copyright” and a “copyrighted article”. He placed reliance on the decision of ITAT, Calcutta in the case of *Graphite India Ltd. vs. DCIT* 78 TTJ 418 (Cal). The ld. counsel for the assessee further submitted that no specific reservation has been expressed by Indian Government outlining India's own position in contrast to OECD position. Therefore, one-sided disagreement after signing the treaty is not maintainable as a contract cannot be revoked or interpreted unilaterally. Accordingly, reliance and reference to the OECD commentary is clearly permissible in law. While giving the decision of *Infrasoft Limited* (supra) wherein identical issue was involved the Delhi Bench has declined to accept HPC as a binding law and the foreign courts judgments relied upon by the Revenue have been rejected on the ground that the same are not applicable to the issue involved in the present case. Referring to TRIPS agreement and WIPO Copyright Treaty the ld. counsel for the assessee submitted that additional right under section 14(b)(ii) of Copyright Act was granted to owners for commercial rentals of copies of computer software. He further submitted that term sale in section 14(b)(ii) of Copyright Act has been used merely to prevent sale of used products by end-users as in such case more than one end-user can use the same copy of software again. In the distribution channel no commercial exploitation can be envisaged as distributor is only a medium to distribute a copy of software product to end-user (without any use, adaptation, alteration etc.). Therefore there is no commercial exploitation by the distributors. It has also been submitted that for a transaction to qualify for royalty under Explanation 2 to section 9(1)(vi) two important ingredients are required i.e. the right should be exclusive under section 14(b)(ii) of Copyright Act and (ii) for the purpose of Explanation 2 to section 9(1)(vi) the consideration must be towards grant of right in copyright. In section 14(b)(ii) of Copyright Act right to sell refers to exclusive right only whereas under distribution agreement MRSC holding a non-exclusive

right to sell the products to Indian distributors for which no separate consideration has been paid to MRSC. Non-existent of both or any of the ingredients renders the provisions inapplicable to the transactions. He further submitted that Microsoft Operations is producing software copies in Singapore and are distributed through MRSC. Keeping in a wider perspective if all the agreements and supply chain obtain a right to sell i.e. MRSC, the distributors and resellers there is no price or such right to sell and the consideration flowing from the end users to MRSC are purely for supply of copy of software. MRSC has neither given any exclusive right in the software programme nor consideration received from Indian distributors towards grant of right to sell software.

64. The Revenue has distinguished decision in the case of Sonnata Information Ltd. (supra) on the ground that the judgement was given under section 195, but since the nature of payment and taxability remains the same the decision of Bangalore Bench could not be distinguished. As regards activation code it has been submitted that activation code cannot be interpreted controlling the ownership in the copy of software sold to end users. As soon as CD containing software programme is sold to end user, such end user on payment or purchase price becomes entitled for activation and no further consideration is charged for the updates.

65. It has further been submitted the assessee has relied upon the judgment of Hon'ble Supreme Court in the case of TCS Ltd only to put forth the argument that distinction between a copyright and copyrighted articles which is a well recognized concept world over was also approved by the apex court. He fairly conceded that the decision rendered in sales tax may not have direct application in interpreting income tax provisions.

66. Commercial exploitation is an imperative requirement in order that such exploitation may be construed as 'use' of copyright. He has further submitted that in the instant supply chain, MO is the entity which is reproducing software copies in Singapore which tantamount to commercial exploitation. After, MO the supply chain involving MRSC and distributor and resellers only distributes the same copy till the time it reaches the end user. Keeping a wider perspective, even if all the elements in the supply chain obtain a right to sell i.e. MRSC, distributors and resellers, there is no price for such right to sell and the consideration flowing from end users till MRSC are purely for supply of copy of software. MRSC has neither given any "exclusive rights" in the software programme nor the consideration received from Indian Distributor is towards grant of "right to sell" software programme.

67. We have heard both the parties and gone through the material available on record. In these cases the Id CIT(A) has upheld the order of the assessing officer holding that the payments made by the end users amounts to royalties within the meaning of section 9(1)(vi) of the Act. In brief the controversy revolves around the point whether the use of or the

right to use (including the granting of licence) in respect of computer programme amounts to royalty or sale of copyrighted articles.

68. The first contention of the ld. counsel for the assessee is that the word “of” should be supplied after “copyright” and before “literary” so as to read the words “copyright, literary, artistic or scientific work.....” appearing in clause (v) of Explanation 2 of section 9(1)(vi) of the income tax Act, 1961 as “copyright of literary, artistic or scientific work.....”, by applying the principle of *casus omissus*.

69. It is a golden rule of interpretation that the language of the statute should be read as it is. The intention of the Legislature is primarily to be gathered from the language used, which means that the attention should be paid to what has been said as also to what has not been said. As a consequence a construction which requires for its support addition or substitution of words or which results in rejection of words as meaningless has to be avoided. Hon’ble Supreme Court in *Director General, Telecommunication vs. T.N. Peethambaram* (1986) 4 SCC 384, p. 349 has observed that it is contrary to all rules of construction to read words into an Act unless it is absolutely necessary to do so. Similarly as has been held in *Union of India vs. Deoki Nandan Agarwal* AIR 1992 SC 96, p. 101 that the Court cannot reframe the legislation for the very good reason that it has no power to legislate. Hon’ble Supreme Court in the case of *Padmasundara Rao vs. State of Tamil Nadu* (supra) has held that under the first principle a *casus omissus* cannot be supplied by the Court except in the case of clear necessity and when reason for it is found in the four corners of the statute itself but at the same time a *casus omissus* should not be readily inferred and for that purpose all the parts of a statute or section must be construed together and every clause of a section should be construed with reference to the context and other clauses thereof so that the construction to be put on a particular provision makes a consistent enactment of the whole statute. This would be more so if literal construction of a particular clause leads to manifestly absurd or anomalous results which could not have been intended by the Legislature. In view of this position of law it has to be seen whether there is any absolute need for addition of word “of” as argued by ld counsel for the assessee. Clause (v) of Explanation 2 to section 9(1)(vi) reads as under:

“(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films”

On plain reading of definition of ‘royalty’ as appearing in clause (v) of Explanation 2 of section 9(1)(vi) one will find that the legislature has used coma (,) after word “copyright”. It is settled law that use of
Tax Review 2011

punctuation marks cannot be said as redundant. The use of punctuation mark coma (,) after word “copyright” indicates that legislative intent is to treat word “copyright” independent of words “literary, artistic or scientific work”. Therefore, word “copyright” cannot be read in conjunction with words literary, artistic or scientific work by substituting punctuation mark coma (,) by word “of”. Therefore, without making any tinkering to the language employed in clause (v) of Explanation 2 it reads “ in a case where there is transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work etc., the consideration received by an assessee will be liable to tax as royalty. Thus none of the words such as 'literary, artistic or scientific work... ' has become redundant or meaningless requiring addition of the word “of” between words ‘royalty’ and ‘literary’; and that too by omitting the punctuation mark coma (,) after word ‘copyright’.

70. Further the definition of term 'royalty' appearing in clause (v) of Explanation 2 is inclusive. Deletion of punctuation mark coma (,) and addition of word “of” between words 'copyright' and 'literary' would limit the scope royalty only to copyright work relating to literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting. The term “copyright” is wide enough to include other works such as dramatic or musical work as included in section 14(a); computer programme in section 14(b); cinematograph film in section 14(d); and a sound recording in section 14(e). The acceptance of the contention of the assessee would mean that copyright in respect of above works would go out of ambit of clause (v) of Explanation 2 of section 9(1)(vi). The Legislature in its wisdom has used word “copyright” independent of subsequent words 'literary, artistic or scientific work.....' by separating them by use of punctuation mark coma (,) appearing in the said clause which cannot be interpreted that there has been an omission of word 'of' on the part of the Parliament while enacting the law. It is a settled law that the need for interpretation arises when words used in the statute are, on their own terms, ambivalent and do not manifest the intention of the Legislature. It is a settled law that where the statutory word is plain and unambiguous, it is not for the judges to invent fancied ambiguities as an excuse for failing to give effect to its plain meaning because they themselves consider that the consequences for doing so would be inexpedient, or even unjust or immoral. In controversial matters, there is room for differences of opinion as to what is expedient, what is just and what is morally justifiable. Parliament’s opinion on these matters is permanent. The language employed in clause (v) of Explanation 2 to section 9(1)(vi) is plain, clear and unambiguous and is not capable of two meanings. Therefore, in our considered opinion there is no need for substitution of word ‘of’ for punctuation mark coma (,) as submitted by ld counsel for the assessee. Hence this contention of the assessee is rejected.

71. Ld Counsel for the assessee has also pleaded that the doctrine of *casus omissus* be applied while explaining the provisions Article 12(7)(b) of Indo –US DTAA. It has been submitted that the term “right” in article 12(7)(b) should be interpreted to mean ‘Copyright’ as used in the Article 12(3)(a) for harmonious construction. What is essential under Article 12(7)(b) is that the copyright itself should be used in India. Accordingly, it has been submitted that Article 12(7)(b) should be read as under:

“Where the consideration for use of, any copyright is relating to the use of such copyright in India, the royalties shall be deemed to arise in India.”

This contention of the Id. Counsel for assessee cannot be accepted as it would amount to modification of Indo-US DTAA. The language of Article 12(7)(b) is clear and unambiguous. The royalties or fees for included services shall be deemed to arise in that Contracting State in which the use of, or the right to use, the right or property, or the fees for included services is performed. There is vast difference between the language used by authors of Article 12(7)(b) and proposed above by the Id counsel for the assessee as is evident from Article 12(7)(b) reproduced as under:

“(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.”

The language of clause (b) of Article 12(7) is plain, clear and unambiguous. It is not conveying two meanings. For the reasons stated in earlier paragraph this contention of the assessee deserves to be rejected.

72. Another contention of the Id. AR of the assessee is that the Id. CIT (Appeals) is wrong in concluding that the provisions of section 115A of the Act characterizes the sale of software products as royalty. It has been submitted that provisions of section 115A of the Act cannot provide any aid to interpret computer software independent of copyright. He further submitted that section 115A is a machinery provision. It cannot create charge. The expression “copyright” used in section 115A (1A) is necessarily to be read with term “computer software”. He has further submitted that opening phrase of sub-section (1A) of section 115A refers back to sub-section (1) of section 115A and, therefore, by default, one has to fall back on Explanation (c) of section 115A(1) which again refers back to Explanation (2) to section 9(1)(vi) of the Act. It is only where a transaction is held liable to be taxed as royalty one can proceed to prescribe the rate of taxes and where the transaction itself is being questioned as to whether taxable or not, reliance cannot be placed upon a machinery provision to create charge.

73. On the other hand, the ld. counsel for the Revenue submitted that one provision of the Act should be construed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The inconsistency or repugnancy either within a section or between two different sections or provisions of same statute has to be avoided. This position gets fortified by the provisions of section 115A(1A) which provides a rate of tax for different incomes of non-residents and refers to royalty from “copyright” in any book, or “in respect of any computer software”. This is clear indication that (i) computer software is very much covered under the definition of “royalty” as appearing in the Act and (ii) the law treats computer software as different from copyright in any book. The suggestion of the assessee that section 115A is only a machinery section is totally misconceived as a section which provides the rate of tax cannot be a machinery provision. He further submitted that a ridiculous proposition has been sought to be advanced that Parliament prescribed rate of tax for an item of income not covered in charging section 9(1)(vi) of the Act. No rate of tax could be provided in section 115A, unless computer software gives rise to royalty income.

74. We have heard both the parties and perused the material available on record. Chapter XII of the Income tax Act, 1961 deals with determination of tax in certain special cases. Section 115A deals with computation of tax payable on income by way of dividend, royalty and technical fees in the case of foreign companies. Section 115A(1A) provides that where the royalty payment is in respect of transfer of all or any rights (including the granting of a licence) in respect of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India, the incometax shall be payable aggregating to amounts specified in clause (b) of section 115-A(1) of the Act. Therefore, for the purposes of computation of tax payable by the non-resident it has to be first determined that the payment is in nature of royalty in respect of transfer of all or any rights (including the granting of a licence) in respect of copyright in any book or computer software. Unless the nature of the payment is determined as per provisions of section 9(1)(vi), the provisions section 115A(1A) for the purposes of levy of income tax cannot be pressed into operation. To this extent we agree with ld. counsel for the assessee that unless nature of the payment is decided provisions of section 115A(1A) cannot be applied.

75. The next contention of the ld counsel for the assessee is that there is a difference between “*copyright*” and “*copyrighted article*” and in the context of computer software the Constitutional Bench of the Hon’ble Supreme Court in the case of Tata Consultancy Services Vs State of Andhra Pradesh (2004) 271 ITR 401 has held that the copyright in the computer programme may remain with the originator of the programme but the moment, copies are made and marketed, it becomes ‘goods’ which are susceptible to sales tax. Therefore, contention of the assessee is that

the consideration received by MRSC / MS Corp/Gracemac from Indian distributors is towards sale of Microsoft software products, being a 'copyrighted article'. The end users have not been granted any right in copyright in such softwares and therefore, the consideration received therefore is not taxable as royalty under section 9(1)(vi) of the Act. To support this contention the ld counsel for the assessee has placed reliance on OECD commentary and decisions of various Benches of the ITAT including the decision of Special Bench in the case of Motorola Inc. Vs. DCIT (supra) wherein it has been held that if the payment is for copyright, it should be classified as royalty both under the Income Tax Act and under the DTAA and it would be taxable in the hands of the assessee on that basis. On the other hand if the payment is for a 'copyrighted article', then it only represents the purchase price of the article and therefore cannot be royalty either under the Act or under the DTAA. On the other hand, the contention of the ld. Counsel for the Revenue is that reliance on OECD commentary should not be placed at all and the issue relating to royalty be decided on the basis of provisions of Income tax Act, 1961 read with Indo-US DTAA. He has also submitted that the computer software is different from 'Article' or 'goods' and the Parliament has recognized the difference by enacting section 80-HHE for export of computer softwares. If computer software was included in the definition of 'article' or 'goods' there was no need for enacting a separate section for export of computer softwares.

76. We have heard both the parties and examined the contentions carefully. In the cases before us the taxation of payments made by end users for computer programme in the form of 'shrink wrapped' software through a distribution channel is involved. The expression 'copyrighted article' is not defined either in the Income-tax Act or in Indo-US DTAA. As per Law Lexicon the term 'copyrighted' means when a copyright is registered. As per section 2(o) of Patents Act, 1970, 'patented article' and 'patented process' means respectively an article or process in respect of which a patent is in force. However, there is no such definition in the Copyright Act, 1957 defining "copyrighted article" on the lines as has been done in the Patents Act, 1970. The term "copyrighted article" is nowhere used even under the IT Act or Indo-US DTAA. The expression 'copyrighted article' finds its origin in U.S. regulations and then found its way in the OECD commentary. In the case of Motorola the Special Bench has differentiated between 'copyright' and 'copyrighted article' by placing reliance on U.S. regulations and the OECD commentary.

77. In the case of *Commissioner of Income-tax vs. P.V.A.L. Kulandagan Chettiar* (2004) 137 Taxman 460 (SC) the respondent-firm was resident of India and owning some immovable properties at Malaysia. During the course of the assessment year, the assessee earned income from rubber estates in Malaysia. The respondent also sold some property there and earned short-term capital gains. The ITO held that

both the incomes were assessable in India and brought the same to tax. On appeal, the Commissioner (Appeals) held that under article 7(1) of the Agreement of Avoidance of Double Taxation entered into between Government of India and Government of Malaysia, unless the respondent had a permanent establishment of the business in India, such business income in Malaysia could not be included in the total income of the assessee and, therefore, no part of the capital gains arising to the respondent in the Malaysia could be taxed in India. On appeal, the Tribunal confirmed the order of the Commissioner (Appeals). Before Hon'ble Madras High Court, the Revenue tried to justify the levy tax by assessing officer relying on OECD commentary. While confirming the order of ITAT, Hon'ble Madras High Court rejected the application of commentaries on the Article of Model Convention of 1977 presented by the Organization for the Economic Co-operation and Development (OECD) as it would not be a safe or acceptable guide or aid for such construction.

78. Before Hon'ble Supreme Court one of the argument advanced by the Revenue was that OECD model Treaty came into existence only in the latter part of 1977, while the Treaty in question was signed in October 1976; that most of the clauses in the OECD model Treaty could not have been in the contemplation of the parties at the time when the Treaty in question was signed and the provisions of OECD model treaty cannot, therefore, be applied to the Treaty in question. In this regard Hon'ble Supreme Court while confirming the decision of Hon'ble Madras High Court in paragraph 16 rejected the contention of Revenue based on OECD commentary by holding as under:

“16. Taxation policy is within the power of the Government and section 90 of the Income-tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income-tax Act, it would be unnecessary to refer to the terms addressed in OECD or in any of the decisions of foreign jurisdiction or in any other agreements.”

79. From the decision of Hon'ble Supreme Court in the case of *Commissioner of Income-tax vs. P.V.A.L. Kulandagan Chettiar* (supra) it is clear that OECD Commentary or US IRS Regulations would not be a safe or acceptable guide or aid for interpretation of provisions of Income tax Act, 1961 or Double Taxation Avoidance Agreement between India or other country. During the course of arguments the ld. Counsel for the assessee has not brought out anything to suggest that the language used in Explanation 2 to section 9(1)(vi) or Article 12(3) of the treaty defining the term “royalty” is ambiguous. In fact the words “copyrighted article” do not find any mention in the Act or in the Treaty or even the Copyright Act, 1957. Respectfully following the decision of Hon'ble Supreme Court

in the case of P.V.A.L. Kulandagan Chettiar (supra) it is held that for the purposes of interpretation of term 'royalty' in respect of computer software reliance cannot be placed on difference made in OECD Commentary or in the US Regulations between expressions "the transfer of a copyright right" and "the transfer of a copyrighted article". The of royalty in respect of computer software has to be decided on the basis of provisions of the Income Tax Act and Indo-US DTAA.

80. Further, Hon'ble Supreme Court in the case of TCS Ltd (supra) observed that in case of a computer software programme which consists of various commands in order to enable the computer to perform a legitimistic task. The copyright in the programme remains with the originator. The moment copies are made and marketed, it becomes goods which are susceptible to Sales-tax. This decision was rendered by Hon'ble Supreme Court under Sales Tax Act. The ld. AR of the assessee had fairly conceded that the decision is not applicable to Income-tax proceedings but it will be relevant while deciding the issue of royalty in respect of computer software programmes as Hon'ble Supreme Court has made distinction between 'copyright' and 'copyrighted article'. In this connection we would like to say that the copies made from master copies of computer programme cannot be used by the users without obtaining activation code which is given on signing of agreement known as EULA. Therefore, it cannot be said that the consideration received by the assessee was in respect of computer programme recorded on CD. It consists of the cost of the CD, the cost of recording the programme on it and the cost of licence granted to by the user on signing of the agreement. The Authority for Advance Ruling [AAR] in the case of Airport Authority of India 304 ITR 216 has observed that the issue of transfer of right to use the goods did not come up for consideration in that case. While holding that the decision of Hon'ble Supreme Court in the case of Tata Consultancy Services Vs. State of Andhra Pradesh (supra) was not applicable to Income-tax the AAR has observed as under:—

“20It may be mentioned that the legislative scheme of Sales tax law and Income-tax law are very different. While the object of the Sales tax law is to tax transactions of sale of movable properties, Income-tax law is concerned with taxing incomes and profits of individuals, companies and other entities in whatever manner earned..... Delivery of goods on hire purchase and transfer of right to use goods are deemed under this branch of law as amounting to same. There is no provision with regard to royalty under the Sales tax law. As could be seen from Tata Consultancy's case (2004) 271 ITR 401 (SC), the court has treated the disc / floppy containing the software as goods, whose value has been greatly enhanced because of the intellectual property input incorporated in it. Passing off the right to use intellectual property as such has not been regarded

as a taxable event. On the other hand, under the Income-tax Act as well as the DTAA the payment made in lieu of transfer of right to use copyright is a royalty income. The transfer of disc / floppy on which the copyrighted software has been inscribed is immaterial for this purpose.”

From the decision of AAR it is clear that the issue of royalty was not before the Hon'ble Supreme Court nor was it required to be adjudicated upon in the Sales-tax provisions. Therefore, the decision of Hon'ble Supreme Court in the case of TCS Ltd. (supra) cannot be applied to the facts of the assessee's case. It is a settled law as held by Hon'ble Supreme Court in the case of Sun Engineering Works Pvt Ltd.(supra) wherein it has been held that *“it is neither desirable nor permissible to pick out a word or a sentence from the judgment of this court, divorced from the context of the question under consideration and treat it to be the complete “law “ declared by this court. The judgment must be read as a whole and the observations from the judgment have to be considered in the light of the questions which were before this court. A decision of this court takes its colour from the questions involved in the case in which it is rendered and, while applying the decision to a later case, the courts must carefully try to ascertain the true principle laid down by the decision of this court and not to pick out words or sentences from the judgment, divorced from the context of the questions under consideration by this court, to support their reasonings.”*. In the case of TCS Ltd (supra) Hon'ble Supreme has decided the issue in the context of sales tax. Passing off the right to use intellectual property as such has not been regarded as a taxable event by Hon'ble Supreme Court.

81. Hon'ble Supreme Court in the case of *R.C. Anand vs. Deluxe Films* AIR 1978 SC 1613 at page 1617 observed as under:—

“There can be no copyright in an idea, subject-matter, themes, plots, or historical or legendary facts, and violation of the copyright in such cases is confined to the form, manner and arrangement and expression of the idea by the author of the **copyrighted work**. Where same idea is being developed in a different manner, it is manifest that the source being common, similarities are bound to occur. In such a case the Courts should determine whether or not the similarities are on the fundamental or substantial aspects of the mode of expression adopted in the **copyrighted work**. If the defendants work is nothing, but a literal imitation of the **copyrighted work** with some variations here and there it would amount to violation of the copyright. In other words, in order to be actionable the copy must be substantial and material one which at once leads to conclusion that the defendant is guilty of an act of piracy.....”

On a careful reading of the decision of Hon'ble Supreme Court in the case of *R. C. Anand vs. Deluxe Films* (supra) above, one would infer that Hon'ble Court has used expression 'copyrighted work' with reference to a work in which a copyright subsists.

82. Before we embark upon any enquiry with respect to construction of Clause (v) of Explanation (2) to section 9(1)(vi), we have to keep in mind certain basic principles of interpretation of statutes. It is settled law that the words of a statute are first understood in their natural, ordinary or popular sense and phrases and sentences are construed according to their grammatical meaning unless that leads to some absurdity or unless there is some thing in the context, or in the object of the statute to suggest the contrary. In a case if the language of the statute is not clear and there is need to resort to aids of construction, such aids can be either internal or external. Internal aids of constructions are definitions, exceptions, explanations, fictions, deeming provisions, headings, marginal notes, preamble, provisos, punctuations, saving clauses, *non obstante* clauses, etc. The external aids are dictionaries, earlier Acts, history of legislation, parliamentary history, parliamentary proceedings, state of law as it existed when the law was passed, the mischief sought to be suppressed and the remedy sought to be advanced by the Act. There is no ambiguity in the definition of term "royalty" as appearing in Explanation 2 to section 9(1)(vi) of the Act or article 12(3) of Indo-US DTAA and therefore, there is no need for importing the expression " Copyrighted Article" from OECD Commentary or US guidelines for the purposes interpretation of term "royalty" Hence for the purposes of income tax a copyrighted article cannot be treated as product.

83. U/s 9(1)(vi) of Income tax Act,1961 income by way of royalty shall be deemed accrue or arise in India:

- (i) royalty payable by the Central Government or any State Government;
- (ii) royalty payable by a resident, except where the payment is relatable to a business or profession carried on by him outside India or to any other source of his income outside India; and
- (iii) royalty payable by a non-resident if the payment is relatable to a business or profession carried on by him in India or to any other source of his income in India.

84. Explanation 2 to clause (vi) of section 9(1) which defines the term "royalty" is wide enough to cover both industrial royalties as well as copyright royalties. It reads as under:

“Explanation 2.—For the purposes of this clause, “royalty” means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head “Capital gains”) for—

- (i) *the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;*
- (ii) *the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;*
- (iii) *the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;*
- (iv) *the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;*
- (iva) *the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;*
- (v) *the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or*
- (vi) *the rendering of any services in connection with the activities referred to in sub-clauses (i) to(iv), (iva) and (v).”*

85. The term “royalty” takes into its ambit the industrial and copyright royalties. Transfer of the “right in the property” is not the subject matter. It is the transfer of the “right in respect of the property”. The two transfers are distinct and have different legal effects. In first category the rights are purchased which enable use of those rights, while in the second category, no purchase is involved, only right to use has been granted. Ownership denotes the relationship between a person and an object forming the subjectmatter of his ownership. It consists of a bundle of rights, all of which are rights in rem, being good against the entire world and not merely against a specific person and such rights are indeterminate in duration and residuary in character as held by Hon'ble Supreme Court in the case of *Swadeshi Ranjan Sinha vs. Hardev Banerjee* AIR 1992 SC 1590. When rights in respect of a property are transferred and not the rights in the property, there is no transfer of the rights in rem which may be good against the world but not against the transferor. In that case the transferee does not have the rights which are indeterminate in duration and residuary in character. Lump sum consideration is not decisive of the matter. That sum may be agreed for the transfer of one right, two rights and so on all the rights but not the ownership. Thus, the definition of term royalty in respect of the copyright, literary, artistic or scientific work, patent, invention, process etc. does not extend to the outright purchase of the right to use an asset.

In case of royalty the ownership on the property or right remains with owner and the transferee is permitted to use the right in respect of such property. A payment for the absolute assignment and ownership of rights transferred is not a payment for the use of something belonging to another party and, therefore, not royalty. In an outright transfer to be treated as sale of property as opposed to licence, alienation of all rights in the property is necessary.

86. In View of above discussion we have to now examine the true nature of the transaction involved in these appeals. In brief the contentions of the Id. counsel for the assessee are that since computer programme is protected under the Copyright Act, the reliance should be placed on Copyright Act only and not on other Intellectual Property Rights laws. The Id. counsel for the assessee has stated that in order to constitute a copyright there should be commercial production. The act of reproduction as envisaged in section 14(a) of the Copy-right Act, 1957 is a right to exploit the copyright commercially whereas the expression used in section 52(1)(aa) of the Copyright Act is the making of copies by lawful possessor of a copy is not infringement of copyright right. According to the Id. counsel for the assessee the installation and storage on hard disc of computer programme is not a copy right. On the other hand, the Id. counsel for the Revenue has submitted that section 14(a)(i) of the Indian Copy-right Act, 1957 defines the term "copyright" to include inter-alia the right to reproduce the work in any material form including the storing of it in any medium. Section 14(b)(ii) takes the activity to sell or give on commercial rental a copy of computer programme within the ambit of copyright. He has referred to Government of India Publication "Hand book of Copyright Laws" according to which copyright means the right to make one or more copies. Therefore, according to the Id. counsel for the Revenue there is no contemplation that reproduction will arise only mass copies are produced or only if these are produced for sale or commercial exploitation.

87. We have considered the submissions made by both the parties. The word "copyright" is neither defined under Income-tax Act nor under Double Taxation Avoidance Agreement. Section 14 of the Copyright Act, 1957 defines the term "copyright". Clauses (a) and (b) of section 14 of the Copyright Act, 1957 which are relevant for deciding of the issue are extracted as below:

"14. Meaning of copyright - For the purposes of this Act, "copyright" means the exclusive right subject to the provisions of this Act, to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely,—

- (a) in the case of a literary, dramatic or musical work, not being a computer programme,—

- (i) to reproduce the work in any material form including the storing of it in any medium by electronic means;
 - (ii) to issue copies of the work to the public not being copies already in circulation;
 - (iii) to perform the work in public, or communicate it to the public;
 - (iv) to make any cinematograph film or sound recording in respect of the work;
 - (v) to make any translation of the work;
 - (vi) to make any adaptation of the work;
 - (vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);
- (b) in the case of a computer programme,–
- (i) to do any of the acts specified in clause (a);
 - (ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme;
- PROVIDED that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental.”

88. Under section 14 (a) of the Copyright Act, 1957 the owner of the copyright in a literary, dramatic or musical work has the “exclusive right” to do the acts such as to reproduce the work in any material form including the storing of it in any medium by electronic means; to issue copies of the work to the public; to perform the work in public, or communicate it to the public; to make any cinematograph film or sound recording in respect of the work; to make any translation of the work; to make any adaptation of the work etc. Any person doing any of these acts without licence, consent or authorization of the owner will be committing an infringement of these rights. Section 14(b) of the Copyright Act, provides that the owner of copyright in computer programme has “exclusive right” to do any of the acts specified in clause (a); sell or give on commercial rental, or offer for sale or hire for commercial rental any copy of computer programme. Thus the expression “exclusive right” used in section 14(a) or section 14(b) of the Copyright Act refers to the rights of author/creator and not the “exclusive right” to be given by him to some party to reproduce the copyrighted work or sell the computer programme etc. It also does not mean that non-exclusive right given by the owner of the copyright to some other party to do one or more acts will not have copyright in respect of the property. Even grant of one right in respect of a copyright or work would amount transfer or the use of copyright. Section 30 of the Copyright Act, 1957 empowers the owner of the

copyright in any existing work or in future work to grant any interest in the right by licence in writing signed by him or by his duly authorised agent. Therefore, for the purposes of a licence there is no requirement in Copyright law that the author should grant exclusive right to other person to do all or any of the acts to which the author is having exclusive rights. The expression 'reproduce' used in section 14(a)(i) is explained in Govt. of India Publication "Handbook of Copyright Law" to mean the right to make "one or more copies". There is no contemplation that reproduction will arise only if mass copies are produced or only if these are produced for sale or commercial exploitation. We are not dealing with an issue whether or not; there is any infringement of copyright for which reference to section 51 or section 52 of the Copyright act, 1957 should be made. The issue of royalty is to be decided as provisions of Income tax Act and Indo-US DTAA. We can only refer to the provisions of the Copyright Act for limited purposes of definition of term "copyright".

89. Section 2(ffc) of the Copyright Act defines the expression "Computer programme" as a set of instructions expressed in words, codes, schemes or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result. Software is usually developed in three stages. First, a System Analyst or Designer prepares a specification, which normally includes data flow setting out the basic logic of programme. Then a source code programme is written in either a higher level computer language (e.g. oracle, or visual basic) for the ease of development or lower level language (e.g. C, C+, C++ or visual C) or power explicit control output. However, in either case, the source code cannot be read directly by a computer. The source code is converted by an assembler or compiler programme into object code. Object code is essentially a form of source code which can be read or acted upon by micro-processor or central processor unit (CPU) of computer. Object code is an expression in binary notation consisting of the series of ones and zeros, (reflecting electrically, 'on' and off states) which are understood by a particular computer. The object code, therefore, is a replication of source code in a different form. An object code is the version of a programme in which the source code language is converted or translated into the machine language of the computer with which it is to be used. The object code is adaptation or mechanical translation of the source code entitled to copyright protection. Authorship of both the source code and the object code are protected by the copyright Act as literary work. Further section 2(ffc) of Copyright Act, 1957 defines "computer programme" and means a set of instructions expressed in words, codes, schemes or in any other form, including a machine, readable medium, capable of causing a computer to perform a particular task or to achieve a particular result. As per section 2(o) of the Copyright Act, literary work includes computer programme, table and compilations including data basis. Thus from the combined reading of sections 2(ffc) and 2(o) of the Copyright Act, it is clear that "computer

programme” is a literary work. Because of the above reasons a computer programme has been treated as literary and the author has been granted protection under the Copyright Act, 1957. Since the computer programme has been considered as a literary work in order to protect the interests of the author under the copyright Act, it would be incorrect and illogical to interpret the income tax provisions relating to royalties based on the Copyright Act. Whether a consideration is in nature of royalty or not reference has to be made to provisions of Income tax Act and Indo-US DTAA. But since the computer programme is a literary work within the meaning of 2(ffc) and 2(o) of the copyright Act, the consideration received will be in nature of royalty if it is in respect of the transfer of all or any rights (including the granting of a licence) in respect of the same under clause (v) of Explanation 2 of section 9(1)(vi) of the Act.

90. There is nothing either in the Income tax Act or Indo-US DTAA that once a case falls in one of the clauses of Explanation 2 of section 9(1)(vi) it cannot be considered in any other clause. Moreover the plain reading of definition of royalty as contained in Explanation 2 to section 9(1)(vi) and Article 12(3) of Indo-US DTAA it is evident that the definition takes into its ambit both the industrial as well as copyright royalties. When provisions of section 9(1)(vi) of Income Tax and Indo-US DTAA are applicable in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property, any copyright, literary, artistic or scientific work etc. and relief under Indo-US DTAA has been provided in respect of income chargeable to tax under Income tax Act, it will not be appropriate to restrict the scope of definition of term royalty under Income tax law only on the ground that since computer programme has been provided protection under copyright Act, the provisions of other IPR laws will not be applicable. We, therefore, are not in agreement with the arguments Id. Counsel for the assessee that other IPR laws with reference to the definition of term “royalty” will not be applicable to the case of the assessee.

91. There is no dispute that the Microsoft products are patented in USA which is evident from Clause 4.1 of the Parent Subsidiary agreement between MS Corp and Gracemac stating that the software is protected both by copyright and patent laws. EULA also refers that the product is protected by copyright and other intellectual property rights. There can be overlap between copyright and patent. Both are mutually exclusive. Indian Patent Act, 1970 differentiates patentable and non-patentable inventions. Under section 2(m) of the Patent Act, 1970 defines a patent to mean a patent for any invention granted under the Act. Clause (iii) of Explanation 2 of section 9(1)(vi) defines royalty as consideration for the use of any patent, invention, model, design, secret formula or process or trade mark or similar property. Therefore, the payments made by the end users as a consideration for the use or the right to use of such patents will be in nature of royalty. Hence the case is

covered by the clause (iii) of section 9(1)(vi) of IT Act, 1961 and also by the definition of term “royalty” appearing in Article 12(3) of Indo-US DTAA.

92. The Revenue has also contended that the right to use a process is also covered under the definition of royalty and computer programme is nothing but a set of instructions designed to provide a certain result to end users and thus payments made for use of computer programme involving a process would result in giving rise to ‘royalty’ payments under Explanation 2(ii)/(iii) of Section 9(1)(vi) of Act. Reliance has been placed on New Oxford Dictionary wherein the meaning assigned to the word ‘process’ is “series of action or steps taken in order to achieve a particular end”. To provide a clear understanding of the term ‘use’ or ‘right to use’ a process, reliance is placed upon the judgment of ITAT given in the case of *Asia Satellite Communications Ltd.* (85 ITD 478) wherein it was held that assessee derived benefit by utilizing the process in the transponder facilitating rely of their programme to the viewers and process involved in the transponder was used by the assessee for carrying on their business.

93. Ld Counsel for the assessee in rejoinder has submitted that since the Parliament has chosen to classify computer programs as literary work under section 2(o) of the Copyright Act, the other category of the IPR’s which are patent, invention, secret formula or process will not operate. However, even if computer software is to be considered as falling under process, the term ‘process’ has to be interpreted as an intellectual property right rather than as being interpreted in the ordinary sense. Reliance is placed on the following judicial precedents:

- *Philips NV vs. Commissioner of Income-tax* 172 ITR 521 (Calcutta);
- *DCM Ltd vs. Income-tax Officer* 29 ITD 123 (Delhi ITAT); and
- *Modern Threads (I) Ltd vs. Deputy Commissioner of Income-tax* 69 ITD 115 (TM) (Jaipur ITAT).

He has further submitted that the expression “process” appearing in Explanation 2(ii) to section 9(1)(vi) of the Act cannot be invoked as consideration paid by the end user is towards the product and not towards the working of a process. It has been submitted that the decision given by the Delhi bench of ITAT in case of *Asia Satellite Telecommunications Co. Ltd vs. DCIT* (Supra) was on entirely different facts where payments were made towards use of transponder capacity and not towards purchase of any product. He placed reliance on the decision of the Bangalore Bench in the case of *Sonata Software Ltd. Vs DCIT* (Supra) wherein it has been held that “computer programme” being specifically covered under copyright, it cannot be again said to be covered under the “process”.

94. We have considered the arguments advanced by both the parties. As per Wikipedia dictionary in computing, a process is instance of a computer programme that is being executed. It contains the programme code and its current activity. Depending on the operating system (OS), a process may be made up of multiple threads of execution that execute instructions concurrently. Thus computer programme is a passive collection of instructions; a process is the actual execution of those instructions. Several processes may be associated with the same programme; for example, opening up several instances of the same programme often means more than one process is being executed. In *CIT vs. Datacons P. Ltd.* 155 ITR 66 (Kar.) the company was engaged in processing the data supplied by its customers by using IBM unit record machine computer. The assessee received vouchers and statements of accounts from its customers and converted them into balance sheets, stock accounts, sales analyses etc. They were printed as per the requirement of the customers. Hon'ble Karnataka High Court held that in all those activities the assessee had to play an active role by coordinating the activities and collecting the information. Such activities amounted to processing of goods. In the case of *Asia Satellite Telecommunications Co. Ltd vs. DCIT* (Supra) it was held that the assessee was deriving income from lease of transponder capacity of its satellites. The assessee was amplifying and relaying the signals in the footprint area after having been linked up by the TV channels. The essence of the agreement of the TV channels with the assessee was to relay their programmes in India. The responsibility of the assessee was to make available programmes of the TV channels in India through transponders on its satellite. The function of the satellite in the transmission chain was to receive the modulator carrier that earth stations emitted as up-linking, amplifying them and retransmitting them and down-link for reception at the destination earth stations. The meaning of the word "process" being a series of action or steps taken in order to achieve a particular end, considering the role of the assessee in the light of meaning of the term 'process', it was evident that the particular end, namely, viewership by the public at large was achieved only through the series of steps taken by receiving the up-linked signals, amplifying them and relaying them after changing the frequency in the foot-print area including India. It was held that the TV channels in entire cycle of relaying the programmes in India were using the process provided by the assessee and, therefore, it was liable to be taxed as royalty income. In *NV Philips vs. CIT* (supra) the assessee received the amount for providing specialized knowledge of manufacturing particular commodity which included working methods, manufacturing processes including indications, instructions, specifications, standards and formulae, method of analysis and quality control. It was held that the payment for the user of such specialized knowledge, though not protected by a patent, was assessable as royalty. This decision supports the cause of

Revenue and the assessee. Similarly in the case of *DCM Ltd. vs. Income-tax Officer* (supra) the issue related to transfer of comprehensive technical information, know-how and supply of equipment. It was held that the collaboration agreement dealing with the dispatch of one or more of its engineers, technologists to visit the factory site of the assessee, train the factory personnel and to commission the specified processes, would not create a permanent establishment. Therefore, it was held that the payments were not in the nature of royalty. The facts of the case before us are entirely different and, therefore, distinguishable on facts and the assessee cannot derive any benefit from the decision of this case. In the case of *Modern Threads (I) Ltd. vs. DCIT* (supra) it was held that the payments were made in installments to Italian company for supply of technical know-how and also for supply of basic process engineering documentation for designing, construction and operation of plant subject to their liability on account of rectifying form, it was held that the amount paid for supply of technical know-how and basic engineering documentation for setting of the plant in India for manufacturing of PTA was the business profit in the hands of Italian company in the absence of permanent establishment in India. Therefore, the facts of this case are also different. The payments did not fall within the term 'royalty' as defined in Article 13(3) of DTAA between India and Italy. Therefore, the facts of this case are also distinguishable.

95. From above discussion it clear that computer programme is a process when it executes instructions lying in it in passive state. Therefore, any consideration made for the use of process would amount to royalty.

96. Coming to the question whether computer software/programme is an invention, the ld counsel for the assessee submits that since computer software/ programme has been granted protection under Indian Copyright Act, 1957, in order to determine the taxability of the assessee pursuant to sale of computer program to end user under provisions of Explanation 2 to section 9(1)(vi), reliance should be placed only on the Indian copyright Act, 1957 and not under any other category of intellectual property right laws. On the contrary the contention of Revenue is that computer software, particularly Microsoft software products also fall within the ambit and scope of an "invention" and a "patent".

97. There is no dispute that MS Softwares are patented in USA and find mention in the parent subsidiary agreements. No doubt the computer software are provided protection under copyright Act as literary work, it does not mean that the computer programme will not be an invention. These softwares are held to be original inventions. The assessee has himself asserted in their agreements that what is being distributed by MRSC is patented software. EULA refers that the product is protected by copyright and other intellectual property rights. Even

though as per section 3(k) of the Patent Act, 1970 a computer programme per se other than its technical application to industry or a combination with hardware, is not invention to be patented but the fact remains that Microsoft programmes being patented are inventions. In section 9(1)(vi) a patent and an invention are two different items. Under section 2(m) of the Patent Act, 1970 defines a patent to mean a patent for any invention granted under the Act. Hence we are in agreement with the arguments of ld. counsel for the Revenue that Microsoft computer programmes are inventions and the payment made for the use or the right to use the same would amount to royalty.

98. Another contention of Ld Counsel for the Revenue is that when the computer software embedded in CD is considered as tangible property then transaction should be examined under explanation 2(iva) for “*the use or right to use any industrial, commercial or scientific equipment...*” and reliance was placed on the decision of Chennai Bench of ITAT in the case of *West Asia Maritime Ltd. vs. ITO* reported in 297 ITR 202 wherein it was held that equipment would include every kind of fixed assets and ship whether or not specifically mentioned under Explanation 2 to section 9(1)(vi) of the Act will be covered by the expression “equipment”. Ld counsel for the assessee on the other hand had submitted that the expression “equipment” used in the Explanation 2 to section 9(1)(vi) of the Act cannot be interpreted to be wide enough to cover within its ambit even a computer software. The decision of Chennai Bench of ITAT in case of *West Asia Maritime Ltd. vs. ITO* (297 ITR 202) is not applicable to the present case as is distinguishable on facts involved in the present appeals. The reliance placed by Revenue on the decision of Hyderabad Bench of ITAT in case of *Frontline Software Ltd vs. DCIT* - ITA No. 1080 to 1082/Hyd./2003, is misplaced as Chennai Bench did not rendered its decision on the issue whether right to use a computer software will mean usage of an ‘industrial, commercial or scientific equipment’, rather the issue on hand was whether based on the facts of the case transaction involved was that of an absolute assignment of ownership or transfer of right to use. We have considered the arguments advanced by parties. There is no dispute that computer programme is not a tangible property. Moreover we have rejected the contention of assessee that computer programme embedded in CD are not “copyrighted articles” and therefore there is no need to decide the issue whether an intangible property will be in nature of equipment. The plea raised by Revenue is an alternate plea and that too in situation when computer programme in a CD was to be considered as a “copyrighted article”.

99. The owner of a copyright may grant an interest in the copyright by a licence. The licence may be confined to one or more interests or to the entire copyright. A licence is an authorization of an act which without such authorization would be an infringement. In the case of a licence the licensee gets the right to exercise particular right subject to the condition

of the licence, but does not become the owner of that right whereas an assignee becomes the owner of the interest assigned. In the case of a sale the purchaser becomes the owner of the property and acquires the right to sell, lease, licence etc. In order to decide the nature of the transaction in the present appeals it is important to refer to various clauses of End User Licence Agreement. EULA contains the following warning “**important - read carefully**” which is reproduced as below:

*“This End User Licence Agreement (EULA) is a legal agreement between you (either an individual or a single entity) and Microsoft Corporation for the Microsoft software product identified above, which includes computer software and may include associated media, printed materials, and “on line” or (electronic documentation) “product”. An amendment or addendum to this EULA may accompany the product. You agree to be bound by the terms of this EULA by installing, copying, or otherwise using the product. **If you do not agree, do not install or use the product;** you may return it to your place of purchase for a full refund.”*

From the plain reading of the above it is clear that Microsoft products have not been sold, but licenced. In case of sale the purchaser becomes the owner and question of further agreement for the use of the property will not arise. Apart from the above warning there are other terms and conditions attached to End User Licence Agreement. Clause (1) of the agreement deals with grant of licence and species under what circumstances the upgrades and additional software will be available. Clause (6) of the agreement deals with termination. It states “that without prejudice to any other rights, Microsoft may cancel this EULA, if you do not abide by the terms and conditions of this EULA, in which case you must destroy all copies of the product and all of its component parts”. This conditions of End User Licence Agreement itself proves that the software is licenced and not sold. This fact is further buttressed by the wordings of clause 19 of EULA which states that “*the product is protected by copyright and other intellectual property laws and treaties. Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product. **The product is licensed and not sold.***” Another important feature of the transaction is the “Activation code” which is given by Microsoft Corporation. Before activation code is granted the end user has to enter into agreement with Microsoft Corporation known as EULA. Unless activation code is given the computer programme embedded on an electronic media cannot be used. It has explicitly been clarified in clause 19 of EULA that Microsoft Corporation or its suppliers own the title, copyright, and other intellectual property rights in the product. Thus on combined reading of clause 19 of EULA; the warning note on the EULA; and termination clause 6, it is clear that the end users have not purchased copy of software products on electronic media as

contended by the assessee but a licence to use such software products. As we have held that copyrighted article means a work in which copyright subsists. Therefore the end user is not simply using the CD but the programme contained in the CD, which is protected by copyright and right to copy the programme has to be exercised before it can be put to use. Therefore, the payments made by the end users is for the granting of license in copyright and other intellectual property rights in the product and will amount to royalty u/s 9(1)(vi) of the Act.

100. After conclusion of the hearing the Revenue has filed a list of some of the cases out of large number of cases in which Hon'ble Delhi High Court disposed of plaints as below:

S.No.	Diary No. / Case No. [STATUS]	Petitioner vs. Advocate	Respondent	Listing date Court No.
1.	CS (OS) 994/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Anr. vs. Mr. Gaurav Arora & Anr. Advocate: Anand & Anand		Disposed on 28/7/2009
2.	CS (OS) 993/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Anr. vs. Mr. S. C. Aggarwal Advocate: Anand & Anand		Court No. 24 Disposed on 8/06/2009
3.	CS (OS) 992/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation vs. Mr. Vinod Kashyap Advocate: Anand & Anand		Disposed on 12/06/2009
4.	CS (OS) 968/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Anr. vs. Mr. Pawan Jain Advocate: Saikrishna & Associates		Disposed on 2/09/2009
5.	CS (OS) 947/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Ors. vs. Mr. P. H. Hussain Kunnel Advocate: Saikrishna & Associates		Last date : 12/05/2010
6.	CS (OS) 946/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Ors. vs. Mr. Pranav Dalal & Anr. Advocate: Anand & Anand		Disposed on 23/09/2009
7.	CS (OS) 945/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Anr. vs. Mr. Sudhir Bajaj Advocate: Saikrishna & Associates		Disposed on 12/06/2009
8.	CS (OS) 899/2009 Order(s) [Disposed off] Judgement	Microsoft Corporation & Ors. vs. Mr. Mahesh B. Advocate: Saikrishna & Associates		Disposed on 4/08/2009

101. A copy of decision of Hon'ble Delhi High Court granting injunction on a plaint filed by Microsoft Corporation & Another against Pawan Jain & Others for infringement of copyrights in the softwares is on records. The Id. counsel for the assessee has filed comments. The plaint has been admitted by Hon'ble Delhi High Court and the request of the plaintiff i.e. *Microsoft Corporation & Another* for investigation of the matter has been granted and order has been passed on May 25th, 2009 [CS (OS) No.968/2009] appointing the Commissioner to investigate the

matter with reference to the plaint. Since plaint is on the record of Hon'ble Delhi high court, its authenticity cannot be doubted. Microsoft Corporation & Another, the plaintiff in the plaint have stated that Microsoft Corporation is the owner of copyrights in various software products including operating systems of software, Microsoft windows operating system (various versions) and application software such as Microsoft office (various versions), Microsoft window server system etc. and development tools like visual studio, visual c++ (various versions). The grievance of the plaintiff before the Hon'ble Delhi High Court was that the defendants i.e. Mr. Pawan Jain & Others were using un-licenced/pirated versions of the plaintiff's softwares in their computer system for their business purposes. Defendant No. 2, M/s. Safexpress Pvt. Ltd. is an entity engaged in the business of providing range of logistics and supply chain solutions and is carrying on its business from its corporate office located at Safexpress, Cargo Complex, Safex centre, National Highway No. 8, Mahipalpur Extn., New Delhi - 110 037. Shri Pawan Jain is the Managing Director of M/s. Safexpress Pvt. Ltd. As per the plaint the plaintiffs have received information in May, 2009 that the defendants were using large volumes of software programmes belonging to the plaintiffs including Microsoft windows, Microsoft office products, windows server, visio etc. on about 380 computer systems including laptops for their business and other commercial purposes at its office. On the basis of information available in the office it has been stated by the plaintiff that defendants have made volume purchases of 99 licenses of Microsoft office standard, one licence of Microsoft project, one licence of Microsoft visio professional, 9 licences of window server with 660 Client Access License (CAL), 250 windows terminals servers and 75 microsoft windows of updates. It has been stated in the plaint that when an entity has a large number of computer systems it normally opts for multiple licences rather than individual packs as volume purchases of individual packs are not feasible from a cost point of view and the plaintiff has a record of all multiple licences held by every customer. The plaintiffs have contended that the fact that the defendants have 350 computer systems and the number of licences held by the defendants does not match with their usage indicates that the defendants were indulging in multiple unlicenced use of licences of Microsoft Corporation. After hearing the Hon'ble Delhi High Court has appointed local commissioners to visit various premises of defendants located in Delhi, Bangalore & Sicandrabad simultaneously without prior notice to defendants and prepare inventories of all unlicenced / pirated softwares of plaintiffs in the computer system / hard disc or in the impact discs / DVDs or any other storage media of defendants at their premises and seize only such storage medias in the central processing unit or outside the central processing unit having unlicenced / pirated softwares of the plaintiffs. They were required to submit reports within two weeks after executing the commission.

102. From the above, it is clear that the computer programmes whether in FPP or VPP contain copyright in them. At one hand the assessee is contending that the Microsoft products sold to the end users are copyrighted articles and do not contain copyright. On the other hand, under Copyright Act they are enforcing their rights stating that the use of unlicensed/pirated copy of software products involves infringement of copyrights. The Microsoft Corporation has got injunction orders from Hon'ble Delhi High Court in a large number of cases. The assessee is thus blowing hot and cold in the same breath on the same issue. When payment of tax is concerned, it is sale of "copyrighted" article and not a licence, but when question of infringement comes, complaints are filed before Hon'ble Delhi High Court claiming that the end users have indulged in use of unlicensed/pirated products. From the decisions of Hon'ble Delhi High Court granting injunctions under the Copyright Act it is proved beyond doubt that computer programmes licensed by the assessee whether in FPP or VPP contain copyright in them.

103. As discussed above under the Copyright Act, 1957 computer programme is a literary work, but section 115(1A) deals with the computation of tax payable on royalties in respect of copyright in any book and in respect of any computer software. The Parliament while prescribing special rates and mode computation of tax has made clear distinction between a copyright in any book which is in the nature of literary work and any computer software. It means for the purposes of the Copyright Act, 1957 computer software is a literary work, but for the purpose of Income-tax it is not so. Further second proviso was inserted to section 9(1)(vi) with effect from 1/04/1991, according to which the provisions of section 9(1)(vi) shall not apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer waste equipment under any scheme approved under the Policy on Computer Software Exports, Software Development and Training, 1986 of Government of India. According to ld counsel for the assessee second proviso to section 9(1)(vi) cannot create charge so as to bring the computer software under the provisions of royalty. According to him an amendment to section 9(1)(vi) is necessary without which royalty from computer software cannot be taxed. It cannot be read into it by implication. He has also stressed that even in Indo-US DTAA entered on 20.12.1990 computer programme has not been incorporated though it got protection in the Copyright Act as literary work long back in 1984. On the other hand the contention of Revenue is that since a proviso carves out an exception from main section the royalty from computer programme was inbuilt in section 9(1)(vi) of the Act since its inception.

104. We have heard both the parties and gone through their submissions carefully. As per section 9(1)(vi) of the Act the income by way of royalty payable by the Government; or a resident ;or a non-resident shall be deemed to accrue or arise in India. The term royalty has been defined in Explanation 2 to section 9(1)(vi) of the Act. In *Keshavji Ravji & Co. vs. CIT* [1990] 183 ITR 1 (SC), the Supreme Court said that an Explanation, generally speaking, is intended to explain the meaning of certain phrases and expressions contained in the statutory provisions. There is no general theory as to the effect and intendment of an Explanation except that the purpose and intendment are determined by its own words. An Explanation depending upon its own language might supply or take away something from the contents of a provision. It is also true that an Explanation may be introduced by way of abundant caution in order to clear any mental cob-webs surrounding the meaning of the statutory provision spun by interpretative errors and to place what Legislature considers to be true meaning beyond any controversy or doubt. In view of decision of Hon'ble Supreme court in *Keshavji Ravji & Co. vs. CIT* (supra) Explanation 2 has to be read as part and parcel of section 9(1)(vi) of the Act.

105. Normally, a proviso is meant to be an exception to something within the main enactment or to qualify something enacted therein which but for the proviso would be within the purview of the enactment. In other words, a proviso cannot be torn apart from the main enactment nor can be used to nullify or set at naught the real object of the main enactment. Sometimes a proviso may be embedded in the main provision and becomes an integral part of it so as to be a substantive provision itself. But such a substantive provision will have to be within the framework of the main section of which it is a proviso.

106. In *State of Rajasthan vs. Mrs. Leela Jain* AIR 1965 SC 1296, section 4(1) of the Rajasthan City Municipal Appeals (Regulation) Act, 1950 fell for consideration before Hon'ble Supreme Court. An order passed by the President of the Municipal Council was set aside by the State Government in purported exercise of its jurisdiction under the proviso to section 4(1) which reads as follows:

“4. Second municipal appeals and revision - (1) Notwithstanding anything contained in any municipal law, no municipal appeal shall lie from any order passed in appeal under section 3. Provided that the Government may, of its own motion or on the application of a Municipal Authority or of an aggrieved person call for the record of any case for the purpose of satisfying itself as to the correctness, legality or expediency of any order passed by a Commissioner or a Municipal authority and may pass such orders therein as the Government may consider fit and reasonable.

(2) Any municipal appeal from orders made in appeal by an officer or authority other than Municipal authority, pending at the commencement of this Act, shall be transferred to the Government and be disposed of in accordance with the proviso to sub-section (1)."

107. Hon'ble Rajasthan High Court expressed the view that the Government had no jurisdiction to interfere under the proviso to section 4 with any order passed in appeal by the Municipality. That view was negated by the Supreme Court by observing (page 1300):

"The primary purpose of the proviso now under consideration is, it is apparent, to provide a substitute or an alternative remedy to that which is prohibited by the main part of section 4(1). There is, therefore, no question of the proviso carrying out any portion out of the area covered by the main part and leaving the other part unaffected. What we have stated earlier should suffice to establish that the proviso now before us is really not a proviso in the accepted sense but an independent legislative provision by which, to a remedy which is prohibited by the main part of the section, an alternative is provided. It is further obvious to us that the proviso is not co-extensive with but covers a field wider than the main part of section 4(1)".

108. In *UP State Road Transport Corporation vs. Mohd. Ismail* (AIR 1991 SC 1099), Hon'ble Supreme Court while interpreting the proviso to regulation 17(3) of the UP State Road Transport Corporation has held that sometimes a proviso in effect becomes a substantive provision. Regulation 17(3) of the UP State Road Transport Corporation reads as follows:

"17(3) The service of a person who fails to pass the fitness test, referred to in subregulation (2), may be dispensed with; Provided that the persons, whose services are dispensed with may, in the discretion of the Corporation, be offered alternative jobs."

109. On further appeal Hon'ble Supreme Court observed:

"The proviso with which we are concerned in regulation 17(3) does not carve out an exception from the general rule contained in the first branch. It is an independent and substantial provision providing discretion to the Corporation to offer an alternative job to the retrenched driver. This offer is to be made after the exercise of power under the first branch of regulation 17(3). There is, therefore, no doubt that the second branch of regulation 17(3) is a substantial provision and not in the nature of a proviso to the first branch thereof."

110. Second proviso to section 9(1)(vi) was inserted in the statute by the Finance (No 2) Act, 1991 w.e.f. 1.4.1991 and reads as under:

“Provided further that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India.”

111. On plain reading of second proviso to section 9(1)(vi) we find that the proviso carves out an exception from main section exempting lump sum payment made by a resident for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Export, Software Development and Training, 1986 of the Government of India. It cannot stand on its own legs and hence cannot be held as a substantive provision. It would, therefore, mean that section 9(1)(vi) from very inception included computer software for the purposes of royalty. If is not so, then how anything can be taken out from a bundle of things which do not include the same. If royalty income from the use or the right to use or transfer of all or any right (including the granting of the licence) in respect of copyright in computer programme was not taxable u/s 9(1)(vi) of the Act, the Parliament would not have prescribed special rate of income tax in respect of royalty income in respect of any computer software u/s 115A(1A). It cannot be presumed that the Parliament was not aware of provisions of section 9(1)(vi) of the Act while enacting section 115A(1A). The most basic rule of interpretation is embodied in the Latin maxim *ex visceribus actus*. Put it simply, this means a statute has to be read as a whole and not piecemeal. Interpretation must not only be close to the statutory language but should also not lead to conflict with the other provisions of the statute. The intention of the Legislature must be found by a reading of the statute as a whole and in its context which is derived from the contextual scheme. Hon'ble Supreme Court in *Unique Butyle Tube Industries (P.) Ltd. vs. UP Financial Corporation* [2003] 2 SCC 455 held that every part of a section should be interpreted in terms of its own context and in relation to other part of the section and ultimately the interpretation placed in a particular provision should result in the whole statute remaining a consistent enactment. Similarly in *Poppatlal Shah v. State of Madras* AIR 1953 SC 274 at page 276, para (7), held as under:

“It is a settled rule of construction that to ascertain the legislative intent, all the constituent parts of a statute are to be taken together and each word, phrase or sentence is to be considered in the light of the general purpose and object of the Act itself.”

112. In view of above it clear that provisions of section 9(1)(vi) have to be considered in the light of provisions of section 115A(1A) of the Act. We, therefore, reject the contention of the assessee that without amendment of section 9(1)(vi) royalty income from the use or the right to use or transfer of all or any right (including the granting of the licence) in respect of copyright in computer programme cannot be taxed u/s 9(1)(vi) of the Act.

113. We may also like say that the use of expressions “in respect of copyright in any book to an Indian concern” or “in respect of any computer software to a person resident in India” in section 115A(1A) by legislature shows that for the purposes of income tax the copyright in “computer software” is different from copyright in any “book” though both are literary works under the Copyright Act, 1957. The Income tax Act and the copyright Act operate in different fields. The object of the Copyright Act is to provide protection to the copyrights in various works of the authors whereas the purpose of income tax is levy and collect tax on various types of incomes. Therefore, provisions of income tax Act cannot be explained by resorting to various provisions of the Copyright Act, 1957. However, a limited reference to understand the meaning of term 'copyright' can be made to the Copyright Act, 1957 as this term has not been defined under IT Act, 1961. Therefore, any reference to Indian Copyright Act 1957 has to be made for the limited purpose of finding out the meaning of the word 'copyright' and that too for the reason that the term 'copyright' is not defined in the Income tax Act or the DTAA. Our view is supported by the decision of Hon'ble Supreme Court in the case of Jagatram Ahuja (supra) wherein it has been held that the interpretation in one statute cannot be made applicable to another statute.

114. From the above discussion it is clear that copyright subsists in computer programme. It is a literary as also scientific work. The computer programme is also a patent, invention or process. As discussed above that Explanation 2 to section 9(1)(vi) deals with the royalty of two types i.e. industrial royalties which arises on transfer or any rights (including the granting of a licence) in respect of a patent, invention or use of any patent, invention or process. Therefore, if the end-users have made payment for transfer of rights (including the granting of a licence) in respect of copyright, patent, invention, process, literary or scientific work, such payment would be in the nature of royalty. Clause (v) of section 9(1)(vi) deals with transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work. The payment will be in the nature of royalty.

115. The Finance Act, 2007 inserted the following Explanation to section 9 with retrospective effect from 1/06/1976, which reads as under:—

“Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-

section (1), such income shall be included in the total income of the non-resident, whether or not the nonresident has a residence or place of business or business connection in India”.

116. Further by the Finance Act, 2010 with retrospective effect from 1/06/1976 the Explanation inserted by the Finance Act, 2007 has been substituted by the following Explanation:—

“Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not, –

- (i) the non-resident has a residence or place of business or business connection in India; or*
- (ii) the non-resident has rendered service in India”*

117. From plain reading of the Explanation inserted with effect from 1/06/1976 by the Finance Act, 2007 which has been again substituted by the Finance Act, 2010 with retrospective effect from 1/06/1976 it is clear that income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) irrespective of the fact whether the non-resident has a residence or a place of business or business connection in India or the non-resident has rendered services in India. Therefore, once the consideration is received by non-resident for the transfer or all or any rights including the granting of a licence in respect of a patent, invention, model, design, secret formula or process or similar property or any copyright literary, artistic or scientific work, the consideration received shall be deemed to accrue or arise in India and will be taxable in India. In earlier paragraphs we have held that the payments made by end-users are in respect of the grant of licence in copyrights in computer programmes and are in nature of royalty. Hence, by virtue of amendment made by inserting Explanation to section 9(1)(vi) royalty income will be taxable in India. Therefore the contention of assessee that in the absence of any business connection or PE in India the payments received by non-resident assessee cannot be taxed in India, is rejected.

118. Section 90 of the Income-tax Act provides relief from double taxation and reads as under:

“90 (1) The Central Government may enter into an agreement with the Government of any country outside India—

- (a) for the granting of relief in respect of—*
 - (i) income on which have been paid both income-tax under this Act and income-tax in that country; or*

- (ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or]
- (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or
- (d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, 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.

(3) Any term used but not defined in this Act or in the agreement referred to in subsection (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation.— For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.”

119. The four clauses of sub section (1) lay down the scope of power of Central Government to enter into an agreement with another country. Clause (a) contemplates situations where tax has already been paid on the same income in both the countries and that case it empowers the Central Government to grant relief in respect of such double taxation. Clause (b) of section 90 which is wider than clause (a) provides that an agreement may be made for the avoidance of double taxation of income under this act and the corresponding laws enforced in that country. Clause (c) and (d) essentially deal with the agreements made for exchange of information, investigation of cases and recovery of Income-tax. The effect of an agreement made pursuant to the section 90 is that if

no tax liability is imposed under this Act, the question of resorting to agreement would not arise. No provision of the agreement can fasten a tax liability when the liability is not imposed by this Act. If a tax liability is imposed by this Act, the agreement may be resorted to for negating or reducing it. In case of difference between the provisions of the Act and of an agreement under section 90, the provisions of the agreement shall prevail over the provisions of the Act and can be enforced by an appellate authority or the court. However, as provided by sub section (2) the provisions of this Act will apply to assessee in the event they are more beneficial to him. Where there is no specific provision in the agreement, it is the basic law i.e. the Income-tax Act which will govern the taxation of income.

120. Another contention of the Id. AR of the assessee is that Article 12(7) of Indo-US DTAA deals with source rule for taxation of royalty which provides for the situation under which a royalty can be considered as arising in India under Article 2(2). He has further submitted that there is no use of copyright in India by the end-user and the transaction is in the nature of sale of copyrighted article effected by Microsoft Operation in Singapore and, therefore, copyright was not used in India. He further submitted that the Revenue can invoke Article 12(7)(b) of Indo-US DTAA for imposition of tax only if Microsoft Operation, Singapore instead of manufacturing and distributing products in Singapore chooses to do from India, in which case by virtue of expression 'use in India' would get the domain power to tax. But in assessee's case the use of copyright is the right to copy the master copy sub-licensed by the assessee to Microsoft Operations and this right to copy the master copy was exercised. Accordingly, Article 12(7)(b) is not attracted. On the other hand the Id. counsel for the Revenue has submitted that the contention with regard to the sale being in the source country or the business being conducted in the source country may be valid arguments for income under the head 'business or profession'. Therefore, the contention of the assessee is not valid. He further submitted that income from royalty is taxable under provisions of section 9(1) of the Income-tax Act, 1961.

121. We have heard both the parties. Article 12 of Indo-US treaty deals with the assessment of royalties and fee for included services. Relevant provisions of Article 12 relating to royalties are extracted as below:

“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 or 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, trade mark, 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) payments of any kind received as consideration for the use of, or the right to use, any 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 of Article 8.

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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.”

122. The definitions of term “royalty” as appearing in Explanation 2 to section 9(1)(vi) and paragraph 3 of Article 12 of Indo-US DTAA are identical. Paragraph 1 of Article 12 says that royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. However as paragraph 2, such royalties 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 is a

resident of the other Contracting State, the tax so charged shall not exceed the amount specified therein. Rate at which tax is payable is specified in the paragraph 2 of Article 12 of Indo-US DTAA. In the case of assessee we have held that payments made by end users is chargeable to tax as royalty u/s 9(1)(vi) of the Act. As per paragraph 7(a) royalties 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. If the person paying royalty has a permanent establishment or a fixed base there in connection with which the liability to pay the royalties is incurred and the liability is borne by such establishment or base the royalty is deemed to arise in state in which the permanent establishment or fixed base is situated. As per Paragraph 7(b) the royalties relate to the use of, or the right to use, the right or property, in one of the Contracting States, the royalties shall be deemed to arise in that Contracting State. We have already held in paragraph 75 to 82 of our order that a "copyrighted article" is one in which copyright subsists. We have also held that the considerations received by the non-resident assessee are for the use of, or the right to use copyright, patent, invention or process in India and consequently liable to tax in India u/s 9(1)(vi) of income tax Act, 1961. Further, we have also held that per Explanation inserted by the Finance Act, 2010 w.r.e.f. 1.4.1976 the income by way of royalty of a non-resident shall be deemed to accrue or arise in India under clause (vi) irrespective of the fact whether the non-resident has a residence or a place of business or business connection in India. Hon'ble Supreme Court in Commissioner of Income-tax v P.V.A.L. Kulandagan Chettiar (supra) has held that the provisions of agreement cannot fasten a tax liability where the liability is not imposed by a local Act. Where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the provisions of the Act, as is clear from the provisions of section 90(2). Section 90(2) makes it clear that the Act gets modified in regard to the assessee in so far as the agreement is concerned if it falls within the category stated therein. No such case conflict between income tax Act and the treaty has been made out by the ld counsel for the assessee. Therefore, in our considered opinion there is no merit in the arguments of ld counsel for the assessee that copyright was not used in India and therefore, stands rejected.

123. We have in preceding paragraph observed that no case of conflict between the provisions of the Act and the Indo-US treaty was made out by the assessee. For a moment for sake of argument it is presumed that such a difference exists, in that situation under section 90 the provisions of the agreement shall prevail over the provisions of the Act. We would like to deal with such a hypothetical situation. The binding nature of the treaty is not without exceptions. The later domestic tax legislation may over-ride tax treaty provisions whenever there is an

irreconcilable conflict. Sovereign power of the Parliament extends not only to the making but also breaking a treaty. Unilateral cancellation of tax treaty through an amendment to the internal law subsequent to conclusion of the treaty is a recognized sovereign power. If after the agreement has come into force, an Act of Parliament is passed which contains contrary provision, the scope and effect of the legislation cannot be curtailed by the reference to the agreement. The agreement is entered into pursuant to the power conferred upon the Government by section 90. Subsequent legislation cannot be controlled by the agreement. In the instant case Indo-US DTAA was entered on 20/12/1990. By an Amendment to section 9(1) by insertion of Explanation with effect from 1/06/1976 the royalties will deem to accrue or arise in India whether or not the non-resident has a residence or place of business or business connection in India. Therefore, by this amendment the income by way of royalty will deem to accrue or arise irrespective of contrary provision in Indo-US DTAA. Hon'ble Supreme Court in the case of Gramophone Company of India Vs. Virendra B. Pandey AIR 1984 SC 667 held as under:—

“National courts cannot say “Yes” if the Parliament has said no to a principle of international law. National courts will endorse international law but not if it conflicts with national law. National courts being organs of the National State and not organs of International law must perforce apply national law, if international conflicts with it. But the Courts are under an obligation within legitimate limits, to so interpret the Municipal Statute as to avoid confrontation with the comity of Nations or the well established principles of international law. But if the conflict is inevitable, the later must yield.”

Further Explanation to section 9(1), as discussed above, was inserted by the Finance Act, 2007 with retrospective effect 1/06/1976 which has been further substituted by Finance Act, 2010 with the same date i.e. 1/06/1976. The legislature by these amendments has declared that the income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of section 9(1) and shall be included in the total income of a non-resident whether or not the non-resident has residence or place of business or business connection in India or the non-resident has rendered services in India. Hence, once it is found that income by way of royalty has deemed to accrue or arise in India such income shall be included in total income of the non-resident whether or not the non-resident has a residence or place of business or business connection in India.

124. The ld. counsel for the assessee in the course of his arguments has placed reliance on OECD Commentary. He has also submitted that the computer programme has not been specifically mentioned in Indo-US DTAA. He has also submitted that in the treaties entered by the

Government of India between 1996 and 2000 with Turkmenistan, Russia, Morocco, Trinidad and Tobago, Kyrgyz Republic and Malaysia the expression computer software has been specifically incorporated in Article 12(3), which is absent in the case of Indo-US DTAA. He has also mentioned several conventions to which India is also a signatory. In this regard we would like to mention that OECD Commentary contains the views of the authors. The commentary cannot be equated with the decision of the apex court or the law enacted by the Parliament. Therefore, while interpreting the provisions of the Income-tax Act and Indo-US DTAA, reliance cannot be placed on OECD Commentary. Though the developed countries are following OECD model convention, but a large number of them had reservation in following the OECD commentary. Therefore, in all humility we decline to agree with the proposition of the ld. counsel for the assessee to rely on the OECD Commentary, particularly in view of the fact that India has clear reservations on OECD Commentary. We may also like to state here that there was cleavage of opinion amongst the group of technical advisors on the issue as to whether a copyrighted article has copyright in it. The majority view was that it does not have copyright in it and is a product. However, the minority view was that the copy of a computer programme has copyright in it. We would also like to observe that we are not deciding the issues relating to International law in relation to various treaties to which India is a signatory. Whenever, a treaty is signed by India, the Government makes necessary provisions in relevant law and rules. So far as income tax matters are concerned the policy of the Government of India towards taxation of a particular income is incorporated in Double Taxation Avoidance Agreement which becomes part of Income-tax Act by virtue of section 90(2) of the Act. The Double Taxation Avoidance Agreements are negotiations between the two countries and the policy of contracting States with regard to assessment of different incomes is incorporated in the treaties. Therefore, the matter has to be decided as per the provisions of Income-tax Act and the terms and conditions stipulated in Double Taxation Avoidance Agreement. Our view is supported by the decision of Hon'ble Supreme court in the case of P.V.A.L. Kulandagan Chettiar (supra).

125. Now coming to the merits of these cases first we would like to dispose of the appeal filed by Microsoft Corporation for assessment year 1996-97. For the reasons discussed above the payments received by Microsoft Corporation from end users through distributors in respect of sale of computer softwares will be taxable as royalty u/s 9(1)(vi) of the Act.

126. In the case of Gracemac Corporation under Parent- subsidiary agreement Microsoft Corporation granted exclusive rights to M/s. Gracemac Corporation, a wholly owned subsidiary to manufacture and distribute Microsoft products, who in turn granted nonexclusive right to

manufacture and distribute the Microsoft products to Microsoft Operations, another wholly owned subsidiary of Microsoft Corporation. Non-exclusive distribution rights for Asia were further transferred by MO to Microsoft Regional Service Corporation, Singapore, again a wholly owned subsidiary Microsoft Corporation. Normally the end-user licence agreement should have been signed between the Gracemac and the end-users, but since the copyrights in the computer programmes are with Microsoft, the agreement was entered into between Microsoft Corporation and the end user. If such an agreement is not made the Microsoft products on CD or electronic media would have been a dumb CD and would not have fetched any amount. From clause -19 of EULA specifically mentions that “*Microsoft or its suppliers own the title, copyright, and other intellectual property rights in the product*”. When Microsoft Corp. and its supplier own copyrights and other intellectual rights in the products, it is immaterial as to have to sign the EULA. It is also a fact that Microsoft Corp has granted exclusive rights in lieu of all the shares of Gracemac Corporation and no further royalty is being paid by Gracemac for exclusive rights granted to it by Microsoft Corp. The reason is obvious. Whatever will be the resultant profits after meeting the expenses it will belong to Microsoft Corp. being holding company.

127. There is another aspect of matter. Though it has been argued that MRSC has been granted distribution rights by MO vide agreement dated 4.1.1999. However, MO has also granted reproduction rights to MRSC, which is evident from the definition of “Select Product” in Exhibit A to Schedule-B to the Enrollment Agreement extracted as below:

“Select Product” shall mean the licences and CD-ROM's which comprise a Select Software Product. Select Software Product shall mean the MO software as designated from time to time by MO which may be reproduced pursuant to an Enrollment Agreement.”

Further Microsoft Operation vide agreement dated 3.5.1999 replaced article 3.2 of agreement dated 4.1.1999 with the following:

“3.2 Marketing Program Manufacturing and Distribution : MO shall provide Distributor with the master copy (whether through diskettes or other media) for the Marketing Programs and the camera ready or other materials for the packaging and documentation. Such materials shall be provided to Distributor at prices set forth on Schedule A. Distributor shall then have the right to copy the Marketing Program(s) in object code form from the master copy provided by MO onto either diskettes or such other media as MO approves, prepare the product documentation and packaging based on the materials provided and approved by MO provided that all documentation remains complete and accurate, and assemble

the final Marketing Programs. Each product package will include a preapproved diskette label attached to the diskette and MS Corp.'s standard end user license agreement for the Territory. All master copies and other material shall remain the sole property of MS Corp. and Distributor agrees not to make any copies of the master copies except as provided herein. Distributor may subcontract all or any portion of the manufacturing of the Marketing Programs; provided Distributor continues to meet all of its obligations set forth in this Article. Distributor agrees that the Marketing Programs if manufactures will meet the quality standards set by MS Corp. in its written specifications. As a guide, it is the parties' intention that the quality of the Marketing Programs produced by Distributor will be approximately equivalent in quality to the software products manufactured by MS Corp. MO shall provide Distributor with updated master copies if and when MS Corp. updates the Marketing Programs. Distributor agrees to pay a royalty to MO for each Marketing Program and update manufactured and distributed by Distributor pursuant to this Article. The royalty amount and payment method shall be as set forth on Schedule A.

Distributor may purchase Marketing Programs from MS Corp. or any MS Corp. affiliate. Distributor may sell Marketing Programs to distributors, resellers, vendors, end users and any MS Corp. affiliate”

128. From the above it is evident that MRSC was also authorized to reproduce certain products and distribute the same to end users through the distributors appointed by MRSC. MRSC vide agreement dated 3rd May, 1999 was authorized to copy the marketing programmes in object code form from the master copy provided by Microsoft Operations (MO) on to either diskettes or such approved media and prepare the product documentation and packaging based on the material provided and approved by MO. We would like to mention here that source code and object code have copyright. Therefore, MRSC also got right to use copyright in computer products from sub-licencee (MO). Each product package would include a pre-approved diskettes label attached to the diskettes and MS Corp. standard End User Licence Agreement for the territory. From the above it is evident that MRSC is not simply a distributor appointed by Microsoft Operations, but was authorized to reproduce certain computer programmes. The End User Licence Agreement was to be in the standard format of Microsoft Corporation. Article 3.2 also provides that the marketing programme released by the distributor will be approximately equivalent in quality of the software product manufactured by MS Corp. The Microsoft Operation also provided up-dated master copies of marketing

programmes as and when the same were up-dated by MS Corp. Since the Microsoft Corporation has granted the right to reproduce and distribute Microsoft Products in lieu of Shares to Gracemac and no further royalty is payable by Gracemac and also the End User Licence Agreement is to be in the standard format of Microsoft Corporation, the Microsoft Corp. is under obligation to sign EULA on behalf of Gracemac. Thus it has to be logically concluded that Microsoft Corporation has signed the EULA on behalf of Gracemac to whom exclusive rights to manufacture and distribute Microsoft products have been granted otherwise the products would have been rendered useless and no revenue could have been earned by anyone in the supply chain. Microsoft Corporation has devised a scheme under which EULA has to be signed by Microsoft Corp. and not by Gracemac Corporation. Hence assessee cannot be permitted to take a plea that since EULA has been signed between end users and Microsoft Corp. no licence was granted by Gracemac and consequently the royalty payments will not be chargeable to tax in the hands of Gracemac. The agreements entered into between group companies have drafted in such a way which give an impression that Gracemac Corporation has no connection with the granting of licence. The real transaction of the granting of the licence in respect of copyrights in computer programmes have camouflaged by entering into various agreements between Microsoft and Gracemac; Gracemac and Microsoft operations; Microsoft operation and MRSC; and MRSC and Indian distributors but when real intention is gathered from the in-depth reading of the agreements, the matter becomes crystal clear. Since we have held that end users have made payments in respect of the granting of licence in respect of copyright in computer programmes the payments made by end-users as consideration for the same will be taxable in the hands of Gracemac.

129. Another contention raised by the ld. counsel for the assessee before us relates to the assessment by the assessing officer assessing the income from royalty under section 9(1)(vi)(c) of the Act, which is applicable in the case of a non-resident making payment of royalty to another non-resident. Since there was no use of copyright in India the income could not be assessed under section 9(1)(vi)(c) of the Act. In this regard, we would like to observe that the ld. CIT (Appeals) while confirming the stand of the assessing officer has held that income will be assessable under section 9(1)(vi)(b) which is applicable in the case of payment of royalty by a resident to a non-resident. Provisions of section 9(1)(vi)(b) are applicable where royalty is paid by a resident and that of 9(1)(vi)(c) by non-resident in respect of any right, property or information used or services utilized for the purpose of business or profession carried on by such person in India or for the purpose of making or earning any income from any source in India. Section 4 of Income-tax Act is charging section and section 5 defines the scope of total income. Under section 5(2), subject to the provisions of Income-tax

Tax Review 2011

Act, 1961, 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 any 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. In the case before us we have arrived at a conclusion that the payments made by end users for the granting of licence in respect of copyright in computer softwares is in the nature of royalty. The payments have been made by residents and, therefore, the same is assessable to tax under clause (b) of section 9(1)(vi). The assessing officer has assessed the income under clause (c) whereas the Id. CIT (A) has directed the assessing officer to assess under clause (b) of section 9(1)(vi) of the Act. The assessment made by the assessing officer by applying a wrong clause cannot be a basis for deletion of addition. The commissioner of Income tax (appeals) under section 250 has co-terminus power with that of the assessing officer as held by Hon'ble Supreme Court in the case of *CIT vs. Kanpur Coal Syndicate* 53 ITR 225 (SC). The Id. CIT (A) can do what the Income-tax Officer do and can also direct him to do what he has failed to do. The Id. CIT (A) exercising his powers conferred upon him by section 251(1)(a) of the Income-tax Act, has directed the assessing officer to assess the royalty income under section 9(1)(vi)(b) of the Act. Therefore, no irregularity can be found with the order of the Id. CIT (Appeals) bringing the royalty income under section 9(1)(vi)(b) of the Act. Accordingly, this contention of the assessee is dismissed.

130. The Id. counsel for the assessee has relied on the decisions of several Benches including the decision of Special Bench in the case of *Motorola* (supra). In the case of *Motorola* (supra) the issue involved related to case of a cellular operator, who had been denied the right to make copies of the software except for archival back-up purposes whereas in the case of the assessee licence has been granted for the use of software. The assessee has granted the end users the right to make copies not only for archival purposes, but also for installation of the programmes on the hard disc. In the case of *Motorola* (supra) the software was part of hardware and it has no use or value independent of it whereas in the case of assessee the computer programme is licenced with the right of reproduction though for limited use. For the ratio of the decision in the case of *Motorola* that copyrighted article is a product without any copyright in it, the special Bench has relied on US Regulations and OECD commentary. Whereas we have followed the decision of Hon'ble Supreme Court in the case of *P.V.A.L. Kulandagan Chettiar* (supra) wherein it has been held that taxation policy is within the power of the Government and section 90 of the Income-tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income-tax Act, it would be unnecessary to refer to the terms addressed in OECD

commentary or in any of the decisions of foreign jurisdiction or in any other agreements. Moreover in the case of assessee before us Microsoft Corporation has been filing petitions every year before Hon'ble Delhi High Court contending that use of computer programme embedded on CD/ electronic media (copyrighted article) without licence is infringement of copyright and Hon'ble Delhi High court has granted injunction and other remedies to the petitioner. Hence facts of the cases before us are distinguishable with that of the case of Motorola. Similarly, in the decision of *Lotus Development Pte. Ltd.*, the Bench has placed reliance on the decision of TCS Ltd.(supra) and Motorola (supra). As held above, the decision of Hon'ble Supreme Court in the case of TCS Ltd. (supra) is not applicable to the Income-tax proceedings and same is the position with the decision of Special Bench in Motorola, hence reliance on the decision of the ITAT in the case of Lotus Development Pte. Ltd. is of no help to assessee. Similarly, in the case of Samsung Electronics (supra) the ITAT had placed reliance on the decision of TCS Ltd. In the case of Infrasoftware Ltd. (supra) ITAT placed reliance on the decision in the case of Motorola (supra) and in the case of Samsung (supra). Likewise, in the case of Sonata Information Technology (supra) reliance has been placed on decision of Hon'ble Supreme Court in TCS Ltd. (supra) and other decisions. When a decision is held to be inapplicable, the subsequent decisions rendered relying on inapplicable decision will also not be applicable. Similar is the position with reference to the other decisions wherein reliance has been placed on the decision of Motorola Inc. (supra). Since these decisions are distinguishable on facts and law and for the reasons discussed in earlier paragraphs, in our considered opinion, the decisions relied upon by the assessee are of no help.

131. Another contention of the ld. AR of the assessee is that Microsoft Operations and Gracemac are legal façade. Microsoft Operations was incorporated under laws of United States and MRSC under the laws of Singapore and had been issued residency certificates. Once these assessee have been issued tax residency certificates by authorities of respective countries, to consider such entities as fictitious or to say that the companies are legal facade is not justified. Hon'ble Gujarat High Court in the case of Arabian Express 212 ITR 31 has held that when a Sovereign State recognizes the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other Sovereign State including India to recognize the same and it is not open to Revenue to declare these entities as façade without any basis and this finding of ld CIT(A) has to be reversed. We order accordingly.

132. As discussed above, MRSC reproduced certain software products and distributed the same through chain of distributors in India. Therefore, the very appointment of distributors by MRSC in India, had business connection in India and the portion of income

earned by MRSC perhaps could have been chargeable to tax as business income under section 9(1)(i) of the Act. But since the assessing officer as well as the Id. CIT (Appeals) has chosen to assess the entire receipts under the head 'royalty' in the hands of MRSC also, in our considered opinion, MRSC cannot be taxed again on the same income by way of royalty for exploitation of same rights which had been assessed in the hands of Gracemac, otherwise it would result in double taxation. Therefore, we delete the addition in the hands of MRSC for all the three years.

133. The last issue for consideration relates to levy of interest under section 234-A, B and C of the Act. Since the issue is now covered by the decision of Hon'ble Supreme Court in the case of *CIT vs. Anjum MH Ghaswala* (supra) wherein it has been held that charging of interest under sections 234-A, B and C is mandatory in nature, the same has to be charged. We, therefore, upheld the levy of interest under sections 234-A, B and C of the Act.

134. Before parting with the issue we would like to mention that the case was fixed for clarification on the ground that the assessee has filed proceedings under MAP. During the course of hearing it was argued by the Id. AR of the assessee that in MAP proceedings the assessee has not accepted tax liability and therefore, the appeals filed by the assessee before the ITAT can be proceeded with independent of MAP proceedings. Reference was made to the decision of Special Bench in the case of *Motorola* (supra). On the other hand, the Id. counsel for the Revenue, submitted that filing of proceedings before the competent authority under MAP shows that the payments received from end users are assessable as royalties under the Income tax Act.

135. We have heard both the parties and gone through the material available on record. We find that similar issue came up before the ITAT, Special Bench in the case of *Motorola* (supra). In the case of the assessee (*Ericsson*) there was no admission on the part of the assessee that the income was taxable in India. Accordingly it was held that MAP proceedings did not come in the way of disposing of the appeal before the Tribunal. Similar is the case before us. The assessee has not accepted the tax liability in the MAP. Since this issue is covered by the decision of Special Bench in the case of *Motorola* (supra) it is held that filing of petitions under MAP will not come in the way of deciding the issue by the Tribunal. Accordingly, we have proceeded to decide the appeals on merits.

136. In the result, the appeals filed by Microsoft Corporation and Gracemac are dismissed and the appeals filed by MRSC are allowed.

The order pronounced in the open court on : **26th October, 2010.**

2011 PTR 1933 (S.C. Ind.)

SUPREME COURT OF INDIA

B. Sudershan Reddy and Surinder Singh Nijjar, JJ

Ram Jethmalani & Ors.

v.

Union of India & Ors.

FACTS/HELD

1. **DTAA Does Not Protect Tax Evaders. SIT Formed To Probe Black Money**
2. Pursuant to a Writ Petition alleging inaction by the Government on the unearthing of unaccounted money, the Supreme Court set up a High Level Committee to act as a Special Investigation Team to supervise the investigation by the Government into black money. In the course of the ruling, the Court considered the impact of the **Double taxation Avoidance Agreements**, the **Vienna Convention** and the judgement in **UOI vs. Azadi Bachao Andolan** 263 ITR 706 (SC). The Court **strongly disapproved** of the stand taken by the Government ([click here](#)) that the names of the tax evaders was a “**secret**” and could not be revealed under the India-Germany DTAA. It HELD:
3. “We have perused the said agreement with Germany. **We are convinced that the said agreement, by itself, does not proscribe the disclosure of the relevant documents and details of the same, including the names of various bank account holders in Liechtenstein.** In the first instance, we note that the names of the individuals are with respect to bank accounts in the Liechtenstein, which though populated by largely German speaking people, is an independent and sovereign nationstate. The agreement between Germany and India is with regard to various issues that crop up with respect to German and Indian citizens’ liability to pay taxes to Germany and/or India. It does not even remotely touch upon information regarding Indian citizens’ bank accounts in Liechtenstein that Germany secures and shares that have no

bearing upon the matters that are covered by the double taxation agreement between the two countries. In fact, the “information” that is referred to in Article 26 is that which is “necessary for carrying out the purposes of this agreement”, i.e. the Indo-German DTAA. Therefore, the information sought does not fall within the ambit of this provision. **It is disingenuous for the Union of India, under these circumstances, to repeatedly claim that it is unable to reveal the documents and names as sought by the Petitioners on the ground that the same is proscribed by the said agreement.** It does not matter that Germany itself may have asked India to treat the information shared as being subject to the confidentiality and secrecy clause of the double taxation agreement. It is for the Union of India, and the courts, in appropriate proceedings, to determine whether such information concerns matters that are covered by the double taxation agreement or not. In any event, we also proceed to examine the provisions of the double taxation agreement below, to also examine whether they proscribe the disclosure of such names, and other documents and information, even in the context of these instant proceedings”.

Order accordingly.

Writ Petition (Civil) No(s). 176 of 2009 with SLP(C) No. 11032 of 2009 (PH) (with prayer for interim relief) with W.P(C) NO. 37 of 2010 (PH) with W.P.(C) No. 136 of 2011 (with office report).

Decided on: 4th July, 2011.

Present at hearing: Anil Divan, Sr. Advocate, Lata Krishnamurthi, R.N. Karanjawala, Manik Karanjawala, Sandeep Kapur, Ranvir Singh, Ravi Sharma, Pranav Diesh, Karan Kalia, Arjun Mahajan, Advocates for M/s. Karanjawala & Co., Advocates, Rajindra Sachchar, Sr. Advocate, Gaurav Jain, and Abha Jain, Advocates for the appearing parties. Krishnan Venugopal, Sr. Advocate, Anuradha Mutatkar, Anagha S. Desai, Shyamohan, and Meenakshi Arora, Advocates for Intervenor K.V.M. PAI. Gopal Subramaniam, SG, H.P. Raval, ASG, Devansh Mohta, T.A. Khan, Arijit Prasad, Kunal Bahri, B.V. Balaram Das, B. Krishna Prasad, Advocates, Mukul Rohatgi, Sr. Advocate and Rajiv Nanda, Advocate for UOI. Pratap Venugopal, Surekha Raman, Dileep Poolakkit, Namrata Sood, and Anuj Sarma, Advocates for M/s. K.J. John & Co., Advocates, Kuldeep S. Parihar, H.S. Parihar, Sanjay Kharde, and Asha Gopalan Nair, Advocates, P.P.

Malhotra, ASG, J.S. Attri, Sr. Advocate, Sadhana Sandhu, Anil Katiyar, and Samir Ali Khan, Advocates, Rajiv Mohiti, and I.P. Bagadia, Sr. Advocates, Santosh Paul, B.V. Reddy, Arvind Gupta, Arti Singh, Mohita Bagati, and Ashok Kumar Gupta-I, Advocates for RR-3 (SEBI).

ORDER

B. Sudershan Reddy, J:-

I

“Follow the money” was the short and simple advice given by the secret informant, within the American Government, to Bob Woodward, the journalist from Washington Post, in aid of his investigations of the Watergate Hotel break in. Money has often been claimed, by economists, to only be a veil that covers the real value and the economy. As a medium of exchange, money is vital for the smooth functioning of exchange in the market place. However, increasing monetization of most social transactions has been viewed as potentially problematic for the social order, in as much as it signifies a move to evaluating value, and ethical desirability, of most areas of social interaction only in terms of price obtained in the market place.

2. Price based notions of value and values, as propounded by some extreme neo-liberal doctrines, implies that the values that ought to be promoted, in societies, are the ones for which people are willing to pay a price for. Values, and social actions, for which an effective demand is not expressed in the market, are neglected, even if lip service is paid to their essentiality. However, it cannot be denied that not everything that can be, and is transacted, in the market for a price is necessarily good, and enhances social welfare. Moreover, some activities, even if costly and without being directly measurable in terms of exchange value, are to be rightly viewed as essential. It is a well established proposition, of political economy, and of statecraft, that the State has a necessary interest in determining, and influencing, the kinds of transactions, and social actions, that occur within a legal order. From prevention of certain kinds of harmful activities, that may range from outright crimes, to regulating or controlling, and consequently mitigating, socially harmful modes of social and economic production, to promotion of activities that are deemed to be of higher priority, than other activities which may have a lower priority, howsoever evaluated in terms of social utility, are all the responsibilities of the State. Whether such activities by the State result in directly measurable benefits or not is often not the most important factor in determining their desirability; their absence, or their substantial evisceration, are to be viewed as socially destructive.

3. The scrutiny, and control, of activities, whether in the economic, social or political contexts, by the State, in the public interest as posited by modern constitutionalism, is substantially effectuated by the State

“following the money.” In modern societies very little gets accomplished without transfer of money. The incidence of crime, petty and grand, like any other social phenomena is often linked to transfers of monies, small or large. Money, in that sense, can both power, and also reward, crime. As noted by many scholars, with increasing globalization, an ideological and social construct, in which transactions across borders are accomplished with little or no control over the quantum, and mode of transfers of money in exchange for various services and value rendered, both legal and illegal, nation-states also have begun to confront complex problems of cross-border crimes of all kinds. Whether this complex web of flows of funds, instantaneously, and in large sums is good or bad, from the perspective of lawful and desired transactions is not at issue in the context of the matters before this Court.

4. The worries of this Court that arise, in the context of the matters placed before us, are with respect to transfers of monies, and accumulation of monies, which are unaccounted for by many individuals and other legal entities in the country, in foreign banks. The worries of this Court relate not merely to the quantum of monies said to have been secreted away in foreign banks, but also the manner in which they may have been taken away from the country, and with the nature of activities that may have engendered the accumulation of such monies. The worries of this Court are also with regard to the nature of activities that such monies may engender, both in terms of the concentration of economic power, and also the fact that such monies may be transferred to groups and individuals who may use them for unlawful activities that are extremely dangerous to the nation, including actions against the State. The worries of this Court also relate to whether the activities of engendering such unaccounted monies, transferring them abroad, and the routing them back to India may not actually be creating a culture that extols the virtue of such cycles, and the activities that engender such cycles are viewed as desirable modes of individual and group action. The worries of this court also relate to the manner, and the extent to which such cycles are damaging to both national and international attempts to combat the extent, nature and intensity of cross-border criminal activity. Finally, the worries of this Court are also with respect to the extent of incapacities, system wide, in terms of institutional resources, skills, and knowledge, as well as about incapacities of ethical nature, in keeping an account of the monies generated by various facets of social action in the country, and thereby developing effective mechanisms of control. These incapacities go to the very heart of constitutional imperatives of governance. Whether such incapacities are on account of not having devoted enough resources towards building such capacities, or on account of a broader culture of venality in the wider spheres of social and political action, they run afoul of constitutional imperatives.

5. Large amounts of unaccounted monies, stashed away in banks located in jurisdictions that thrive on strong privacy laws protecting bearers of those accounts to avoid scrutiny, raise each and every worry delineated above. First and foremost, such large monies stashed abroad, and unaccounted for by individuals and entities of a country, would suggest the necessity of suspecting that they have been generated in activities that have been deemed to be unlawful. In addition, such large amounts of unaccounted monies would also lead to a natural suspicion that they have been transferred out of the country in order to evade payment of taxes, thereby depleting the capacity of the nation to undertake many tasks that are in public interest.

6. Many schools of thought exist with regard to the primary functions of the State, and the normative expectations of what the role of the State ought to be. The questions regarding which of those schools provide the absolutely correct view cannot be the criteria to choose or reject any specific school of thought as an aid in constitutional adjudication. Charged with the responsibility of having to make decisions in the present, within the constraints of epistemic frailties of human knowledge, constitutional adjudicators willy-nilly are compelled to choose those that seem to provide a reasoned basis for framing of questions relevant, both with respect to law, and to facts. Institutional economics gives one such perspective which may be a useful guide for us here. Viewed from a functional perspective, the State, and governments, may be seen as coming into existence in order to solve, what institutional economists have come to refer to as, the coordination problems in providing public goods, and prevent the disutility that emerges from the moral hazard of a short run utility maximizer, who may desire the benefits of goods and services that are to be provided in common to the public, and yet have the interest of not paying for their production.

7. Security of the nation, infrastructure of governance, including those that relate to law making and law keeping functions, crime prevention, detection and punishment, coordination of the economy, and ensuring minimal levels of material, and cultural goods for those who may not be in a position to fend for themselves or who have been left by the wayside by the operation of the economy and society, may all be cited as some examples of the kinds of public goods that the State is expected to provide for, or enable the provision of. In as much as the market is primarily expected to cater to purely self centered activities of individuals and groups, markets and the domain of purely private social action significantly fail to provide such goods. Consequently, the State, and government, emerges to rectify the coordination problem, and provide the public goods.

8. Unaccounted monies, especially large sums held by nationals and entities with a legal presence in the nation, in banks abroad, especially in tax havens or in jurisdictions with a known history of silence about

sources of monies, clearly indicate a compromise of the ability of the State to manage its affairs in consonance with what is required from a constitutional perspective. This is so in two respects. The quantum of such monies by itself, along with the numbers of individuals or other legal entities who hold such monies, may indicate in the first instance that a large volume of activities, in the social and the economic spheres within the country are unlawful and causing great social damage, both at the individual and the collective levels. Secondly, large quanta of monies stashed abroad, would also indicate a substantial weakness in the capacity of the State in collection of taxes on incomes generated by individuals and other legal entities within the country. The generation of such revenues is essential for the State to undertake the various public goods and services that it is constitutionally mandated, and normatively expected by its citizenry, to provide. A substantial degree of incapacity, in the above respect, would be an indicia of the degree of failure of the State; and beyond a particular point, the State may spin into a vicious cycle of declining moral authority, thereby causing the incidence of unlawful activities in which wealth is sought to be generated, as well as instances of tax evasion, to increase in volume and in intensity.

9. Consequently, the issue of unaccounted monies held by nationals, and other legal entities, in foreign banks, is of primordial importance to the welfare of the citizens. The quantum of such monies may be rough indicators of the weakness of the State, in terms of both crime prevention, and also of tax collection. Depending on the volume of such monies, and the number of incidents through which such monies are generated and secreted away, it may very well reveal the degree of “softness of the State.”

10. The concept of a “soft state” was famously articulated by the Nobel Laureate, Gunnar Myrdal. It is a broad based assessment of the degree to which the State, and its machinery, is equipped to deal with its responsibilities of governance. The more soft the State is, greater the likelihood that there is an unholy nexus between the law maker, the law keeper, and the law breaker.

11. When a catchall word like “crimes” is used, it is common for people, and the popular culture to assume that it is “petty crime,” or crimes of passion committed by individuals. That would be a gross mischaracterization of the seriousness of the issues involved. Far more dangerous are the crimes that threaten national security, and national interest. For instance, with globalization, nation states are also confronted by the dark worlds of international arms dealers, drug peddlers, and various kinds of criminal networks, including networks of terror. International criminal networks that extend support to home-grown terror or extremist groups, or those that have been nurtured and sustained in hostile countries, depend on networks of formal and informal, lawful and unlawful mechanisms of transfer of monies across

boundaries of nationstates. They work in the interstices of the microstructures of financial transfers across the globe, and thrive in the lacunae, the gaps in law and of effort. The loosening of control over those mechanisms of transfers, guided by an extreme neoliberal thirst to create a global market that is free of the friction of law and its enforcement, by nation-states, may have also contributed to an increase in the volume, extent and intensity of activities by criminal and terror networks across the globe.

12. Increasingly, on account of “greed is good” culture that has been promoted by neo-liberal ideologues, many countries face the situation where the model of capitalism that the State is compelled to institute, and the markets it spawns, is predatory in nature. From mining mafias to political operators who, all too willingly, bend policies of the State to suit particular individuals or groups in the social and economic sphere, the *raison d’être* for weakening the capacities and intent to enforce the laws is the lure of the lucre. Even as the State provides violent support to those who benefit from such predatory capitalism, often violating the human rights of its citizens, particularly its poor, the market begins to function like a bureaucratic machine dominated by big business; and the State begins to function like the market, where everything is available for sale at a price.

13. The paradigm of governance that has emerged, over the past three decades, prioritizes the market, and its natural course, over any degree of control of it by the State. The role for the State is visualized by votaries of the neo-liberal paradigm as that of a night watchman; and moreover it is also expected to take its hands out of the till of the wealth generating machinery. Based on the theories of Arthur Laffer, and pushed by the Washington Consensus, the prevailing wisdom of the elite, and of the policy makers, is that reduction of tax rates, thereby making tax regimes regressive, would incentivise the supposed genius of entrepreneurial souls of individuals, actuated by pursuit of self-interest and desire to accumulate great economic power. It was expected that this would enable the generation of more wealth, at a more rapid pace, thereby enabling the State to generate appropriate tax revenues even with lowered tax rates. Further, benefits were also expected in moral terms – that the lowering of tax rates would reduce the incentives of wealth generators to hide their monies, thereby saving them from the guilt of tax evasion. Whether that is an appropriate model of social organization or not, and from the perspective of constitutional adjudication, whether it meets the requirements of constitutionalism as embedded in the texts of various constitutions, is not a question that we want to enter in this matter.

14. Nevertheless, it would be necessary to note that there is a fly in the ointment of the above story of friction free markets that would always clear, and always work to the benefit of the society. The strength of tax

collection machinery can, and ought to be, expected to have a direct bearing on the revenues collected by the State. If the machinery is weak, understaffed, ideologically motivated to look the other way, or the agents motivated by not so salubrious motives, the amount of revenue collected by the State would decline, stagnate, or may not generate the revenue for the State that is consonant with its responsibilities. From within the neo-liberal paradigm, also emerged the under-girding current of thought that revenues for the State implies a big government, and hence a strong tax collecting machinery itself would be undesirable. Where the elite lose out in democratic politics of achieving ever decreasing tax rates, it would appear that state machineries in the hands of the executive, all too willing to promote the extreme versions of the neo-liberal paradigm and co-opt itself in the enterprises of the elite, may also become all too willing to not develop substantial capacities to monitor and follow the money, collect the lawfully mandated taxes, and even look the other way. The results, as may be expected, have been disastrous across many nations.

15. In addition, it would also appear that in this miasmatic cultural environment in which greed is extolled, conspicuous consumption viewed as both necessary and socially valuable, and the wealthy viewed as demi-gods, the agents of the State may have also succumbed to the notions of the neoliberal paradigm that the role of the State ought to only be an enabling one, and not exercise significant control. This attitude would have a significant impact on exercise of discretion, especially in the context of regulating economic activities, including keeping an account of the monies generated in various activities, both legal and illegal. Carried away by the ideology of neoliberalism, it is entirely possible that the agents of the State entrusted with the task of supervising the economic and social activities may err more on the side of extreme caution, whereby signals of wrong doing may be ignored even when they are strong. Instances of the powers that be ignoring publicly visible stock market scams, or turning a blind eye to large scale illegal mining have become all too familiar, and may be readily cited. That such activities are allowed to continue to occur, with weak, or non-existent, responses from the State may, at best, be charitably ascribed to this broader culture of permissibility of all manner of private activities in search of ever more lucre. Ethical compromises, by the elite – those who wield the powers of the state, and those who fatten themselves in an ever more exploitative economic sphere- can be expected to thrive in an environment marked by such a permissive attitude, of weakened laws, and of weakened law enforcement machineries and attitudes.

16. To the above, we must also add the fragmentation of administration. Even as the range of economic, and social activities have expanded, and their sophistication increased by leaps and bounds, the response in terms of administration by the State has been to create ever more specialized agencies, and departments. To some degree this has

been unavoidable. Nevertheless, it would also appear that there is a need to build internal capacities to share information across such departments, lessen the informational asymmetries between, and friction to flow of information across the boundaries of departments and agencies, and reduce the levels of consequent problems in achieving coordination. Life, and social action within which human life becomes possible, do not proceed on the basis of specialized fiefdoms of expertise. They cut across the boundaries erected as a consequence of an inherent tendency of experts to specialize. The result, often, is a system wide blindness, while yet being lured by the dazzle of ever greater specialization. Many dots of information, now collected in ever increasing volume by development of sophisticated information technologies, get ignored on account of lack of coordination across agencies, and departments, and tendency within bureaucracy to jealously guard their own turfs. In some instances, the failure to properly investigate, or to prevent, unlawful activities could be the result of such over-specialization, frictions in sharing of information, and coordination across departmental and specialized agency boundaries.

17. If the State is soft to a large extent, especially in terms of the unholy nexus between the law makers, the law keepers, and the law breakers, the moral authority, and also the moral incentives, to exercise suitable control over the economy and the society would vanish. Large unaccounted monies are generally an indication of that. In a recent book, Prof. Rotberg states, after evaluating many failed and collapsed states over the past few decades:

“Failed states offer unparalleled economic opportunity – but only for a privileged few. Those around the ruler or ruling oligarchy grow richer while their less fortunate brethren starve. Immense profits are available from an awareness of regulatory advantages and currency speculation and arbitrage. But the privilege of making real money when everything else is deteriorating is confined to clients of the ruling elite.... The nation-state’s responsibility to maximize the well-being and prosperity of all its citizens is conspicuously absent, if it ever existed.... Corruption flourishes in many states, but in failed states it often does so on an unusually destructive scale. There is widespread petty or lubricating corruption as a matter of course, but escalating levels of venal corruption mark failed states.”¹

18. India finds itself in a peculiar situation. Often celebrated, in popular culture, as an emerging economy that is rapidly growing, and expected to be a future economic and political giant on the global stage, it is also popularly perceived, and apparently even in some responsible and scholarly circles, and official quarters, that some of its nationals and

¹ “The Failure and Collapse of Nation-States – Breakdown, Prevention and Repair” in “WHEN STATES FAIL: CAUSES AND CONSEQUENCES”, Rotberg, Robert I., Ed. Princeton University Press (2004).
Tax Review 2011

other legal entities have stashed the largest quantum of unaccounted monies in foreign banks, especially in tax havens, and in other jurisdictions with strong laws of secrecy. There are also apparently reports, and analyses, generated by Government of India itself, which place the amounts of such unaccounted monies at astronomical levels.

19. We do not wish to engage in any speculation as to what such analyses, reports, and factuality imply with respect to the state of the nation. The citizens of our country can make, and ought to be making, rational assessments of the situation. We fervently hope that it leads to responsible, reasoned and reasonable debate, thereby exerting the appropriate democratic pressure on the State, and its agents, within the constitutional framework, to bring about the necessary changes without sacrificing cherished, and inherently invaluable social goals and values enshrined in the Constitution. The failures are discernible when viewed against the vision of the constitutional project, and as forewarned by Dr. Ambedkar, have been on account of the fact that man has been vile, and not the defects of a Constitution forged in the fires of wisdom gathered over eons of human experience. If the politico-bureaucratic, power wielding, and business classes bear a large part of the blame, at least some part of blame ought to be apportioned to those portions of the citizenry that is well informed, or is expected to be informed. Much of that citizenry has disengaged itself with the political process, and with the masses. Informed by contempt for the poor and the downtrodden, the elite classes that have benefited the most, or expects to benefit substantially from the neo-liberal policies that would wish away the hordes, has also chosen to forget that constitutional mandate is as much the responsibility of the citizenry, and through their constant vigilance, of all the organs of the state, and national institutions including political parties. To not be engaged in the process, is to ensure the evisceration of constitutional content. Knee jerk reactions, and ill advised tinkering with the constitutional framework are not the solutions. The road is always long, and needs the constant march of the citizenry on it. There is no other way. To expect instant solutions, because this law or that body is formed, without striving to solve system wide, and systemic, problems that have emerged is to not understand the demands of a responsible citizenry in modern constitutional republican democracies.

20. These matters before us relate to issues of large sums of unaccounted monies, allegedly held by certain named individuals, and loose associations of them; consequently we have to express our serious concerns from a constitutional perspective. The amount of unaccounted monies, as alleged by the Government of India itself is massive. The show cause notices were issued a substantial length of time ago. The named individuals were very much present in the country. Yet, for unknown, and possibly unknowable, though easily surmisable, reasons the investigations into the matter proceeded at a laggardly pace. Even the

named individuals had not yet been questioned with any degree of seriousness. These are serious lapses, especially when viewed from the perspective of larger issues of security, both internal and external, of the country.

21. It is in light of the above, that we heard some significant elements of the instant writ petitions filed in this Court, and at this stage it is necessary that appropriate orders be issued. There are two issues we deal with below: (i) the appointment of a Special Investigation Team; and (ii) disclosure, to the Petitioners, of certain documents relied upon by the Union of India in its response.

II

22. The instant writ petition was filed, in 2009, by Shri. Ram Jethmalani, Shri. Gopal Sharman, Smt. Jalbala Vaidya, Shri. K.P.S. Gill, Prof. B.B. Dutta, and Shri. Subhash Kashyap, all well known professionals, social activists, former bureaucrats or those who have held responsible positions in the society. They have also formed an organization called Citizen India, the stated objective of which is said to be to bring about changes and betterment in the quality of governance, and functioning of all public institutions.

23. The Petitioners state that there have been a slew of reports, in the media, and also in scholarly publications that various individuals, mostly citizens, but may also include noncitizens, and other entities with presence in India, have generated, and secreted away large sums of monies, through their activities in India or relating to India, in various foreign banks, especially in tax havens, and jurisdictions that have strong secrecy laws with respect to the contents of bank accounts and the identities of individuals holding such accounts. The Petitioners allege that most of such monies are unaccounted, and in all probability have been generated through unlawful activities, whether in India or outside India, but relating to India. Further, the Petitioners also allege that a large part of such monies may have been generated within India, and have been taken away from India, breaking various laws, including but not limited to evasion of taxes.

24. The Petitioners contend: (i) that the sheer volume of such monies points to grave weaknesses in the governance of the nation, because they indicate a significant lack of control over unlawful activities through which such monies are generated, evasion of taxes, and use of unlawful means of transfer of funds; (ii) that these funds are then laundered and brought back into India, to be used in both legal and illegal activities; (iii) that the use of various unlawful modes of transfer of funds across borders, gives support to such unlawful networks of international finance; and (iv) that in as much as such unlawful networks are widely acknowledged to also effectuate transfer of funds across borders in aid of various crimes committed against persons and the State, including but

not limited to activities that may be classifiable as terrorist, extremist, or unlawful narcotic trade, the prevailing situation also has very serious connotations for the security and integrity of India.

25. The Petitioners also further contend that a significant part of such large unaccounted monies include the monies of powerful persons in India, including leaders of many political parties. It was also contended that the Government of India, and its agencies, have been very lax in terms of keeping an eye on the various unlawful activities generating unaccounted monies, the consequent tax evasion; and that such laxity extends to efforts to curtail the flow of such funds out, and into, India. Further, the Petitioners also contend that the efforts to prosecute the individuals, and other entities, who have secreted such monies in foreign banks, have been weak or non-existent. It was strongly argued that the efforts at identification of such monies in various bank accounts in many jurisdictions across the globe, attempts to bring back such monies, and efforts to strengthen the governance framework to prevent further outflows of such funds, have been sorely lacking.

26. The Petitioners also made allegations about certain specific incidents and patterns of dereliction of duty, wherein the Government of India, and its various agencies, even though in possession of specific knowledge about the monies in certain bank accounts, and having estimated that such monies run into many scores of thousands of crores, and upon issuance of show cause notices to the said individual, surprisingly have not proceeded to initiate, and carry out suitable investigations, and prosecute the individuals. The individual specifically named is one Hassan Ali Khan. The Petitioners also contended that Kashinath Tapuria, and his wife Chandrika Tapuria, are also party to the illegal activities of Hassan Ali Khan.

27. Specifically, it was alleged that Hassan Ali Khan was served with an income tax demand for Rs. 40,000.00 Crores (Rupees Forty Thousand Crores), and that the Tapurias were served an income tax demand notice of Rs. 20,580.00 Crores (Rupees Twenty Thousand and Five Hundred and Eighty Crores). The Enforcement Directorate, in 2007, disclosed that Hassan Ali Khan had "dealings amounting to 1.6 billion US dollars" in the period 2001-2005. In January 2007, upon raiding Hassan Ali's residence in Pune, certain documents and evidence had been discovered regarding deposits of 8.04 billion dollars with UBS bank in Zurich. It is the contention of the Petitioners that, even though such evidence was secured nearly four and half years ago, (i) a proper investigation had not been launched to obtain the right facts from abroad; (ii) the individuals concerned, though present in India, and subject to its jurisdiction, and easily available for its exercise, had not even been interrogated appropriately; (iii) that the Union of India, and its various departments, had even been refusing to divulge the details and information that would reveal the actual status of the investigation,

whether in fact it was being conducted at all, or with any degree of seriousness; (iv) given the magnitude of amounts in question, especially of the demand notice of income tax, the laxity of investigation indicates multiple problems of serious non-governance, and weaknesses in the system, including pressure from political quarters to hinder, or scuttle, the investigation, prosecution, and ultimately securing the return of such monies; and (v) given the broadly accepted fact that within the political class corruption is rampant, illbegotten wealth has begun to be amassed in massive quantities by many members in that class, it may be reasonable to suspect, or even conclude, that investigation was being deliberately hindered because Hassan Ali Khan, and the Tapurias, had or were continuing to handle the monies of such a class. The fact that both Income Tax department, and the Enforcement Directorate routinely, and with alacrity, seek the powers for long stretches of custodial interrogation of even those suspected of having engaged in money laundering, or evaded taxes, with respect to very small amounts, ought to raise the reasonable suspicion that inaction in the matters concerning Hassan Ali Khan, and Tapurias, was deliberately engineered, for nefarious reasons.

28. In addition, the Petitioners also state that in as much as the bank in which the monies had been stashed by Hassan Ali Khan was UBS Zurich, the needle of suspicion has to inexorably turn to high level political interference and hindrance to the investigations. The said bank, it was submitted, is the biggest or one of the biggest wealth management companies in the world. The Petitioners also narrated the mode, and the manner, in which the United States had dealt with UBS, with respect to monies of American citizens secreted away with the said bank. It was also alleged that UBS had not cooperated with the U.S. authorities. Contrasting the relative alacrity, and vigour, with which the United States government had pursued the matters, the Petitioners contend the inaction of Union of India is shocking.

29. The Petitioners further allege that in 2007, the Reserve Bank of India had obtained some “knowledge of the dubious character” of UBS Security India Private Limited, a branch of UBS, and consequently stopped this bank from extending its business in India by refusing to approve its takeover of Standard Chartered Mutual Funds business in India. It was also claimed by the Petitioners that the SEBI had alleged that UBS played a role in the stock market crash of 2004. The said UBS Bank has apparently applied for a retail banking license in India, which was approved in principle by RBI initially. In 2008, this license was withheld on the ground that “investigation of its unsavoury role in the Hassan Ali Khan case was pending investigation in the Enforcement Directorate.” However, it seems that the RBI reversed its decision in 2009, and no good reasons seem to be forthcoming for the reversal of the decision of 2008.

30. The Petitioners contend that such a reversal of decision could only have been accomplished through high level intervention, and that it is further evidence of linkages between members of the political class, and possibly even members of the bureaucracy, and such banking operations, and the illegal activities of Hassan Ali Khan and the Tapurias. Hence, the Petitioners argued, in the circumstances it would have to be necessarily concluded that the investigations into the affairs of Hassan Ali Khan, and the Tapurias, would be severely compromised if the Court does not intervene, and monitor the investigative processes by appointing a special investigation team reporting directly to the Court.

31. The learned senior counsel for the Petitioners sought that this Court intervene, order proper investigations, and monitor continuously, the actions of the Union of India, and any and all governmental departments and agencies, in these matters. It was submitted that their filing of this Writ Petition under Article 32 is proper, as the inaction of the Union of India, as described above, violates the fundamental rights – to proper governance, in as much as Article 14 provides for equality before the law and equal protection of the law, and Article 21 promises dignity of life to all citizens.

32. We have heard the learned senior counsel for the Petitioners, Shri. Anil B. Divan, the learned senior counsel for interveners, Shri. K.K. Venugopal, and the learned senior counsel for the petitioners in the connected Writ Petition, Shri. Shanti Bhushan. We have also heard the learned Solicitor General, Shri. Gopal Subramaniam, on behalf of the respondents.

33. Shri. Divan, specifically argued that, having regard to the nature of the investigation, its slow pace so far, and the non-seriousness on the part of the respondents, there is a need to constitute a Special Investigation Team (“SIT”) headed by a former judge or two of this court. However, this particular plea has been vociferously resisted by the Solicitor General. Relying on the status reports submitted from time to time, the learned Solicitor General stated that all possible steps were being taken to bring back the monies stashed in foreign banks, and that the investigations in cases registered were proceeding in an appropriate manner. He expressed his willingness for a Court monitored investigation. He also further submitted that the Respondents, in principle, have no objections whatsoever against the main submissions of the Petitioners.

34. The real point of controversy is, given above, as to whether there is a need to constitute a SIT to be headed by a judge or two, of this court, to supervise the investigation.

35. We must express our serious reservations about the responses of the Union of India. In the first instance, during the earlier phases of hearing before us, the attempts were clearly evasive, confused, or

originating in the denial mode. It was only upon being repeatedly pressed by us did the Union of India begin to admit that indeed the investigation was proceeding very slowly. It also became clear to us that in fact the investigation had completely stalled, in as much as custodial interrogation of Hassan Ali Khan had not even been sought for, even though he was very much resident in India. Further, it also now appears that even though his passport had been impounded, he was able to secure another passport from the RPO in Patna, possibly with the help or aid of a politician.

36. During the course of the hearings the Union of India repeatedly insisted that the matter involves many jurisdictions, across the globe, and a proper investigation could be accomplished only through the concerted efforts by different law enforcement agencies, both within the Central Government, and also various State governments. However, the absence of any satisfactory explanation of the slowness of the pace of investigation, and lack of any credible answers as to why the respondents did not act with respect to those actions that were feasible, and within the ambit of powers of the Enforcement Directorate itself, such as custodial investigation, leads us to conclude that the lack of seriousness in the efforts of the respondents are contrary to the requirements of laws and constitutional obligations of the Union of India. It was only upon the insistence and intervention of this Court has the Enforcement Directorate initiated and secured custodial interrogation over Hassan Ali Khan. The Union of India has explicitly acknowledged that there was much to be desired with the manner in which the investigation had proceeded prior to the intervention of this court. From the more recent reports, it would appear that the Union of India, on account of its more recent efforts to conduct the investigation with seriousness, on account of the gravitas brought by this Court, has led to the securing of additional information, and leads, which could aid in further investigation. For instance, during the continuing interrogation of Hassan Ali Khan and the Tapurias, undertaken for the first time at the behest of this Court, many names of important persons, including leaders of some corporate giants, politically powerful people, and international arms dealers have cropped up. So far, no significant attempt has been made to investigate and verify the same. This is a further cause for the grave concerns of this Court, and points to the need for continued, effective and day to day monitoring by a SIT constituted by this Court, and acting on behalf, behest and direction of this Court.

37. In light of the fact that the issues are complex, requiring expertise and knowledge of different departments, and the necessity of coordination of efforts across various agencies and departments, it was submitted to us that the Union of India has recently formed a High Level Committee, under the aegis of the Department of Revenue in the Ministry of Finance, which is the nodal agency responsible for all

economic offences. The composition of the High Level Committee (“HLC”) is said to be as follows: (i) Secretary, Department of Revenue, as the Chairman; (ii) Deputy Governor, Reserve Bank of India; (iii) Director (IB); (iv) Director, Enforcement; (v) Director, CBI; (vi) Chairman, CBDT; (vii) DG, Narcotics Control Bureau; (viii) DG, Revenue Intelligence; (ix) Director, Financial Intelligence Unit; and (x) JS (FT & TR-I), CBDT. It was also submitted that the HLC may co-opt, as necessary, representation not below the rank of Joint Secretary from the Home Secretary, Foreign Secretary, Defense Secretary and the Secretary, Cabinet Secretariat. The Union of India claims that such a multi-disciplinary group and committee would now enable the conducting of an efficient and a systematic investigation into the matters concerning allegations against Hassan Ali Khan and the Tapurias; and further that such a committee would also enable the taking of appropriate steps to bring back the monies stashed in foreign banks, for which purposes a need may arise to register further cases. The Union of India also claims that the formation of such a committee indicates the seriousness with which it is viewing the entire matter.

38. While it would appear, from the Status Reports submitted to this Court, that the Enforcement Directorate has moved in some small measure, the actual facts are not comforting to an appropriate extent. In fact we are not convinced that the situation has changed to the extent that it ought to so as to accept that the investigation would now be conducted with the degree of seriousness that is warranted. According to the Union of India the HLC was formed in order to take charge of and direct the entire investigation, and subsequently, the prosecution. In the meanwhile a charge sheet has been filed against Hassan Ali Khan. Upon inquiry by us as to whether the charge-sheet had been vetted by the HLC, and its inputs secured, the counsel for Union of India were flummoxed. The fact was that the charge-sheet had not been given even for the perusal of the HLC, let alone securing its inputs, guidance and direction. We are not satisfied by the explanation offered by the Directorate of Enforcement by way of affidavit after the orders were reserved. Be it noted that a nodal agency was set up, pursuant to directions of this Court in Vineet Narain case given many years ago. Yet the same was not involved and these matters were never placed before it. Why? 39. From the status reports, it is clear that the problem is extremely complex, and many agencies and departments spread across the country have not responded with the alacrity, and urgency, that one would desire. Moreover, the Union of India has been unable to answer any of the questions regarding its past actions, and their implications, such as the slowness of the investigation, or about grant of license to conduct retail banking by UBS, by reversing the decision taken earlier to withhold such a license on the grounds that the said bank’s credentials were suspect. To this latter query, the stance of the Union of India has been that entry of UBS would facilitate flow of foreign investments into India. The question

that arises is whether the task of bringing foreign funds into India override all other constitutional concerns and obligations?

40. The predominant theme in the responses of Union of India before this court has been that it is doing all that it can to bring back the unaccounted monies stashed in various banks abroad. To this is added the qualifier that it is an extremely complex problem, requiring the cooperation of many different jurisdictions, and an internationally coordinated effort. Indeed they are complex. We do not wish to go into the details of arguments about whether the Union of India is, or is not, doing necessary things to achieve such goals. That is not necessary for the matters at hand.

41. What is important is that the Union of India had obtained knowledge, documents and information that indicated possible connections between Hassan Ali Khan, and his alleged co-conspirators and known international arms dealers. Further, the Union of India was also in possession of information that suggested that because the international arms dealing network, and a very prominent dealer in it, could not open a bank account even in a jurisdiction that is generally acknowledged to lay great emphasis on not asking sources of money being deposited into its banks, Hassan Ali Khan may have played a crucial role in opening an account with the branch of the same bank in another jurisdiction. The volume of alleged income taxes owed to the country, as demanded by the Union of India itself, and the volume of monies, by some accounts US \$8.04 billion, and some other accounts in excess of Rs. 70,000 crores, that are said to have been routed through various bank accounts of Hassan Ali Khan, and Tapurias. Further, from all accounts it has been acknowledged that none of the named individuals have any known and lawful sources for such huge quantities of monies. All of these factors, either individually or combined, ought to have immediately raised questions regarding the sources being unlawful activities, national security, and transfer of funds into India for other illegal activities, including acts against the State. It was only at the repeated insistence by us that such matters have equal, if not even greater importance than issues of tax collection, has the Union of India belatedly concluded that such aspects also ought to be investigated with thoroughness. However, there is still no evidence of a really serious investigation into these other matters from the national security perspective.

42. The fact remains that the Union of India has struggled in conducting a proper investigation into the affairs of Hassan Ali Khan and the Tapurias. While some individuals, whose names have come to the adverse knowledge of the Union of India, through the more recent investigations, have been interrogated, many more are yet to be investigated. This highly complex investigation has in fact just begun. It is still too early to conclude that the Union of India has indeed placed all the necessary machinery to conduct a proper investigation. The formation

of the HLC was a necessary step, and may even be characterized as a welcome step. Nevertheless, it is an insufficient step.

43. In light of the above, we had proposed to the Union of India that the same HLC constituted by it be converted into a Special Investigation Team, headed by two retired judges of the Supreme Court of India. The Union of India opposes the same, but provides no principle as to why that would be undesirable, especially in light of the many lapses and lacunae in its actions in these matters spread over the past four years.

44. We are of the firm opinion that in these matters fragmentation of government, and expertise and knowledge, across many departments, agencies and across various jurisdictions, both within the country, and across the globe, is a serious impediment to the conduct of a proper investigation. We hold that it is in fact necessary to create a body that coordinates, directs, and where necessary orders timely and urgent action by various institutions of the State. We also hold that the continued involvement of this Court in these matters, in a broad oversight capacity, is necessary for upholding the rule of law, and achievement of constitutional values. However, it would be impossible for this Court to be involved in day to day investigations, or to constantly monitor each and every aspect of the investigation.

45. The resources of this court are scarce, and it is over-burdened with the task of rendering justice in well over a lakh of cases every year. Nevertheless, this Court is bound to uphold the Constitution, and its own burdens, excessive as they already are, cannot become an excuse for it to not perform that task. In a country where most of its people are uneducated and illiterate, suffering from hunger and squalor, the retraction of the monitoring of these matters by this Court would be unconscionable.

46. The issue is not merely whether the Union of India is making the necessary effort to bring back all or some significant part of the alleged monies. The fact that there is some information and knowledge that such vast amounts may have been stashed away in foreign banks, implies that the State has the primordial responsibility, under the Constitution, to make every effort to trace the sources of such monies, punish the guilty where such monies have been generated and/or taken abroad through unlawful activities, and bring back the monies owed to the Country. We do recognize that the degree of success, measured in terms of the amounts of monies brought back, is dependent on a number of factors, including aspects that relate to international political economy and relations, which may or may not be under our control. The fact remains that with respect to those factors that were within the powers of the Union of India, such as investigation of possible criminal nexus, threats to national security etc., were not even attempted. Fealty to the Constitution is not a matter of mere material success; but, and probably more importantly from the perspective of the moral authority of the

State, a matter of integrity of effort on all the dimensions that inform a problem that threatens the constitutional projects. Further, the degree of seriousness with which efforts are made with respect to those various dimensions can also be expected to bear fruit in terms of building capacities, and the development of necessary attitudes to take the law enforcement part of accounting or following the money seriously in the future.

47. The merits of vigour of investigations, and attempts at law enforcement, cannot be measured merely on the scale of what we accomplish with respect to what has happened in the past. It would necessarily also have to be appreciated from the benefits that are likely to accrue to the country in preventing such activities in the future. Our people may be poor, and may be suffering from all manner of deprivation. However, the same poor and suffering masses are rich, morally and from a humanistic point of view. Their forbearance of the many foibles and failures of those who wield power, no less in their name and behalf than of the rich and the empowered, is itself indicative of their great qualities, of humanity, trust and tolerance. That greatness can only be matched by exercise of every sinew, and every resource, in the broad goal of our constitutional project of bringing to their lives dignity. The efforts that this Court makes in this regard, and will make in this respect and these matters, can only be conceived as a small and minor, though nevertheless necessary, part. Ultimately the protection of the Constitution and striving to promote its vision and values is an elemental mode of service to our people.

48. We note that in many instances, in the past, when issues referred to the Court have been very complex in nature, and yet required the intervention of the Court, Special Investigation Teams have been ordered and constituted in order to enable the Court, and the Union of India and/or other organs of the State, to fulfill their constitutional obligations. The following instances may be noted: *Vineet Narain vs. Union of India*¹, *NHRC vs. State of Gujarat*², *Sanjiv Kumar vs. State of Haryana*³, and *Centre for PIL vs. Union of India*⁴.

49. In light of the above we herewith order:

- (i) That the High Level Committee constituted by the Union of India, comprising of (i) Secretary, Department of Revenue; (ii) Deputy Governor, Reserve Bank of India; (iii) Director (IB); (iv) Director, Enforcement; (v) Director, CBI; (vi) Chairman, CBDT; (vii) DG, Narcotics Control Bureau; (viii) DG, Revenue Intelligence; (ix) Director, Financial Intelligence Unit; and (x)

¹ (1996) 2 SCC 199

² (2004) 8 SCC 610

³ (2005) 5 SCC 517

⁴ (2011) 1 SCC 560.

JS (FT & TR-I), CBDT be forthwith appointed with immediate effect as a Special Investigation Team;

- (ii) That the Special Investigation Team, so constituted, also include Director, Research and Analysis Wing;
- (iii) That the above Special Investigation Team, so constituted, be headed by and include the following former eminent judges of this Court: (a) Hon'ble Mr. Justice B.P. Jeevan Reddy as Chairman; and (b) Hon'ble Mr. Justice M.B. Shah as Vice-Chairman; and that the Special Investigation Team function under their guidance and direction;
- (iv) That the Special Investigation Team, so constituted, shall be charged with the responsibilities and duties of investigation, initiation of proceedings, and prosecution, whether in the context of appropriate criminal or civil proceedings of: (a) all issues relating to the matters concerning and arising from unaccounted monies of Hassan Ali Khan and the Tapurias; (b) all other investigations already commenced and are pending, or awaiting to be initiated, with respect to any other known instances of the stashing of unaccounted monies in foreign bank accounts by Indians or other entities operating in India; and (c) all other matters with respect to unaccounted monies being stashed in foreign banks by Indians or other entities operating in India that may arise in the course of such investigations and proceedings. It is clarified here that within the ambit of responsibilities described above, also lie the responsibilities to ensure that the matters are also investigated, proceedings initiated and prosecutions conducted with regard to criminality and/or unlawfulness of activities that may have been the source for such monies, as well as the criminal and/or unlawful means that are used to take such unaccounted monies out of and/or bring such monies back into the country, and use of such monies in India or abroad. The Special Investigation Team shall also be charged with the responsibility of preparing a comprehensive action plan, including the creation of necessary institutional structures that can enable and strengthen the country's battle against generation of unaccounted monies, and their stashing away in foreign banks or in various forms domestically.
- (v) That the Special Investigation Team so constituted report and be responsible to this Court, and that it shall be charged with the duty to keep this Court informed of all major developments by the filing of periodic status reports, and following of any special orders that this Court may issue from time to time;
- (vi) That all organs, agencies, departments and agents of the State, whether at the level of the Union of India, or the State

Government, including but not limited to all statutorily formed individual bodies, and other constitutional bodies, extend all the cooperation necessary for the Special Investigation Team so constituted and functioning;

- (vii) That the Union of India, and where needed even the State Governments, are directed to facilitate the conduct of the investigations, in their fullest measure, by the Special Investigation Team so constituted and functioning, by extending all the necessary financial, material, legal, diplomatic and intelligence resources, whether such investigations or portions of such investigations occur inside the country or abroad.
- (viii) That the Special Investigation Team also be empowered to further investigate even where charge-sheets have been previously filed; and that the Special Investigation Team may register further cases, and conduct appropriate investigations and initiate proceedings, for the purpose of bringing back unaccounted monies unlawfully kept in bank accounts abroad.

50. We accordingly direct the Union of India to issue appropriate notification and publish the same forthwith. It is needless to clarify that the former judges of this Court so appointed to supervise the Special Investigation Team are entitled to their remuneration, allowances, perks, facilities as that of the judges of the Supreme Court. The Ministry of Finance, Union of India, shall be responsible for creating the appropriate infrastructure and other facilities for proper and effective functioning of the Special Investigation Team at once.

III

51. We now turn our attention to the matter of disclosure of various documents referenced by the Union of India, as sought by the Petitioners. These documents, including names and bank particulars, relate to various bank accounts, of Indian citizens, in the Principality of Liechtenstein (“Liechtenstein”), a small landlocked sovereign nation-state in Europe. It is generally acknowledged that Liechtenstein is a tax haven.

52. Apparently, as alleged by the Petitioners, a former employee of a bank or banks in Liechtenstein secured the names of some 1400 bank account holders, along with the particulars of such accounts, and offered the information to various entities. The same was secured by the Federal Republic of Germany (“Germany”), which in turn, apart from initiating tax proceedings against some 600 individuals, also offered the information regarding nationals and citizens of other countries to such countries. It is the contention of the Petitioners that even though the Union of India was informed about the presence of the names of a large number of Indian citizens in the list of names revealed by the former bank employee, the Union of India never made a serious attempt to secure such information and proceed to investigate such individuals. It is

the contention of the Petitioners that such names include the identities of prominent and powerful Indians, or the identities of individuals, who may or may not be Indian citizens, but who could lead to information about various powerful Indians holding unaccounted monies in bank accounts abroad. It is also the contention of the Petitioners that, even though they had sought the information under the Right to Information Act (2005), the Respondents had not revealed the names nor divulged the relevant documents. The Petitioners argue that such a reluctance is only on account of the Union of India not having initiated suitable steps to recover such monies, and punish the named individuals, and also because revelation of names of individuals on the list would lead to discovery of powerful persons engaged in various unlawful activities, both in generation of unlawful and unaccounted monies, and their stashing away in banks abroad.

53. It was also alleged by the Petitioners that in fact Germany had offered such information, freely and generally to any country that requests the same, and did not specify that the names and other information pertaining to such names ought to be requested only pursuant to any double taxation agreements it has with other countries. The Petitioners also alleged that Union of India has chosen to proceed under the assumption that it could have requested such information only pursuant to the double taxation agreement it has with Germany. The Petitioners contend that the Government of India took such a step primarily to conceal the information from public gaze.

54. The response of the Union of India may be summed up briefly: (i) that they secured the names of individuals with bank accounts in banks in Liechtenstein, and other details with respect to such bank accounts, pursuant to an agreement of India with Germany for avoidance of double taxation and prevention of fiscal evasion; (ii) that the said agreement proscribes the Union of India from disclosing such names, and other documents and information with respect to such bank accounts, to the Petitioners, even in the context of these ongoing proceedings before this court; (iii) that the disclosure of such names, and other documents and information, secured from Germany, would jeopardize the relations of India with a foreign state; (iv) that the disclosure of such names, and other documents and information, would violate the right to privacy of those individuals who may have only deposited monies in a lawful manner; (v) that disclosure of names, and other documents and information can be made with respect to those individuals with regard to whom investigations are completed, and proceedings initiated; and (vi) that contrary to assertions by the Petitioners, it was Germany which had asked the Union of India to seek the information under double taxation agreement, and that this was in response to an earlier request by Union of India for the said information.

55. For the purposes of the instant order, the issue of whether the Union of India could have sought and secured the names, and other documents and information, without having to take recourse to the double taxation agreement is not relevant. For the purposes of determining whether Union of India is obligated to disclose the information that it obtained, from Germany, with respect to accounts of Indian citizens in a bank in the Principality of Liechtenstein, we need only examine the claims of the Union of India as to whether it is proscribed by the double taxation agreement with Germany from disclosing such information. Further, and most importantly, we would also have to examine whether in the context of Article 32 proceedings before this court, wherein this court has exercised jurisdiction, the Union of India can claim exemption from providing such information to the Petitioners, and also with respect to issues of right to privacy of individuals who hold such accounts, and with respect of whom no investigations have yet been commenced, or only partially conducted, so that the State has not yet issued a show cause and initiated proceedings.

56. We have perused the said agreement with Germany. We are convinced that the said agreement, by itself, does not proscribe the disclosure of the relevant documents and details of the same, including the names of various bank account holders in Liechtenstein. In the first instance, we note that the names of the individuals are with respect to bank accounts in the Liechtenstein, which though populated by largely German speaking people, is an independent and sovereign nationstate. The agreement between Germany and India is with regard to various issues that crop up with respect to German and Indian citizens' liability to pay taxes to Germany and/or India. It does not even remotely touch upon information regarding Indian citizens' bank accounts in Liechtenstein that Germany secures and shares that have no bearing upon the matters that are covered by the double taxation agreement between the two countries. In fact, the "information" that is referred to in Article 26 is that which is "necessary for carrying out the purposes of this agreement", i.e. the Indo-German DTAA. Therefore, the information sought does not fall within the ambit of this provision. It is disingenuous for the Union of India, under these circumstances, to repeatedly claim that it is unable to reveal the documents and names as sought by the Petitioners on the ground that the same is proscribed by the said agreement. It does not matter that Germany itself may have asked India to treat the information shared as being subject to the confidentiality and secrecy clause of the double taxation agreement. It is for the Union of India, and the courts, in appropriate proceedings, to determine whether such information concerns matters that are covered by the double taxation agreement or not. In any event, we also proceed to examine the provisions of the double taxation agreement below, to also examine whether they proscribe the disclosure of such names, and other

documents and information, even in the context of these instant proceedings.

57. Relevant portions of Article 26 of the double taxation agreement with Germany, a copy of which was submitted by Union of India, reads as follows:

- “1. *The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the purposes of this Agreement. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Agreement. They may disclose the information in public court proceedings or in judicial proceedings.*
2. *In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:*
 - (a) *to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;*
 - (b) *to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;*
 - (c) *to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (order public)”*

58. The above clause in the relevant agreement with Germany would indicate that, contrary to the assertions of Union of India, there is no absolute bar of secrecy. Instead the agreement specifically provides that the information may be disclosed in public court proceedings, which the instant proceedings are. The proceedings in this matter before this court, relate both to the issue of tax collection with respect to unaccounted monies deposited into foreign bank accounts, as well as with issues relating to the manner in which such monies were generated, which may include activities that are criminal in nature also. Comity of nations cannot be predicated upon clauses of secrecy that could hinder constitutional proceedings such as these, or criminal proceedings.

59. The claim of Union of India is that the phrase “public court proceedings”, in the last sentence in Article 26(1) of the double taxation agreement only relates to proceedings relating to tax matters. The Union of India claims that such an understanding comports with how it is

understood internationally. In this regard Union of India cites a few treatises. However, the Union of India did not provide any evidence that Germany specifically requested it to not reveal the details with respect to accounts in the Liechtenstein even in the context of proceedings before this court.

60. Article 31, “General Rule of Interpretation”, of the Vienna Convention of the Law of Treaties, 1969 provides that a “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” While India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also.

61. This Court in *Union of India v. Azadi Bachao Andolan*,¹ approvingly noted Frank Bennion’s observations that a treaty is really an indirect enactment, instead of a substantive legislation, and that drafting of treaties is notoriously sloppy, whereby inconveniences obtain. In this regard this Court further noted the dictum of Lord Widgery, C.J. that the words “are to be given their general meaning, general to lawyer and layman alike.... The meaning of the diplomat rather than the lawyer.” The broad principle of interpretation, with respect to treaties, and provisions therein, would be that ordinary meanings of words be given effect to, unless the context requires or otherwise. However, the fact that such treaties are drafted by diplomats, and not lawyers, leading to sloppiness in drafting also implies that care has to be taken to not render any word, phrase, or sentence redundant, especially where rendering of such word, phrase or sentence redundant would lead to a manifestly absurd situation, particularly from a constitutional perspective. The government cannot bind India in a manner that derogates from Constitutional provisions, values and imperatives.

62. The last sentence of Article 26(1) of the double taxation agreement with Germany, “[T]hey may disclose this information in public court proceedings or in judicial decisions,” is revelatory in this regard. It stands out as an additional aspect or provision, and an exception, to the preceding portion of the said article. It is located after the specification that information shared between contracting parties may be revealed only to “persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to taxes covered by this Agreement.” Consequently, it has to be understood that the phrase “public court proceedings” specified in the last sentence in Article 26(1) of the double taxation agreement with Germany refers to

¹ (2004) 10 SCC 1
Tax Review

court proceedings other than those in connection with tax assessment, enforcement, prosecution etc., with respect to tax matters. If it were otherwise, as argued by Union of India, then there would have been no need to have that last sentence in Article 26(1) of the double taxation agreement at all. The last sentence would become redundant if the interpretation pressed by Union of India is accepted. Thus, notwithstanding the alleged convention of interpreting the last sentence only as referring to proceedings in tax matters, the rubric of common law jurisprudence, and fealty to its principles, leads us inexorably to the conclusion that the language in this specific treaty, and under these circumstances cannot be interpreted in the manner sought by Union of India.

63. While we agree that the language could have been tighter, and may be deemed to be sloppy, to use Frank Bennion's characterization, negotiation of such treaties are conducted and secured at very high levels of government, with awareness of general principles of interpretation used in various jurisdictions. It is fairly well known, at least in Common Law jurisdictions, that legal instruments and statutes are interpreted in a manner whereby redundancy of expressions and phrases is sought to be avoided. Germany would have been well aware of it.

64. The redundancy that would have to be ascribed to the said last sentence of Article 26(1) of the double taxation agreement with Germany, if the position of Union of India were to be accepted, also leads to a manifest absurdity, in the context of the Indian Constitution. Such a redundancy would mean that constitutional imperatives themselves are to be set aside. Modern constitutionalism, to which Germany is a major contributor too, especially in terms of the basic structure doctrine, specifies that powers vested in any organ of the State have to be exercised within the four corners of the Constitution, and further that organs created by a constitution cannot change the identity of the constitution itself.

65. The basic structure of the Constitution cannot be amended even by the amending power of the legislature. Our Constitution guarantees the right, pursuant to Clause (1) of Article 32, to petition this Court on the ground that the rights guaranteed under Part III of the Constitution have been violated. This provision is a part of the basic structure of the Constitution. Clause (2) of Article 32 empowers this Court to issue "directions or orders or writs, including writs in the nature of *habeas corpus*, *mandamus*, *prohibition*, *quo warranto* and *certiorari*, whichever may be appropriate for the enforcement of any of the rights conferred by" Part III. This is also a part of the basic structure of the Constitution.

66. In order that the right guaranteed by Clause (1) of Article 32 be meaningful, and particularly because such petitions seek the protection of fundamental rights, it is imperative that in such proceedings the petitioners are not denied the information necessary for them to properly

articulate the case and be heard, especially where such information is in the possession of the State. To deny access to such information, without citing any constitutional principle or enumerated grounds of constitutional prohibition, would be to thwart the right granted by Clause (1) of Article 32.

67. Further, in as much as, by history and tradition of common law, judicial proceedings are substantively, though not necessarily fully, adversarial, both parties bear the responsibility of placing all the relevant information, analyses, and facts before this court as completely as possible. In most situations, it is the State which may have more comprehensive information that is relevant to the matters at hand in such proceedings. However, some agents of the State may perceive that because these proceedings are adversarial in nature, the duty and burden to furnish all the necessary information rests upon the Petitioners, and hence the State has no obligation to fully furnish such information. Some agents of the State may also seek to cast the events and facts in a light that is favourable to the government in the immediate context of the proceedings, even though such actions do not lead to rendering of complete justice in the task of protection of fundamental rights. To that extent, both the petitioners and this Court would be handicapped in proceedings under Clause (1) of Article 32.

68. It is necessary for us to note that the burden of asserting, and proving, by relevant evidence a claim in judicial proceedings would ordinarily be placed upon the proponent of such a claim; however, the burden of protection of fundamental rights is primarily the duty of the State. Consequently, unless constitutional grounds exist, the State may not act in a manner that hinders this Court from rendering complete justice in such proceedings. Withholding of information from the petitioners, or seeking to cast the relevant events and facts in a light favourable to the State in the context of the proceedings, even though ultimately detrimental to the essential task of protecting fundamental rights, would be destructive to the guarantee in Clause (1) of Article 32, and substantially eviscerate the capacity of this Court in exercising its powers contained in clause (2) of Article 32, and those traceable to other provisions of the Constitution and broader jurisprudence of constitutionalism, in upholding fundamental rights enshrined in Part III. In the task of upholding of fundamental rights, the State cannot be an adversary. The State has the duty, generally, to reveal all the facts and information in its possession to the Court, and also provide the same to the petitioners. This is so, because the petitioners would also then be enabled to bring to light facts and the law that may be relevant for the Court in rendering its decision. In proceedings such as those under Article 32, both the petitioner and the State, have to necessarily be the eyes and ears of the Court. Blinding the petitioner would substantially detract from the integrity of the process of judicial decision making in

Article 32 proceedings, especially where the issue is of upholding of fundamental rights.

69. Furthermore, we hold that there is a special relationship between Clause (1) of Article 32 and Sub-Clause (a) of Clause (1) of Article 19, which guarantees citizens the freedom of speech and expression. The very genesis, and the normative desirability of such a freedom, lies in historical experiences of the entire humanity: unless accountable, the State would turn tyrannical. A proceeding under Clause (1) of Article 32, and invocation of the powers granted by Clause (2) of Article 32, is a primordial constitutional feature of ensuring such accountability. The very promise, and existence, of a constitutional democracy rests substantially on such proceedings.

70. Withholding of information from the petitioners by the State, thereby constraining their freedom of speech and expression before this Court, may be premised only on the exceptions carved out, in Clause (2) of Article 19, "in the interests of sovereignty and integrity of India, security of the State, friendly relations with foreign States, public order, decency or morality, or in relation to contempt of court, defamation or incitement to an offence" or by law that demarcate exceptions, provided that such a law comports with the enumerated grounds in Clause (2) of Article 19, or that may be provided for elsewhere in the Constitution.

71. It is now a well recognized proposition that we are increasingly being entwined in a global network of events and social action. Considerable care has to be exercised in this process, particularly where governments which come into being on account of a constitutive document, enter into treaties. The actions of governments can only be lawful when exercised within the four corners of constitutional permissibility. No treaty can be entered into, or interpreted, such that constitutional fealty is derogated from. The redundancy, that the Union of India presses, with respect to the last sentence of Article 26(1) of the double taxation agreement with Germany, necessarily transgresses upon the boundaries erected by our Constitution. It cannot be permitted.

72. We have perused the documents in question, and heard the arguments of Union of India with respect to the double taxation agreement with Germany as an obstacle to disclosure. We do not find merit in its arguments flowing from the provisions of double taxation agreement with Germany. However, one major constitutional issue, and concern remains. This is with regard to whether the names of individuals, and details of their bank accounts, with respect to whom there has been no completed investigations that reveal wrong doing and proceedings initiated, and there is no other credible information and evidence currently available with the Petitioners that there has been any wrong doing, may be disclosed to the Petitioners.

73. Right to privacy is an integral part of right to life. This is a cherished constitutional value, and it is important that human beings be allowed domains of freedom that are free of public scrutiny unless they act in an unlawful manner. We understand and appreciate the fact that the situation with respect to unaccounted monies is extremely grave. Nevertheless, as constitutional adjudicators we always have to be mindful of preserving the sanctity of constitutional values, and hasty steps that derogate from fundamental rights, whether urged by governments or private citizens, howsoever well meaning they may be, have to be necessarily very carefully scrutinised. The solution for the problem of abrogation of one zone of constitutional values cannot be the creation of another zone of abrogation of constitutional values. The rights of citizens, to effectively seek the protection of fundamental rights, under Clause (1) of Article 32 have to be balanced against the rights of citizens and persons under Article 21. The latter cannot be sacrificed on the anvil of fervid desire to find instantaneous solutions to systemic problems such as unaccounted monies, for it would lead to dangerous circumstances, in which vigilante investigations, inquisitions and rabble rousing, by masses of other citizens could become the order of the day. The right of citizens to petition this Court for upholding of fundamental rights is granted in order that citizens, inter-alia, are ever vigilant about the functioning of the State in order to protect the constitutional project. That right cannot be extended to being inquisitors of fellow citizens. An inquisitorial order, where citizens' fundamental right to privacy is breached by fellow citizens is destructive of social order. The notion of fundamental rights, such as a right to privacy as part of right to life, is not merely that the State is enjoined from derogating from them. It also includes the responsibility of the State to uphold them against the actions of others in the society, even in the context of exercise of fundamental rights by those others.

74. An argument can be made that this Court can make exceptions under the peculiar circumstances of this case, wherein the State has acknowledged that it has not acted with the requisite speed and vigour in the case of large volumes of suspected unaccounted monies of certain individuals. There is an inherent danger in making exceptions to fundamental principles and rights on the fly. Those exceptions, bit by bit, would then eviscerate the content of the main right itself. Undesirable lapses in upholding of fundamental rights by the legislature, or the executive, can be rectified by assertion of constitutional principles by this Court. However, a decision by this Court that an exception could be carved out remains permanently as a part of judicial canon, and becomes a part of the constitutional interpretation itself. It can be used in the future in a manner and form that may far exceed what this Court intended or what the Constitutional text and values can bear. We are not proposing that Constitutions cannot be interpreted in a manner that allows the nationstate to tackle the problems it faces. The principle is

that exceptions cannot be carved out willy-nilly, and without forethought as to the damage they may cause.

75. One of the chief dangers of making exceptions to principles that have become a part of constitutional law, through aeons of human experience, is that the logic, and ease of seeing exceptions, would become entrenched as a part of the constitutional order. Such logic would then lead to seeking exceptions, from protective walls of all fundamental rights, on grounds of expediency and claims that there are no solutions to problems that the society is confronting without the evisceration of fundamental rights. That same logic could then be used by the State in demanding exceptions to a slew of other fundamental rights, leading to violation of human rights of citizens on a massive scale.

76. It is indeed true that the information shared by Germany, with regard to certain bank accounts in Liechtenstein, also contains names of individuals who appear to be Indians. The Petitioners have also claimed that names of all the individuals have been made public by certain segments of the media. However, while some of the accounts, and the individuals holding those accounts, are claimed to have been investigated, others have not been. No conclusion can be drawn as to whether those who have not been investigated, or only partially investigated and proceedings not initiated have committed any wrong doing. There is no presumption that every account holder in banks of Liechtenstein has acted unlawfully. In these circumstances, it would be inappropriate for this Court to order the disclosure of such names, even in the context of proceedings under Clause (1) of Article 32.

77. The revelation of details of bank accounts of individuals, without establishment of prima facie grounds to accuse them of wrong doing, would be a violation of their rights to privacy. Details of bank accounts can be used by those who want to harass, or otherwise cause damage, to individuals. We cannot remain blind to such possibilities, and indeed experience reveals that public dissemination of banking details, or availability to unauthorized persons, has led to abuse. The mere fact that a citizen has a bank account in a bank located in a particular jurisdiction cannot be a ground for revelation of details of his or her account that the State has acquired. Innocent citizens, including those actively working towards the betterment of the society and the nation, could fall prey to the machinations of those who might wish to damage the prospects of smooth functioning of society. Whether the State itself can access details of citizens bank accounts is a separate matter. However, the State cannot compel citizens to reveal, or itself reveal details of their bank accounts to the public at large, either to receive benefits from the State or to facilitate investigations, and prosecutions of such individuals, unless the State itself has, through properly conducted investigations, within the four corners of constitutional permissibility, been able to establish prima facie grounds to accuse the individuals of wrong doing. It is only after the State

has been able to arrive at a prima facie conclusion of wrong doing, based on material evidence, would the rights of others in the nation to be informed, enter the picture. In the event citizens, other persons and entities have credible information that a wrong doing could be associated with a bank account, it is needless to state that they have the right, and in fact the moral duty, to inform the State, and consequently the State would have the obligation to investigate the same, within the boundaries of constitutional permissibility. If the State fails to do so, the appropriate courts can always intervene.

78. The major problem, in the matters before us, has been the inaction of the State. This is so, both with regard to the specific instances of Hassan Ali Khan and the Tapurias, and also with respect to the issues regarding parallel economy, generation of black money etc. The failure is not of the Constitutional values or of the powers available to the State; the failure has been of human agency. The response cannot be the promotion of vigilantism, and thereby violate other constitutional values. The response has to necessarily be a more emphatic assertion of those values, both in terms of protection of an individual's right to privacy and also the protection of individual's right to petition this Court, under Clause (1) of Article 32, to protect fundamental rights from evisceration of content because of failures of the State. The balancing leads only to one conclusion: strengthening of the machinery of investigations, and vigil by broader citizenry in ensuring that the agents of State do not weaken such machinery.

79. In light of the above we order that:

- (i) The Union of India shall forthwith disclose to the Petitioners all those documents and information which they have secured from Germany, in connection with the matters discussed above, subject to the conditions specified in (ii) below;
- (ii) That the Union of India is exempted from revealing the names of those individuals who have accounts in banks of Liechtenstein, and revealed to it by Germany, with respect of who investigations/enquiries are still in progress and no information or evidence of wrongdoing is yet available;
- (iii) That the names of those individuals with bank accounts in Liechtenstein, as revealed by Germany, with respect of whom investigations have been concluded, either partially or wholly, and show cause notices issued and proceedings initiated may be disclosed; and
- (iv) That the Special Investigation Team, constituted pursuant to the orders of today by this Court, shall take over the matter of investigation of the individuals whose names have been disclosed by Germany as having accounts in banks in Liechtenstein, and expeditiously conduct the same. The Special

Investigation Team shall review the concluded matters also in this regard to assess whether investigations have been thoroughly and properly conducted or not, and on coming to the conclusion that there is a need for further investigation shall proceed further in the matter. After conclusion of such investigations by the Special Investigation Team, the Respondents may disclose the names with regard to whom show cause notices have been issued and proceedings initiated.

80. Compliance reports shall be filed by Respondents, with respect of all the orders issued by this Court today. List for further directions in the week following the Independence Day, August 15, of 2011.

Ordered accordingly.
