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Daily Tax News (DTN) is a special email service from Tuesday to Friday, part of your subscription, aims at keeping you informed about changes taking place in tax laws in real time. It also contains in-depth articles, analyses and changes taking place all over the world. On Saturday evening we send Weekly Tax Journal (WTJ) online which you can read till Monday at your convenience

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Kind regards

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FBR seeks waiver of Rs28m sales tax on imported buses

The Federal Board of Revenue (FBR) has sought a waiver of sales tax amounting to Rs28 million at the import stage for settling outstanding dues to a number financial institutions, revealed a summary of the FBR on Wednesday.

M/s Swede Bus Pakistan Ltd imported 32 scania diesel buses under the Prime Minister's urban transport strategy plan, 1999 and these buses were exempted from custom duty under SRO 812(I) 1999, dated July 1999.

The summary- sent to the ECC of the Cabinet for approval- justifies by saying, "The buses were not operated and the case can not be compared with other bus operators who paid tax at the import stage".

According to the taxpayer's representatives, the said buses never really took-off due to politico-economic conditions prevailing in the country at the right time and were grounded in 2005.

Accordingly, the taxpayer, under pressure for payment of liabilities from different leasing/lending companies, decided to dispose off the said buses.

The ECC of the cabinet, in its meeting on February 2011, approved the proposal saying, "One time exemption from customs duty granted under SRO 812(I)/1999 dated 01-07-1999." However, exemption from sales tax was neither sought nor granted, said the summary, quoting the decision of the ECC.

The summary further said that in a letter to chairman FBR, Khalid Rafi, Chairman M/s Swede Bus Pakistan requested for exemption from sales tax amounting to Rs28 million that was payable at import stage, which is in dispute since the import of these buses in 2002, in order to enable the company to dispose off these buses and to pay back its liabilities amounting Rs133 million owed to various leasing companies.

Justifying its case for exemption of sales tax at import stage, the FBR said the latest available copies of the audited financial statements and previous correspondence that the company will be unable to discharge its liabilities to financial institutions, unless, it is in a position to dispose off its fleet of buses.

Even if the entire fleet is sold, the company will still not be able to fully discharge its liabilities. It further said that the company will be facilitated in selling its fleet of buses, if the sales tax at import stage, which is in dispute since 2002, is exempted. – *Courtesy The News*

NTN holders purchasing taxable goods: FBR to verify withholdings, one percent ST on value

The Federal Board of Revenue (FBR) has begun sales tax audit of all National Tax Numbers (NTNs) being withholding agents to confirm/verify withholdings and deposit one percent sales tax of the value of taxable goods purchased by them from relevant suppliers.

In this connection, the FBR here on Wednesday issued instructions to all Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) to check the withholding of sales tax by NTN holders, whether or not registered for sales tax purpose, but falling within the jurisdiction of Large Taxpayer Units (LTUs).

According to the FBR's instructions to the LTUs/RTOs, the FBR has detected serious violations of the Sales Tax Special Procedure (Withholding) Rules 2007.

A large number of NTN holders, despite having deducted income tax @ 3.5% of the gross value of supplies, did not deposit sales tax @ 1% of the value of taxable supplies, as required under the Sales Tax Special Procedure (Withholding) Rules 2007.

The FBR's instructions to the field formations said that in accordance with clause (d) of sub-rule (2) of rule-1 of the Sales Tax Special Procedure (Withholding) Rules 2007, notified vide SRO 660(1)/2007 dated 30th June, 2007, all the taxpayers falling within the jurisdiction of LTU, whether or not registered for sales tax purpose, are declared withholding agents of sales tax.

Under the provision of sub Rule (3B) of Rule (2), a taxpayer registered in a Large Taxpayers Unit (LTU) shall deduct withhold sales tax @ one percent of the value of taxable supplies received by him from a registered person, other than the one registered in LTU, and deposit the same in the Government Treasury under the Head of Account "B-02341 -Sales Tax".

The FBR said that the snap audit conducted by the Special Monitoring Team of FBR revealed that a large number of NTN holders, despite having deducted Income Tax @ 3.5% of the gross value of supplies, did not deposit sales tax @ 1% of the value of taxable supplies, as required under the aforesaid Rules.

A synopsis indicating details of such NTN holders (not registered for sales tax purpose), for the tax period JuIy-2009 to March-2012 has been compiled by the special team of the FBR.

In this backdrop, it is requested that a Special Audit Team, headed by an officer of Inland Revenue Service, not below the rank of an Additional Commissioner, and comprising experienced/skilled IR Audit Officers may immediately be constituted and assigned the task of carrying out desk audit of all NTN holders, whether or not registered for sales tax purpose, to confirm/verify withholding and deposit of sales tax @ 1% of the value of taxable goods purchased by them from a supplier not registered in a Large Taxpayers' Unit, during the aforesaid tax period, FBR maintained.

The FBR said that the Audit Team constituted as aforesaid may be advised to take into consideration the exclusions as provided under rule-5 of the aforesaid Rules while conducting desk audit.

They may also be advised to undertake the exercise thoroughly, in a professional manner and without harassing the taxpayers.

The audit shall be completed and report be sent to the Board on or before May 25, 2012 positively, and in case of short/non payment of sales tax, immediate recovery action shall be initiated to ensure that such short/unpaid amount of sales tax is deposited in the government treasury during the current fiscal year 2011-12, the FBR instructions added.

The whole exercise of checking illegal input tax adjustments and sales tax deductions/withholding has been assigned to a seasoned tax official Dr Muhammad Zubair Chief Sales Tax.

He has vast experience of dealing in cases of sales tax refunds and input tax adjustments and also drafted different procedures/rules and tax laws for the FBR to handle the refund related issues in the past. – *Courtesy Business Recorder*

Sugar mills' taxable supplies: 50 percent input tax adjustment disallowed

The Federal Board of Revenue has disallowed 50 percent input tax adjustment against the taxable supplies of sugar mills under an old SRO(I)/2009 of August 23, 2009 which had exempted 50 percent of sales tax on supply of sugar, requiring the registered units to apportion the input tax accordingly.

It is learnt here on Wednesday that the FBR has issued a clarification on the apportionment of input tax which has resulted in issuance of show cause notices to various sugar mills on the basis of the FBR"s legal interpretation.

The sugar industry has strongly contested against the FBR"s clarification and termed it illegal as well as against the relevant provisions of the Sales Tax Act 1990.

The industry has approached the FBR for withdrawal of the clarification in view of accurate interpretation of the rescinded SRO and Sales Tax Act, 1990.

On the other hand, tax officials were of the view that under SRO(I)/2009 the supplies of sugar was exempted from 50% sales tax.

Resultantly, the registered persons were required to apportion the input tax accordingly ie only fifty percent of the input tax shall be available for adjustment against the taxable supplies.

In a communication to the FBR Chairman Mumtaz Haider Rizvi, Pakistan Sugar Mills Association (PSMA) said that the FBR had issued SRO F. No 1(3)STM/2004 (Pt-II) dated August 23, 2009 under clause (a) of sub - section (2) of section 13 of the Sales Tax Act, 1990 that reads as under:–

"In exercise of the powers conferred by clause (a) of sub section (2) of Section 13 of Sales Tax Act, 1990, the Federal Government is pleased to direct that sales tax on local supplies of sugar shall be charged at the rate of eight per cent with immediate effect and until further orders." The above notification was rescinded by S.R.O. 480 (I)/2011 dated 3rd June, 2011.

Moreover, section 8 of the Sales Tax Act, 1990 reads as:

Tax credit not allowed

(1) Notwithstanding anything contained in this Act, a registered person shall not be entitled to reclaim or deduct input tax paid on–

(a) the goods used or to be used for any purpose other than for the manufacture or production of taxable goods or for taxable supplies made or to be made by him;

(b) any other goods which the Federal Government may, by a notification in the official Gazette, specify; and

(c) on the goods under sub-sections (1A) and 5 of section3.

(2) If a registered person deals in taxable and non-taxable supplies, he can reclaim only such proportion of the input tax as is attributable to taxable supplies in such manner as may be specified by the Board.

Upon an enquiry, the Second Secretary (ST-L&P) Federal Board of Revenue vide letter C.No 1(3)STM/2004(Pt-III) dated 02 May 2012 has stated as under:-

"I am directed to refer to LTU, Lahore"s letter Ref.

No AC(HQ)F.07(IT)2012/8931 dated 20-04-2012 on the subject cited above and to say that FBR agrees with the view point of LTU, Lahore that as per SRO__(1)/2009 dated 23-08-2009 the supplies of sugar were exempt from 50% of the sales tax under the provisions of section 13 of the Sales Tax Act, 1990.

Sub-section (2) of section 8 of the Sales Tax Act, 1990 provides as under:

"If a registered person deals in taxable and non-taxable supplies, he can reclaim only such proportion on the input tax as is attributable to taxable supplies in such manner as may be specified by the Board."

(2) The registered persons, therefore, were required to apportion the input tax accordingly ie only fifty percent of the input tax shall be available for adjustment against the taxable supplies," it added.

The sugar industry opined that the viewpoint taken by the FBR vide his letter dated 02 May, 2012 is incorrect.

The FBR has issued SRO dated August 23, 2009, purportedly exercising powers conferred upon it under clause (a) of sub-section (2) of section 13 of the Act.

The said SRO remained operative for almost 22 months which was later rescinded vide SRO dated 03 June, 2011.

The FBR has misinterpreted SRO dated 23 August, 2009 and proposing fifty percent disallowance on input tax by misconstruing the said SRO under an impression that FBR has exempted fifty percent of sales tax on supply of sugar by wrongly resorting to the provisions of sub-section (2) of section 8 of the Act.

The creating a sales tax charge at higher or lower rate and granting exemption are entirely two different concepts.

Section 13 of the Act, empowers the Federal Government to exempt any taxable supply from whole or any part of tax, meaning thereby that whole or any part of tax can be exempted which is entirely different from lowering the rate of tax.

The substance of the language as used in SRO is important.

Perusal thereof would reveal that by no stretch of imagination any exemption flows out of it but for the reduction of rate of tax to 8%, keeping intact the taxability of the goods.

It has been further argued that the provisions of sub-section (2) of section 8 of the Act are not applicable to the sugar industry for the reason that petitioner only has taxable supplies, hence input cannot be disallowed proportionately.

In view of the legal position, sugar industry has requested the FBR that the interpretation of the SRO may be withdrawn.

Hence the show cause notices issued to various sugar mills may be declared unlawful, sources added. – *Courtesy Business Recorder*

Customs tariff slabs to be reduced to six: FBR finalises budgetary proposals

The Federal Board of Revenue finalised the customs budgetary proposals here on Wednesday including tariff rationalisation and decided to reduce the number of general customs tariff slabs from existing nine to six by reducing higher slabs of customs duty in the upcoming budget (2012-13).

It is learnt here on Wednesday that the budget preparation exercise focused on customs proposals here at the FBR House and discussed the impact of each and every budget proposal.

The proposals would be presented before the Ministry of Finance for clearance and subsequent approval by the policymakers.

Pakistan Customs Tariff (2012-13) would be issued in a simplified form.

From July 1, 2012 customs tariff would be made transparent and predictable for the investors, rate of import duty mentioned in the Pakistan Customs Tariff would be applicable on imports and there would be no mismatch in rates of duty mentioned in tariff and SROs.

The FBR has also redrafted a numbers of Customs SROs to simplify the language particularly to facilitate investors and importers.

Meanwhile, Minister of Finance Abdul Hafiz Sheikh has directed the Federal Board of Revenue to finalize the budget proposals focusing on relief measures to be announced in the upcoming federal budget (2012-13).

The Finance Minister visited the FBR Headquarters and appreciated the revenue collection efforts of the tax machinery.

During visit of the Finance Minister, the policy measures and enforcement/administrative efforts of the FBR were discussed in detail.

Tax mangers have assured the Finance Minister that the FBR will be able to achieve the revenue collection target of Rs 1952 billion for 2011-12.

Sources said a high level meeting also held at the FBR House late night to discuss the budget proposals under the chairmanship of the FBR Chairman Mumtaz Haider Rizvi.

So far there is no change in the date of announcement of budget (2012-13).

The Federal Budget will be announced on June 1, 2012. – *Courtesy Business Recorder*

RRTO Multan official: FTO refers corruption case to NAB

Federal Tax Ombudsman (FTO) Dr Muhammad Shoaib Suddle here on Wednesday referred a case of corruption to the Chairman National Accountability Bureau (NAB) for initiating criminal investigation into the case involving tax officials of Regional Tax Office Multan, seeking bribes from the taxpayers by raising illegal tax demands.

This case is first of its kind where the FTO has forwarded the copy of the above findings/recommendations, along with CD of recordings and copy of transcripts to Chairman NAB for initiating criminal investigation into the matter, as per law.

At the same time, the FTO has also directed the Federal Board of Revenue (FBR) to take disciplinary action against the relevant officials involved in demanding bribes from the taxpayers.

These are the recommendations of the FTO in a complaint No 04-06/LHR/IT (03-05) 22-24/2012 filed by three complaints by a Burewala, Gagoo Mandi Based taxpayer named Sohail Amin represented by a leading Lahore based tax lawyer Waheed Butt.

These complaints are against illegal and arbitrary demand of tax (Rs 21,418,998/-) ostensibly raised under Section 161 of the Income Tax Ordinance, 2001, extortion of Rs 200,000 as bribe and raising a further demand for additional tax of over Rs 3,000,000.

According to the findings of the FTO, although the complainants' grievance to the extent of illegal tax demand has been redressed due to the intervention of the Federal Tax Ombudsman, the alleged acts of omission and commission committed by officials of RTO Multan are tantamount to maladministration as defined under Section 2(3) of FTO Ordinance2000.

Rana Sajjad Hussain, IRO, passed an illegal order under Section 161 of the Ordinance on April, 25.2011 when there was no default by the complainant, or his wife, Javeria Sohail. prima facie, Rana Sajjad Hussain, IRO, deliberately raised heavy demand of tax in order to extort bribe from the complainant for himself and for other officials in RTO, Multan, connected with the case.

He received a bribe of Rs 200,000/- from the complainant, on 29.04.2011, in his office, as per the affidavit dated 15.03.2012 filed by Sohail Amin.

The mobile phone recordings also apparently support this contention, FTO's findings said.

The FTO has recommended the FBR to take necessary corrective/disciplinary action as provided under Section 13 of the FTO Ordinance against the relevant officials, and report compliance within 30 days.

A copy of the above findings/recommendations, along with CD of recordings and copy of transcripts, be forwarded to Chairman NAB for initiating criminal investigation into the matter, as per law, FTO added.

The FTO order said that the complainants deal in fertilisers for Fuji Fertiliser Co Ltd (FFC).

According to them, Rana Sajjad Hussain, IRO, Burewala, raised tax demand of Rs 10,372,378/- and Rs 11,046,620/- against Sohail Amin, managing partner in M/s Jeddah Traders and Zamindara Corporation and his wife, Javeria Amin, managing partner in Umer Trading Company respectively on account of non deduction of withholding tax on payments made to FFC for purchase of fertiliser in Tax Years 2009 and 2010.

The complainants applied for rectification on the ground that FFC had already paid its due tax liability along with the returns filed for Tax years 2009 and 2010.

When confronted, the Deptt raised a preliminary objection that the complaints were 'time barred' in terms of the limitation laid down in Section 10(3) of the FTO Ordinance.

The Deptt further contended that the orders passed being appealable before the Commissioner (Appeals) the complaints did not lie before the FTO because of the bar laid down in Section 9(2)(b) of the FTO Ordinance.

On merits, the Dept defended the action under Section 161 of the Ordinance as justified, denying that the Complainants had been discriminated against in any manner.

The preliminary Departmental objections have been considered and found misconceived / non maintainable, FTO order said.

The complainants filed rectification applications before Rana Sajjad Hussain, IRO, and his successor, Ghulam Nasir, IRO, to apprise them of the fact that there was no default of payment of withholding tax.

This contention of the Complainants ultimately proved correct, when, during the course of this investigation, the Deptt vacated the orders passed by Rana Sajjad Hussain, IRO.

Rana Sajjad Hussain, IRO, initially justified the tax demand raised by him, as also his refusal to rectify the tax demand.

However, when confronted with the evidence that he himself at one stage had advised the Commissioner Inland Revenue (Saleem Raza Asif, and his successor, Basharat Ahmad Qureshi) that the tax demand raised under Section 161 of the Ordinance was not tenable in law and needed to be struck down, Rana Sajjad Hussain acknowledged that the tax demand was indeed bereft of any objective basis and needed to be vacated, FTO order said.

On transfer, Rana Sajjad Hussain, IRO, was succeeded by Ghulam Nasir, IRO.

Even though the successor officer was aware that Rana Sajjad Hussain had written to Mr Basharat Ahmad Qureshi, CIR, E&C, RTO, Multan, advising him that the tax demand under Section 161 of the Ordinance was not tenable in law, he took no action on the rectification applications filed before him.

During the hearing, the AR requested to be allowed to confront Rana Sajjad Hussain, IRO, with evidence in his possession purporting to show that he had demanded and indeed received Rs 200,000 from the Complainant by way of illegal gratification.

He was permitted to do so.

He then played five recordings of mobile phone conversations with Rana Sajjad Hussain, IRO, FTO said.

During the hearing on March 16, 2012, Rana Sajjad Hussain, IRO, acknowledged that the voice in the recordings was his.

He, however, denied receiving any bribe from the Complainant and said that he was being unduly targeted for levying tax on the Complainant.

He said that he was posted out of Burewala on 23.07.2011 and was in no position to do anything for the Complainant thereafter.

Rana Sajjad Hussain, IRO, was given a copy of the recordings along with a translated (Urdu) transcript and asked to make a written response on 19.03.2012 but no response was received from him.

The complaint was next heard on 19.03.2012.

Rana Sajjad Hussain, IRO, appeared on the due date but did not make any written response.

He stated verbally that the recordings were tampered with and important segments of the conversation between him and the Complainant had been doctored.

He denied receiving any amount by way of bribe from the complainant.

Playback of the recordings apparently does not reveal any gap or break in the flow of conversation or any other sudden change in conversation between the two persons (Rana Sajjad Hussain and Sohail Amin).

Prima facie, the recordings appear to be authentic.

Rana Sajjad Hussain appears to have created the basis to extort a bribe by raising heavy tax demand without proper enquiry and without giving sufficient opportunity to the Complainant to explain his position with regard to his role as tax withholding agent.

When the Complainant found out that there was no bona fide reason for raising demand under Section 161 as the due tax had already been paid by FFC along with the Return, he filed a rectification application before Rana Sajjad, which was ignored, on two occasions: on 11.05.2011 and 22.06.2011.

His successor, Ghulam Nasir, IRO, went a step further.

Not only did he ignore three reminders for rectification sent by the Complainant on 12.08.2011, 21.11.2011 and 15.12.2011, but issued notice to levy default surcharge under Section 205 of the Ordinance.

He knew that his predecessor, Rana Sajjad Hussain, had written to the CIR that the demand raised under Section 161 of the Ordinance was not maintainable as there was no withholding tax default by the three AOPs.

On 17.01.2012, Ghulam Nasir rejected the pending applications for rectification.

The ambient circumstances of this complaint strongly suggest that Ghulam Nasir, IRO, and Rana Sajjad Hussain, IRO, were in contact with each other and were acting in concert in pressurizing the Complainant to extort more and more money from him.

During the conversations between Rana Sajjad Hussain and Sohail Amin, the former kept on taking names of different tax functionaries in the Dept, conveying the message that in order for the Complainant to get complete relief from the undue tax burden with which he had been saddled and also to avoid being targeted in audit, he would have to make payments over and above Rs 200,000/- that he had already paid.

The complaint case proceedings before the Federal Tax Ombudsman however had a sobering effect on Rana Sajjad Hussain, IRO, Ghulam Nasir, IRO, and the senior officials in the RTO, Multan, with whom they were in league, as, vide order dated 23.02.2012, the entire illegal demand raised under Section 161 was recalled by the CIR.

The hope was that the complainant would withdraw from the case after the illegal demand had been vacated under Section 122A and would not press any further action.

Rana Sajjad got extremely worried when he was told on 16.03.2012 that there was recorded evidence available with the Complainant that pointed to corruption in the Dept.

Part of the recorded evidence was played before Rana Sajjad during the hearing at FTO's Regional Office, Lahore, and transcripts of the recordings also given to him.

However, he did not make any written response, FTO added. – *Courtesy Business Recorder*

Setting up trade terminals at Khokhrapar: SRB proposal receives no response

The Sindh government high ups did not took seriously the proposal of Sindh Revenue Board (SRB) for setting up trade terminals at Khokhrapar.

In November 2011, the SRB had proposed the provincial government to set up trade terminals at Khokhrapar to boost up economy by starting trade through Khokhrapar-Munabao border with India.

Sources said that the proposal had been sent to Chief Minister Sindh Qaim Ali Shah through a summary.

The summary states Sindh government can earn more than Rs one billion in the head of Sales Tax on Services with establishment of trade terminals at Khokhrapar.

It said that all the provinces including Punjab, Balochistan and Khyber Pakhtunkhwa had their trade terminals on their land trade routes, therefore, it was the need of the hour to establish trade terminals at Khokhrapar.

A high official of SRB on condition of anonymity told this scribe that the Chief Minister had not yet responded to the summary.

He said before the partition there was a dry port in Khokhrapar, from where rice, wheat, cotton clothes, dates were exported India.

He added that now dates from Sukkur were exported through Wahga border.

"Had the proposed terminals been established such products would have easily and timely reached in Indian markets," he added.

He told that traditional dresses, betel nuts, leaves of Beri and others were imported from India and Pakistan used to export ceramics, rugs, cotton cloths, pure cotton, horses and other livestock. – *Courtesy Business Recorder*

Tax ombudsman saves three companies

Federal Tax Ombudsman (FTO) Dr Shoaib Suddle has saved three companies dealing in fertilizers from ìextortionî by the officials of the Regional Tax Office (RTO) Multan but failed to save the complainant from gun shots fired at him injuring him.

When the crippled complainant, Sohail Amin, approached police for registration of case against the tax officials, they refused to lodge it saying they canít do so against government personnel and would record a ìblindî FIR (first information report) against unknown culprits.

During the hearing, five recordings of mobile phone conversations of the complainant with one of the key officials held responsible for demanding bribes were played, the FTO decision.

Dr Suddle recommended to the Federal Board of Revenue (FBR) to take necessary corrective and disciplinary action against the concerned officials to ensure that schemes to extract bribes were not resorted to in future.

He sought compliance report from the FBR within thirty days and forwarded a copy of his ruling to the National Accountability Bureau (NAB) chairman for initiation of criminal investigation into the matter.

His findings said that although the complainantís grievance to the extent of illegal tax demand has been redressed due to his intervention, the alleged acts of omission and commission committed by officials of RTO Multan are tantamount to mal-administration. – *Courtesy The News*

IMF mission postpones visit before budget announcement

In the wake of the ongoing critical developments for resumption of Nato supply as well as Islamabad's intention to unveil budget 2012-13 without taking into account tough prescriptions suggested by the donors, the IMF's mission is not coming for holding consultation with Pakistani authorities prior to upcoming budget, it is learnt.

Official sources confirmed to The News on Wednesday that the IMF mission would visit Pakistan probably in July 2012 after the announcement of budget 2012-13 because Islamabad is no more under the fund program and there is no requirement to formally hold talks with IMF before the upcoming budget.

But the sources said that the Post Program Monitoring (PPM) was due in ongoing month for which an IMF mission was expected to visit to evaluate Islamabad's ability to pay back the IMF loans.

"There is no problem of repayment and Pakistan will pay back the second installment of over $400 million on May 24, 2012," official sources confirmed. Another installment would be paid back on June 29, 2012, said the official sources.

The sources said that the IMF authorities showed reluctance to visit the country prior to budget announcement on the pretext that Islamabad's top ruling elites expressed their intentions for presenting relief oriented budget by not broadening the tax base and not pursuing key reforms so there was no room left for the IMF to visit Islamabad.

"When you have taken a decision not to listen our advice then there is no purpose to hold talks before the unveiling of the budget 2012-13," sources quoted IMF officials as saying during their interactions with Pakistani authorities on eve of recently held annual spring meeting of IMF/WB held at Washington DC.

Without getting any fresh IMF loan, Pakistan has become eligible for Post Program Monitoring (PPM) to remain under continuous surveillance of the fund because the outstanding IMF credit to Pakistan exceeds the 200 percent of quota threshold. Pakistan fell into the PPM category because of former finance minister Shaukat Tarin and former advisor to Finance Ministry Dr Ehitsham Ahmed's decision for getting maximum IMF resources at first stage which were later on augmented up to $11.3 billion from the initial loan package of $7.6 billion, under an unsuccessful Standby Arrangement Program (SBA) that expired last year.

"In accordance with fund policy, the Managing Director of IMF recommends the initiation of PPM. Outstanding fund credit to Pakistan exceeds the 200 percent of quota threshold for PPM, and there are no exceptional circumstances that would indicate that PPM is not warranted," the last IMF staff report stated.

It further stated that the first PPM Board discussion was envisaged in mid-2012. In addition, Pakistan is an exceptional access borrower from the Fund and, therefore, an Ex-Post Evaluation (EPE) has begun, and a report will be produced for the Board.

This scribe sent question to IMF high ups for seeking their comments but got no reply till the filing of this report. – *Courtesy The News*

Revenue body rejects airlines' request for FED waiver

The Federal Board of Revenue (FBR) has rejected a request by representatives of airlines for a waiver of the federal excise duty (FED), worth Rs4 billion, which is collected against tickets purchased for travelling to Pakistan, official sources said on Wednesday.

"Board of Airline Representatives in Pakistan (BARIP) in a meeting recently held with tax authorities in Karachi requested for a waiver as such kind of tax was not applicable in other countries," a FBR official said on condition of anonymity.

"The BARIP also suggested that such taxation would discourage investment in airline industry," the official added.

The official said that the tax authorities had endorsed the objections raised by the airlines representatives but refused to allow a waiver because such tax is applicable under Pakistan taxation law.
The FBR initiated the recovery of around Rs4 billion in April 2012 from airlines, which have failed to deposit FED on tickets purchased to travel Pakistan.

FBR Inland Revenue (IR) Wing has taken up the issue of FED payable on tickets purchased by passengers for travelling to Pakistan and airlines are bound to deposit such amount to the national exchequer.

The FED laws bind airlines to charge and pay FED in respect of passengers travelling to Pakistan from abroad. It further explains that no airline or person in charge of the aircraft should board any passenger on the aircraft unless passenger pays the excise duty.

The official said that for further scrutiny on FED issue the FBR had issued notices to various airlines for providing documents of last three years.

The FBR clarified through a notification issued on October 20, 2007 that FED is chargeable on international travel originated from abroad across the board since September 1, 2007.

BARIP had earlier approached the Member Inland Revenue, FBR and raised objections on the subject and requested to withdraw notices for providing information of last three years.

The BARIP rejected deduction of tax and provide information involved in the collection of FED on one way tickets sold outside. It stated: "If UK VAT (value added tax) cannot be collected on one way ticket from Karachi to Lahore destination, therefore, FED in respect of travel pertaining to Pakistan cannot be collected in respect of ticket sold outside Pakistan."

The airline representatives' body also raised difficulties in respect of collection of FED on air tickets issued outside Pakistan by airlines which do not operate their aircraft to Pakistan.

Sources in the airline industry said that BARIP would not approach the finance ministry for duty waiver of previous years and for amendment in laws in upcoming budget.

The Federal Board of Revenue has estimated an amount of about Rs13 billion is involved due to non-compliance by the airlines, however Rs4 billion is identified as confirmed amount that can be recovered. – *Courtesy The News*

S.R.O. 464(I)/2012, Islamabad, the 4th May, 2012.– In exercise of the powers conferred by sub-section (1) of section 71 of the Sales Tax Act, 1990, read with clauses* (9) and (46) of section 2, section 3 and 4, sub-section (2) of section 6, sub-sections (3) and (4) of section 7, section 7A, clause (b) of sub-section 22, proviso to sub-section (1), and** sub-sections (3) and (4) of section 23 and section 60 thereof, the Federal Government is pleased to direct that the following further amendment shall be made in the Sales Tax Special Procedure Rules, 2007, namely:–

In the aforesaid Rules, in rule 13 in sub-rule (3), for the words "HUBCO or KAPCO", occurring twice, the words and comma "HUBCO, KAPCO or WAPDA Hydroelectric Power" shall be substituted.

C.No.4(4)ST-L&P/2011 Islamabad, the 15th May, 2012

SALES TAX GENERAL ORDER NO. 27/2012

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. 1058(I)/2011, dated the 23rd November, 2011" shall be substituted by "S.R.O. 1125(I)/2011, dated the 31st December, 2011".

(b) in the table, after serial number 572 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.
573	M/S Pak Embroidery Services	2500354167117	27122140720600U

C.No.4(11)ST-L&P/2011 Islamabad, the 15th May, 2012

SALES TAX GENERAL ORDER NO. 28/2012

Subject: **Amendment in STGO 17/2007 dated 13.09.2007 – allowing facility of zero-rating on supply of gas.**

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

* It should have been "sub-sections".
** The word "and" is superfluous.

following further amendments in its Sales Tax General Order No. 17 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. 1058(I)/2011, dated the 23rd November, 2011" shall be substituted by "S.R.O. 1125(I)/2011, dated the 31st December, 2011".

(b) in the table, after serial number 1099 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.**
1100	M/S Sally Textile Mills Limited	1301520501564	49797505937

2012 PTR 1041 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

G.E. Veerabhadrappa, President, D.K.Agarwal, Judicial Member, R.S. Syal, P.M. Jagtap and B. Ramakotaiah, Accountant Members

FACTS/HELD

1. **While interest paid by PE of foreign bank to H.O. is deductible in hands of PE, same interest is not taxable in hands of H.O.**

2. The assessee, a Japanese bank, carrying on business through a PE in India, paid interest of Rs. 5 crores to its H.O. & other branches. The assessee, in computing the profits assessable to tax in India, claimed that while the interest received by the H.O. & other branches from the PE was not chargeable to tax in India on the principle that the PE & H.O. were one & the same entity, the PE was entitled to claim a deduction under Article 7 of the DTAA. The AO held that the PE & the H.O. were deemed to be separate entities and that while the interest received by the H.O. from the PE was taxable under Article 11, deduction for that interest could not be allowed to the PE u/s 40(a)(i) as it had failed to deduct TDS. The CIT (A) followed the verdict of the Special Bench in ABN Amro Bank 98 TTJ 295 (Kol) (partly affirmed in ABN AMRO198 TM 376) and held that the interest was neither chargeable to tax nor allowable as a deduction. On appeal to the Tribunal, the matter was referred to a 5 Member Special Bench. HELD by the Special Bench:

   (i) On the question whether the interest paid by the PE to the H.O. is deductible, while such interest is not deductible under the Act because the payer & payee are the same person, Article 7(2) and 7(3) of the DTAA & its Protocol makes it clear that for the purpose of computing the profits attributable to the PE in India, **the PE is to be treated as a distinct and separate entity which is**

dealing wholly independently with the general enterprise of which it is a part and deduction has to be allowed for, inter alia, interest on moneys lent by the PE of a bank to its H.O.

(ii) On the question of taxability of the interest received by the H.O. from the PE, such interest is **not taxable** under the Act as both are, under the Act, the **same person and not separate entities & one cannot make profit out of himself**. The fiction created in Article 7(2) of the DTAA treating the PE as separate and independent entity does not extend to Article 11. Also, the interest paid by the PE is not interest paid in respect of debt claims forming part of the assets of the PE so as to attract Article 11(6). The DTAA, even assuming that it does create a liability, cannot be applied u/s 90(2) as it is contrary to the Act and less favourable to the assessee (Q whether the interest paid by the PE should be netted off against the interest received left open).

Appeals remanded back.

I.T.A. No. 5402/Mum/2006 (Assessment Year : 2003-04), I.T.A. No. 5458/Mum/2006 (Assessment Year : 2003-04) and I.T.A. No.3211/Mum/2007 (Assessment Year : 2003-04).

Decided on: 30th March, 2012.

Present at hearing: P.G. Pardiwala and S.E.Dastur, for Assessee. Girish Dave, G.C.Srivastava, Malthi Sridharan and Shri Jitendra Yadav, for Respondent.

JUDGMENT

Per Bench:–

This Special Bench of five Members has been constituted by the Hon'ble President, Income Tax Appellate Tribunal to consider and decide the following questions which are arising from the cross appeals filed in this case:

1. Whether or not on the facts and in the circumstances of the case, the CIT(A) was justified in holding that interest payable by the Indian PE of the foreign bank to its HO and other Overseas Branches, is not deductible in computing its total income.
2. Whether or not, on the facts and in the circumstances of the case and in law, the ld. CIT(A) erred in holding that interest income payable by the Indian PE of a foreign bank to its HO and

branch offices abroad cannot be taken into account for the purpose of computing the income of HO liable to be taxed in India.

2. The assessee in the present case viz. M/s Sumitomo Mitsui Banking Corporation is a Foreign Banking Company incorporated in and controlled from Japan. It carries on banking business in India through branch offices at Mumbai and New Delhi. The return of income for the year under consideration was filed by it on 28-11-2003 declaring total income of Rs.25,68,33,480/-. During the course of assessment proceedings, it was noted by the AO from the details of interest furnished by the assessee that interest of Rs.5,02,66,781/- was provided by the Indian branch offices (also referred to as Permanent Establishment i.e. 'PE in India') of the assessee bank as payable to its Head Office (also referred to as General Enterprise i.e. 'GE' in short) and overseas branches for the year under consideration. The AO also noted that tax at source was not deducted by the assessee from the said interest. He, therefore, required the assessee to explain why the interest payable by its Indian branches to head office and overseas branches should not be disallowed u/s 40(a)(i). In reply, it was submitted that the assessee bank is a non resident in India and as per the provisions of section 195 of the Income-tax Act, 1961, person making payment to a non resident of any sum is required to deduct tax from such payments only if such sum is chargeable to tax under the Act. It was contended that in a case where the payment to a non resident is not of the sum which is chargeable to tax under the Act, tax is not required to be deducted at all. It was submitted that the branches of the assessee bank in India constituted its permanent establishment and the same are not independent persons who are assessed to tax separately in India. It was contended that the said branches not being the separate entity and the entity being the one i.e. the assessee bank, interest payable to the head office and overseas branches of the assessee bank by its Indian branches did not constitute its income. Relying on the decision of Hon'ble Supreme Court in the case of *CIT vs. Kikabhai Prenchand (Sir) vs. CIT* 24 ITR 506, it was contended that no person can make profit or loss out of oneself and the recipient and payer of interest being the same i.e. Head Office of the assessee bank and its branches in India, it could not give rise to any income. Reliance was also placed on behalf of the assessee on the decision of Hon'ble Calcutta High Court in the case of *Belts Hartley Huett and Co. Ltd. vs. CIT* 116 ITR 425 wherein it was held that in law there could not be a valid transaction of sale between the branch office of the assessee in India and its head office in London and it was a elementary proposition that no person can enter into a contract with oneself. It was held that debiting or crediting one's account cannot alter this legal position. It was contended on behalf of the assessee that interest payable by its branches in India to head office thus was payment to self and such payment did not give rise to any income. Relying on the decision of Hon'ble Supreme Court in the

case of Transmission Corporation of *Andhra Pradesh Ltd. vs. CIT* 239 ITR 587, it was contended that interest payable to the head office of the assessee bank by its branches in India thus was not income chargeable to tax in India and there was no requirement of deduction of tax at source from the said interest and no question of disallowance of the said interest u/s 40(a)(i).

3. In so far as deductibility of the interest payable to the head office in the hands of branch offices in India is concerned, it was submitted on behalf of the assessee that interest so payable was allowable as deduction while computing profits attributable to the branch offices in India constituting permanent establishment in view of article 7(2) and 7(3) of the Indo-Japanese DTAA. It was contended that the provisions of article 7(3) of the DTAA makes it amply clear that in determining the profits of a permanent establishment, there shall be allowed as a deduction expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred, whether in the contracting state in which the permanent establishment is situated or elsewhere. It was submitted that paragraph 8 of the protocol no doubt makes it clear that no deduction shall be allowed for any payments made or amounts charged by a PE of an enterprise to its head office for the items specified therein. It was contended that the said paragraph 8, however, carves out an exception and specifies that any interest payable by a PE to the GE which is a banking institution, should be allowed. It was submitted that the assessee in the present case is a banking corporation and the interest payable to its head office by the Indian branches constituting PE is allowable as a deduction in view of the provisions of article 7(2) and 7(3) of the DTAA read with paragraph 8 of the protocol to the DTAA.

4. In support of its claim that interest payable by its branches in India to the head office in Japan was not chargeable to tax in India, another argument was raised on behalf of the assessee company relying on the provisions of article 11 of the DTAA between India and Japan. It was contended that as per article 11(2) of the DTAA, any interest arising in India and paid to a resident of Japan may also be taxed in India, although at the prescribed lower rate. It was contended that in terms of paragraph (6) of article 11, the provisions of paragraph 1 and 2, however, would not be applicable if the beneficial owner of the interest, being resident of contracting state, carries on business in other contracting State in which the interest arises through a permanent establishment situated therein and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment. It was contended that the assessee bank in the present case, which is resident of Japan and beneficial owner of the interest, is carrying on business in India through its permanent establishment and the debt in respect of which interest is payable was effectively connected with such permanent

establishment. It was contended that the provisions of paragraphs (1) and (2) of article 11 thus are not applicable in its case as per the provisions contained in paragraph (6) of article 11 of the Indo-Japanese DTAA. Attention of the AO was also invited by the assessee to article 14(3) of the Indo-US DTAA which specifically provided that the interest payable by a branch of a bank in India to its head office in USA should be taxed in India at the rates specified therein. It was contended that the Indo-Japanese DTAA, however, does not have any such provision corresponding to article 14(3) of the Indo-US DTAA providing that the interest payable to the head office of a bank in Japan by the branch in India will be taxable in India. It was contended that the deeming fiction created in article 7(2) treating the permanent establishment in India as a separate and independent entity is for the limited purpose of determining the profits attributable to the said PE and the same could not be extended to say that since the interest is allowable as deduction in the hands of PE, the same should also be taxed in the hands of the recipient GE as income. It was contended that interest earned by the head office of the assessee bank from its Indian branches thus could not be taxed in India.

5. The AO did not find merit in the submissions made on behalf of the assessee. According to him, as per the provisions of section 9(1)(v)(c), income by way of interest payable by a person who is a non resident, where the interest is payable in respect of any debt incurred or moneys borrowed and used, for the purposes of a business or a profession carried on by such person in India shall be deemed to accrue or arise in India. He also relied on Circular No. 740 dated 17-04-1996 issued by CBDT clarifying that the branch of a foreign company/concern in India is a separate entity for the purposes of taxation and interest paid or payable by such branch abroad would be liable to tax in India and would be governed by the provisions of section 115A of the Act. It was further clarified that if the double taxation avoidance agreement with the country where the parent company is assessed to tax provides for a lower rate of taxation, the same would be applicable. The AO held that interest in question was payable by a non resident i.e. the Indian branch of the assessee bank and since the said interest was payable in respect of debt incurred or moneys borrowed and used for the purpose of the business or profession carried on by such a person in India, the same was income deemed to accrue or arise in India as per the provisions of section 9(1)(v)(c). He, therefore, held that interest payable by the branches of assessee bank in India to its head office and London branch office was chargeable to tax in India and the Indian branches were liable to deduct tax at source from the said interest as per the provisions of section 195. Since no such tax was deducted at source from the interest payable to head office and London branch office, the AO disallowed the interest so paid by invoking the provisions of section 40(a)(i) and made addition to the extent of Rs.5,02,66,781/-. Relying on the CBDT Circular No. 740

(supra), the AO also held that interest payable to the head office of the assessee bank in Japan and London branch by the Indian branches was chargeable to tax at a concessional rate as per article 11 of the Indo-Japanese treaty. In addition to the said circular, reliance was also placed by the AO on the commentary of Klause Vogal in his book "Klause Vogel on Double Taxation Conventions" - Third Edition at para No. 89 and 90 on page No. 750 wherein it was stated that under article 11(5), interest shall be deemed to arise in a contracting state where, irrespective of the payer's residence, the interest is paid on an indebtedness of a permanent establishment in that contracting State and is borne by such permanent establishment.

6. As regards the argument of the assessee that payment of interest being a payment to self does not give rise to any income, the AO held that the same is not tenable because of the deeming provisions contained in article 7 of the treaty providing that the income of the branch should be computed as if it is a separate and distinct entity from the non resident. He held that the branch in India thus has to be treated as if it is an entity separate from the main entity for the purpose of computation of income and the provisions of domestic law including section 40(a)(i) will apply accordingly. He held that although the entity is one for the purpose of assessment, these are two separate entities for the purpose of computation of income. He thus held that even though the interest was allowable as deduction in the computation of income of the PE in India, the same was liable to be disallowed as per the provisions of section 40(a)(i) because of the failure to deduct tax on payment of such interest. Accordingly, the claim of the assessee for deduction of the said interest was disallowed by the AO by invoking the provisions of section 40(a)(i) in the assessment completed vide an order passed u/s 143(3).

7. Against the order passed by the AO u/s 143(3), an appeal was preferred by the assessee before the learned CIT(Appeals). As regards the deductibility of interest payable by the Indian branches to the Head Office of the assessee bank, it was submitted on behalf of the assessee before the learned CIT(Appeals) that the interest so payable was allowable as deduction in view of Article 7(3) of the Indo-Japanese DTAA. As regards the action of the AO in disallowing the said deduction by invoking the provisions of section 40(a)(i), it was contended that the Indian branch and head office of the assessee bank being one and the same entity, there was no liability to deduct tax from the interest u/s 195. It was contended that two different persons should be involved for application of section 195 viz. payer and payee and in the case of the assessee, both the payer and payee being one and the same person, there was no liability to deduct tax u/s 195. It was contended that the provisions of section 40(a)(i) thus had no application and the AO was not justified in invoking the said provisions for disallowing the deduction

claimed by the assessee on account of interest payable by Indian branches of the assessee bank to its head office.

8. After considering the submissions made on behalf of the assessee and the material available on record, the learned CIT(Appeals) was of the opinion that the issue relating to assessee's claim for deduction on account of interest payable by its Indian branches to the head office was squarely covered against the assessee by the decision of Kolkatta Special Bench of ITAT in the case of ABN Amro Bank NV 98 TTJ 295 wherein it was held that identity of head office and the branch being same, there cannot be any expenditure in case of Indian branches for the interest payable to the head office. Following the said decision of the Tribunal in the case of ABN Amro Bank NV (supra), he held that interest payable by the Indian branches of the assessee bank to its head office could not be allowed as deduction while computing the income of the Indian branches. Accordingly the addition made by the AO on account of disallowance of interest payable by the Indian branches to the head office while computing the profit attributable to the said branches constituting PE of the assessee bank in India was confirmed by the learned CIT(Appeals). He also held, following the decision of the Tribunal in the case of ABN Amro Bank NV (supra), that such interest not being allowable as deduction while computing the income of the Indian branches which constituted permanent establishment of the assessee bank, could not be brought to tax in India as income of the head office of the assessee bank. The addition made by the AO on account of such interest receivable by the head office of the assessee bank while computing its total income chargeable to tax in India therefore was deleted by him. Aggrieved by the order of the learned CIT(Appeals), the assessee and Revenue both have raised their grievance in the respective appeals filed before the Tribunal, which has been projected in the questions referred to this Special Bench for consideration and decision.

9. Shri Percy Pardiwala, learned Senior Advocate, appearing on behalf of M/s Sumitomo Mitsui Banking Corporation, appellant and M/s Bank of Tokyo Mitubhushi UFJ Ltd., intervener opened the arguments. He submitted that the issue arising from the appeal of the assessee, which has been referred to this Special Bench, relates to the deductibility of interest payable by the Indian branches of a foreign bank to its head office while computing the income of the said branches which constitute PE of the foreign bank in India. He submitted that such interest was held to be allowable expenditure by the AO accepting the stand of the assessee based on article 7(2) and 7(3) of the Indo-Japanese treaty. He submitted that deduction for the said interest representing expenditure of the PE of the assessee bank in India, however, was disallowed by the AO by invoking the provisions of section 40(a)(i) since no tax at source was deducted by the PE of the assessee bank in India from the said interest payable to the head office. He submitted that the learned CIT(Appeals),

however, has taken a different stand and held following the decision of Kolkatta Special Bench of ITAT in the case of ABN Amro Bank NV (supra) that interest payable by the PE of the assessee bank to its head office was not an expenditure since it constituted a payment to self. He then took us through the order of the Special Bench passed in the case of ABN Amro Bank NV (supra) to point out that branch in India of a foreign bank and its overseas head office were treated as two parts of the same entity and it was held that payment of interest by the branch to head office being a payment to self was not allowable as expenditure as per the domestic law. He submitted that the said decision of Kolkatta Special Bench of ITAT in the case of ABN Amro Bank NV(supra) has since been reversed by the Hon'ble Calcutta High Court holding that the PE in India is to be treated as independent entity for determining the profit attributable to it in India and the interest payable to head office has to be allowed as expenditure. He submitted that it was also held by the Hon'ble Calcutta High Court that tax is not deductible from such interest payable by the PE in India to the overseas head office of a foreign bank and there is no question of making disallowance of such interest expenditure by invoking the provisions of section 40(a)(i).

10. Shri Pardiwala took us through the provisions of article 7(2) and 7(3) of the Indo-Japanese DTAA placed at page No. 133 of the Revenue's paper book II. He also took us through para 7 and 8(1) of the protocol placed at page No. 148 of the Revenue's paper book II. He submitted that this portion of the protocol makes it clear that as per article 7(2) read with article 7(3) of the Indo-Japanese treaty, interest payable by PE in India to the overseas head office is an allowable expenditure while computing the profit attributable to the PE only in case of banking institution. He contended that such interest under the domestic law no doubt cannot be claimed as deduction by the assessee being payment to self but under the relevant treaty, the assessee is entitled to claim deduction as per article 7(2) and 7(3) on account of interest payable by its PE to head office while computing the profit attributable to the PE. As regards the applicability of the provisions of section 40(a)(i) which were invoked by the AO to make a disallowance on account of such interest paid by PE to GE, Shri Pardiwala submitted that the said provisions are attracted only when interest payable by PE in India to the overseas head office of the assessee bank is chargeable to tax in India. He submitted that the issue relating to chargeability of the said interest to tax in the hands of the assessee in India is involved in the appeal of the Revenue and since the said issue is also referred to this Special Bench, arguments on this aspect of the matter will be advanced by him in more details while replying to the arguments of the Revenue thereon.

11. Shri Girish Dave, Special Counsel of the Revenue, in reply, did not raise any material contention to dispute the claim of the assessee that interest payable by PE of the assessee bank in India to its HO abroad is

allowable as deduction while computing the profits of the PE chargeable to tax in India in terms of article 7(2) & 7(3) of the Indo-Japanese treaty. He, however, strongly supported the action of the AO in disallowing the deduction claimed by the assessee for the said interest by invoking the provisions of section 40(a)(i) of the Act as a result of the assessee's failure to deduct tax at source from the payment of the said interest as required by the provisions of section 195 of he Act. He contended that the said interest is chargeable to tax in India in the hands of GE and assessee therefore was liable to deduct tax at source from the same. In support of this contention, he relied heavily on the decision of Hon'ble Supreme Court in the case of Hyundai Heavy Industries reported in 291 ITR 482. He submitted that permanent establishment in India has been treated by the Hon'ble Supreme Court in the said decision as a separate profit centre and although the observation of the Hon'ble Supreme Court in this context has come as obiter dicta, the same is binding on this Special Bench. He submitted that legal jurisdiction and fiscal jurisdiction are two different concepts and contended that when a foreign enterprise carries on business through a permanent establishment in India, it brings itself within the fiscal jurisdiction of India. He invited our attention to the observation recorded by the Hon'ble Supreme Court in the case of Hyundai Heavy Industries at page No. 492 of the report treating the permanent establishment as a distinct and separate entity. He also invited our attention to the observations recorded by the Hon'ble Supreme Court at page 493 of the report to the effect that when GE sets up a PE in another country, it brings itself within the fiscal jurisdiction of that country to such a degree that such other country can tax all profits that the GE derives from the source country, whether through a PE or not. It was held that it is the act of setting up a PE which triggers the taxability of transactions in the source state.

12. As regards the decision of Hon'ble Calcutta High Court in the case of ABN Amro NV (supra) relied upon by Shri. Pardiwala, Shri Dave contended that the said decision not being that of Jurisdictional High Court is not binding on this Special Bench. In support of this contention, he relied inter alia, on the decision of Hon'ble Bombay High Court in the case of *Geoffrey Manners and Co. vs. CIT* 221 ITR 695 and that of Mumbai Special Bench of the Tribunal in the case of *Mahindra & Mahindra Ltd. vs. DCIT* 30 SOT 374 (Mumbai) (S.B.). He then invited our attention to a chart prepared and furnished by him showing contradictions and inconsistencies in the findings and observations recorded by the Hon'ble Calcutta High Court in the judgment delivered in the said case. He submitted that the PE in India and overseas head office of a foreign bank are held to be two distinct and separate entities by the Hon'ble Calcutta High Court in some places whereas they are treated as one entity for the purpose of TDS u/s 195(1). He submitted that interest payable by the PE in India has been held to be not taxable in the hands of head office in India by the Hon'ble Calcutta High Court without giving

any reason whatsoever in support. He submitted that even article 11 of the DTAA, which is relevant and vital in this context, has not been discussed and considered by the Hon'ble Calcutta High Court.

13. Shri Girish Dave submitted that the assessee is adopting split approach by claiming deduction for interest under treaty and by claiming exemption for the same interest in the hands of recipients under local law. He submitted that articles 7(2) and 7(3) of the treaty under which the assessee is claiming deduction for such interest recognize PE and head office as two distinct entities especially in respect of interest in so far as banking entity is concerned. He contended that full effect has to be given to such treatment for considering the deductibility as well as taxability of interest. He invited our attention to page No. 133 of his paper book to show the new convention agreed by both the Governments in exercise of the powers conferred by section 90 of the Income-tax Act and submitted that as a result of such agreement, the said convention has become a part of local law. He also invited our attention to article 23 of the said convention at page No. 143 of his paper book which provides that the laws in force in either of the contracting states shall continue to govern the taxation of income in the contracting state except where express provisions to the contrary are made in the convention. He contended that this issue, therefore, has to be decided as per the relevant provisions made in the said convention governing the issue and not as per the provisions of local law.

14. Shri Girish Dave invited our attention to the Balance Sheet of Indian branches of the assessee bank as on 31-03-2003 placed at page No. 7 of his paper book Vol. No. I. to point out that there was no borrowing made by the Indian branches in India whereas the total borrowing made from outside India was to the tune of Rs. 238.10 crores. He also pointed out that capital remitted by head office was reflected separately in the balance sheet of the Indian branches which clearly shows that PE and HO are independent entities. He invited our attention to page 9 of his paper book Vol. I to show that subordinate debts of Rs.47.48 crores were shown to be received by the Indian branches of the assessee bank from its head office which were payable only after settlement of other priority debts. He contended that these entries passed in the books of accounts of the Indian branches further show that head office is a distinct and separate entity. He then invited our attention to page No. 19 of the paper book Vol. I to point out that interest received by the Indian branches from London branch of the assessee bank was shown as income of PE in India.

15. Reference was made by Mr. Dave to article 7(3)(b) of India-Netherland treaty whereby interest payable by head office to PE in case of banking enterprise is made chargeable to tax in India in the hands of Indian PE. He contended that accounts prepared symmetrically can be accepted by the tax authorities and PE in such case should be treated as subsidiary. He contended that there is virtually no difference in PE and

subsidiary when it comes to taxation and, therefore, PE is to be treated as subsidiary while dealing with the taxation of a banking enterprise.

16. Shri Dave then took us through the provisions of article 11 of Indo-Japanese treaty and contended that treaty is to be read as part of the domestic law and it is to be applied when there is nothing contrary contained in the domestic law. He contended that interest payable by Indian branches of the assessee bank to its head office is income of the head office which has definitely arisen in India and since the same is payable to the head office which is resident of Japan, it is taxable in Japan as per article 11(1). He contended that the said interest income, however, is also be taxed in India at the concessional rate of 10% as per article 11(2) of the Indo-Japanese treaty in the hands of head office if it is the beneficial owner of interest. He submitted that section 5(2)(b) of the Income-tax Act,1961 covers income that accrues or arises in India or deemed to accrue or arise in India. He submitted that article 11(2), on the other hand, covers only interest income arising in India. He submitted that article 11(6) of the Indo-Japanese treaty enumerates the circumstances in which interest will be treated as business income under article 7 of the treaty. He contended that article 7 thus makes inroad in article 11. He contended that similar provision is there in article 10(4) which deals with taxation of dividend. He then referred to the commentary on clause (6) of article 11 and also referred to article 23 of Indo-Japanese treaty to explain the applicability thereof.

17. Shri Dave cited the decision of Canadian Federal Court of Appeal in the case of Cudd Pressure Control Inc. (Docket no. A-369-95 dated October 19, 1998) and invited our attention to paragraph no. 32 thereof at page 131 of his paper book wherein it was held that if the amount of notional rent was never included as income in the parent company's tax return, the PE may not derive the corresponding benefit of a deduction for rent. It was held that to allow such a deduction would lead to the avoidance of tax on the rental income attributed to the parent company. He contended that this decision is relevant and equally applicable in the present context. He also relied on the decision of Sindh High Court in the case of ABN Ambro Bank 2011 PTD 438 and invited our attention specifically to the conclusion recorded in paragraph No. 19 of the said judgment which, according to him, is relevant in the present context. He also relied on the decision of Mumbai Bench of ITAT in the case of Dresdner Bank AG 108 ITD 375 and contended that observations and findings recorded in the said case in the context of PE are equally applicable in the case of GE.

18. Shri Girish Dave then invited our attention to page No.5 of the Revenue's paper book Vol. I to point out that interest of Rs.66.16 crores earned by the Indian branches was inclusive of interest of Rs.3 lakhs received by the said branches from London branch of the assessee bank. He pointed out that similarly interest expenses of Rs.31.59 crores shown

by the Indian branches was inclusive of interest payable to head office of the assessee bank. He contended that the stand taken by the assessee in this regard before the AO (page No. 12 of the paper book) that entries made in the books alone cannot give rise to income in India is not in conformity with the decision of Hon'ble Supreme Court in the case of *Standard Triumph Motor Co. Ltd. vs. CIT* reported in 67 Taxman 160. He submitted that similarly the stand taken by the assessee that interest payable by the PE in India was not taxable income in the hands of overseas GE in India in view of article 11(6) of the treaty is not acceptable. He submitted that scope of article 11(6) has been explained in the UN commentary and the situations in which article 11(6) is applicable are also well identified. He contended that such situation does not exist in the present case especially when we are concerned with interest paid by the PE of the assessee bank in India to its UK branch.

19. Shri Girish Dave then took us through pages 11 to 13 of the assessment order where the AO has dealt with the contentions raised on behalf of the assessee on this issue and strongly relied on the same. He submitted that the CBDT circular No. 740 dated 17-04-1996 relied upon by the AO is squarely applicable in the present context. He also relied on the OECD commentary wherein scope and purpose of articles 11(1) and 11(2) of the treaty has been explained. He then relied on the decision of Queen's Bench Division & Court of Appeal in the case of *Solomon vs. Commissioners of Customs & Excise* [1967] 2 QB 116 and submitted that the observations recorded therein at page 254 of his paper book book Vol. 2 are vital to resolve the conflict in treaty and domestic law. He contended that when interest payable by PE to head office is deductible while computing the income of the PE, how the same interest is not taxable as income in the hands of head office.

20. Shri Percy Pardiwala, in reply, submitted that interest payable by the PE of assessee bank in India to its head office abroad is not allowable as deduction under domestic law since it is a payment to self. He contended that similarly there is no question of taxing such interest in India as income of the head office under domestic law. He contended that only because of the provisions contained in article 7(2) and 7(3), the assessee is entitled to get deduction on account of interest payable to head office for the purpose computing profit attributable to the PE in India. He submitted that such deduction on account of interest can be disallowed u/s 40(a)(ia) if assessee fails to deduct tax at source. He contended that the said provision, however, is not applicable in the present case firstly because interest expenses are allowed as deduction under treaty and domestic law has no application in relation to allowability thereof including section 40(a)(i) and secondly because section 195 itself is not attracted since interest is not income chargeable to tax in India in the hands of payee i.e. head office of the assessee bank either under the domestic law or even under the relevant DTAA.

21. Shri Pardiwala invited our attention to the decision of Special Bench of ITAT in the case of ABN Amro Bank NV (supra) wherein it was held that interest paid by PE to GE being payment made to self cannot be allowed as deduction in the hands of PE or treated as income in the hands of GE under domestic law. He submitted that the claim of the assessee for deduction of such interest based on article 7(2) and 7(3) of DTAA was also disallowed by the Special Bench of ITAT and the decision to this effect only was challenged by the assessee in an appeal filed before the Hon'ble Calcutta High Court. He submitted that this issue has been decided by the Hon'ble Calcutta High Court in favour of the assessee allowing its claim for deduction on account of interest paid by PE to GE relying on article 7(2) and 7(3) of the treaty. He then briefly took us through the said articles and para No. 7 and 8 of the protocol to show how the assessee is entitled for deduction on account of interest payable by PE to GE under treaty.

22. Shri Pardiwala then invited our attention to article 11(1) of the treaty dealing with interest deemed to arise in India. He contended that the said article has no application to the facts of the assessee's case since it is a case of interest payable by assessee's own PE in India. He contended that similarly article 11(2) of the treaty has no application in the present context since it provides that the interest may also be taxed in the contracting States in which it arises but only according to the laws of that contracting States. He contended that as far as Indian Tax Laws are concerned, interest payable by PE is not taxable as income in the hands of GE being payment to self. He contended that the expression used in article 11(2) "taxed" means and includes chargeability, rate and collection. He referred to article 14(3) of Indo-US treaty in this context and submitted that if interest income received by head office from PE in India had been taxable in India as per article 11(2), there would have been no need to have such an article separately as article 14(3) of Indo-Us treaty. He contended that the deeming fiction created in article 7(2) and 7(3) treating PE and GE as separate entities has limited application and the same cannot be extended and applied to article 11(1) and 11(2). In support of this contention, he relied on the decision of the Hon'ble Supreme Court in the cases of *CIT vs. Ajay Products Ltd.* 55 ITR 741 and *CIT vs. Mother India Refrigeration Industries P. Ltd.* 155 ITR 711. He also contended that in any case there is no charging provision in local law to bring the interest payable by PE to head office to tax in India and in the absence of such charging provision, the treaty cannot be relied upon to bring to tax such interest income which is otherwise not taxable as per the domestic law. He reiterated that the legal fiction created in article 7(2) is applicable for the limited purpose of determining the profit attributable to the PE in India and the same cannot be extended and applied to article 11(2). In support of this contention, he relied on the decision of Hon'ble Gujarat High Court in the case of *CIT vs. Bai Vina* 57 ITR 100 wherein the scope of legal fiction has been explained.

23. Shri Pardiwala then proceeded to submit that even if both GE and PE are treated as separate entities, the taxability of interest receivable by GE from PE will have to be considered as per article 11(6). He then took us through the relevant portion of commentary on article 11 at page 164 of the paper book to point out that the power given in article 11(2) to tax interest in the source country is subject to the condition that the local law of that country permits such charge. He relied on the commentary of Klause Vogal to contend that article 11(6) in such case becomes applicable and it takes out the case of the assessee out of article 11(2) and put it under article 7. He contended that the interest payable by PE to GE, however, cannot be the income attributable directly or indirectly to the PE and the same, therefore, cannot be brought to tax in India even under article 7. He submitted that this is so because the PE cannot be said to have played any role in generation of interest income to the head office because this interest is payable by the PE itself to the head office. He contended that if at all this interest is considered as income indirectly attributable to the PE, the deduction allowed to the PE for such interest under article 7(2) and 7(3) will get nullified, which cannot be the intention.

24. Shri Pardiwala then took us through the relevant portion of the judgment of Hon'ble Calcutta High Court in the case of ABM Amro Bank (supra) to explain the exact proposition propounded therein and the effects thereof. He submitted that interest payable by PE to head office, as held by the Hon'ble Calcutta High Court in the case of *ABN Amro Bank* (supra), is not chargeable to tax in India in the hands of head office as per the convention. Although he agreed that no reasons are specifically given by the Hon'ble Calcutta High Court for coming to this conclusion, he submitted that the Tribunal for this reason cannot hold the decision of Hon'ble Calcutta High Court as per incurim. He contended that this Special Bench of the Tribunal, on the other hand, is bound to follow the said decision of the Hon'ble Calcutta High Court being the only decision of the High Court available on the issue. He contended that the decision rendered by the Hon'ble Calcutta High Court on the issue is very clear although there may not be elaborate reasons given by their lordships to come to this conclusion.

25. Shri Pardiwala then referred to the provisions of section 195 and submitted that the liability to deduct tax as per the said provisions is that of the company i.e. foreign enterprise. He submitted that impugned interest was payable to the foreign enterprise and how it could have deducted tax from payment made to itself. He contended that the provisions of section 195 as well as other provisions relevant in this context contemplate two different entities and the same, therefore, are not applicable in the present case where payer and payee are not two different entities but are one and the same entity. He contended that there was thus no requirement of deduction of tax at source from the

impugned interest payable by the PE to GE as per the provisions of section 195 and there was no question of disallowance for such interest u/s 40(a)(i) for failure to deduct tax at source.

26. As regards the decision of Hon'ble Bombay High Court in the case of Geoffrey Manners and Co. vs. CIT (supra) cited by Shri. Girish Dave, Mr. Pardiwala invited our attention to the relevant portion of the said judgment (at page No. 393 of the paper book) to point out that the earlier decision rendered in the case of Thane Electricity has been simply followed by the Hon'ble Bombay High Court in the said case. He submitted that the decision in the case of Thane Electricity has been duly considered by the Hon'ble High Court in the case of Vilso Dine (copy enclosed). As regards the decision of the Special Bench of ITAT in the case of Mahendra & Mahendra (supra) cited by Shri Girish Dave, Shri Pardiwala submitted that the decision of non jurisdictional High Court in that case was not followed by the Special Bench of the Tribunal for specific reasons which are not in existence in the present case. He submitted that there is no material difference even between the Indo-Netherland treaty and Indo-Japanese treaty so as to say that the decision of Hon'ble Calcutta High Court in the case of ABN Amro Bank rendered in the context of Indo-Netherland treaty cannot be applied in the present case involving Indo-Japanese treaty.

27. As regards the separate profit & loss account and balance sheet prepared by the assessee of Indian branches on which reliance was placed by Shri Girish Dave to make out the case that the said branches constituting PE of the assessee bank in India has separate and independent existence, Shri Pardiwala submitted that the profit & loss account and balance sheet of Indian branches were prepared separately by the assessee as per the specific requirement of the Reserve Bank of India. He submitted that finally the accounts of the assessee bank are consolidated at head office level or entity level wherein inter branch figures would get squared off and are not reflected separately. He contended that branch of a bank is only a part of the entity having no separate existence or identity in legal parlance. As regards the decision of Mumbai Bench of ITAT in the case of *Industries Development Bank of India* reported in 91 ITD 34 and relied upon by Shri. Girish Dave in this context, Shri Pardiwala submitted that the issue involved in the said case was in relation to exemption u/s 54E in respect of IDBI Bonds. He submitted that the assessee in the said case viz. the IDBI had claimed the exemption u/s 54E in respect of Bonds issued by itself and the decision was rendered by the Tribunal in this context which is entirely different from the context in which the issue has arisen for consideration of the Special Bench of the Tribunal in the present case.

28. As regards the contention of Shri Girish Dave that Kolkata Special Bench of the Tribunal in the case of ABN Amro Bank (supra) had placed mistaken reliance on the decision of Hon'ble Calcutta High Court

in the case of *Bunge & Co. Ltd.* 79 ITR 93 in paragraph Nos. 31 and 32, Shri Pardiwala invited our attention to paragraph No. 30 of the order of the Special Bench to submit that the issue was decided by the Special Bench independently de-horse the decision of Hon'ble Calcutta High Court. He submitted that the said decision was rendered on the basis of pre-amended provisions of section 195 and it was only supported by relying on two decisions of Hon'ble Calcutta High Court. He contended that it cannot, therefore, be said that amendment in section 195 has not been considered by the Special Bench.

29. As regards the decision of Sindh High Court in the case of ABN Amro Bank (supra) relied upon by Shri Girish Dave, Shri Pardiwala submitted that the issue involved in that case was relating to taxation of interest income received by the branch from head office and not relating to interest received by head office. He submitted that the issue involved in the said case, therefore, was different and the same in any case was decided on the basis of local law and not treaty. He submitted that similarly the decision of Canadian Federal Court of Appeal in the case of Cudd Pressure Control Inc. (supra) relied upon by Shri Girish Dave involved a limited issue relating to deduction of notional rent in the case of branch which is entirely different from the issue involved in the present case.

30. As regards the decision of Mumbai Bench of ITAT in the case of *Dresdner Bank AG* (supra) relied upon by Shri Girish Dave, Mr. Pardiwala submitted that the issue involved in the said case was whether interest income received by Indian branch from other branch is taxable in India or not. He submitted that the decision rendered by the Tribunal on this issue in the case of *Dresdner Bank AG* (supra) is running contrary to the decision of Special Bench of ITAT in the case of *ABN Amro Bank* (supra) and the Tribunal in its subsequent decision rendered in the case of *American Express Bank Ltd.* (ITA No.2439/Mum/1996 dated 28-02-2007) has clearly made out and highlighted this aspect. He submitted that in the case of *Dresden Bank AG*, reliance was placed by the Tribunal on its earlier decision rendered in the case of *Bank Indosuez* which was in relation to treaty and the said reliance, therefore, was clearly misplaced. As regards the contention of Shri Girish Dave that interest having been credited in the books, it is deemed to have been received by head office, reliance was placed by Shri Pardiwala on the decision of Hon'ble Supreme Court in the case of *CIT vs. Soshoku Ltd.* 125 ITR 525 wherein it was held that credit in the books does not always tantamount to receipt.

31. As regards the CBDT Circular No. 740 (supra) relied upon by Shri Girish Dave, Shri Paridwala submitted that the same is detrimental to the assessee and, therefore, cannot be relied upon. He submitted that the said circular in any case has been issued with reference to section 115A which covers interest received by a foreign company from Indian concern. He contended that Indian branch of a foreign bank cannot be

considered as Indian concern as held by the Hon'ble Bombay High Court in the case of *CIT vs. Dorr-Oliver (India) Ltd.* 209 ITR 691. As regards the decision of *Soloman* (supra) relied upon by Shri Girish Dave, Shri Pardiwala submitted that the relevant portion of the said decision relied upon by the learned DR at page No. 254 of the paper book contains only intervening observation and not the decision of the Court. He submitted that the conclusion of the Court actually starts on page No. 258 with J. Diplock's portion on page 263 and the observations relied upon by Shri Girish Dave at page 254 are not there in the main judgment.

32 In the rejoinder, Shri Girish Dave submitted that the relevant DTAA becomes part of domestic law and it overrides the domestic law wherever there is contradiction between domestic law and treaty. He submitted that fiction created in article 7(2) and 7(3) cannot be restricted to the said article alone but the same operates through the entire treaty which is to be read as a whole. He again invited our attention to the judgment of Hon'ble Sindh High Court in the case of *ABN Amro Bank (Royal Bank of Scotland)* (supra) and submitted that a very clear principle of law has been laid down therein on this issue in paragraph No. 15. As regards the decision of Volson Dine (supra) cited by Shri Pardiwala, Shri Dave submitted that the said decision was rendered by Hon'ble Madras High Court in the context of constitutional validity and the said decision of non jurisdictional High Court was held to be binding on the Tribunal because the Tribunal was held to have no power to go into constitutionality. As regards the decision of Hon'ble Madhya Pradesh High Court in the case of *National Textile Corporation Ltd. vs. CIT* 171 Taxman 179 cited by Shri. Pardiwala in relation to sub-silencio decision, Mr. Dave submitted that only the latter portion of commentary of Soloman Jurispudance was considered therein ignoring the earlier portion wherein instances are specifically given to point out the situations where binding precedent gets diluted on account of sub silencio. As regards the decision of Special Bench of ITAT in the case of *ABN Amro Bank* (supra), Shri Dave invited our attention to page No. 8 of the judgment of Hon'ble Calcutta High Court passed in the case of ABN Amro Bank (supra) and pointed out that the earlier decision of the Court relied upon by the Special Bench has been diluted by the Hon'ble High Court itself.

33. Shri Dave submitted that interest payable by PE to GE is the income which has arisen in India and the same, therefore, is chargeable to tax in India in the hands of GE u/s 5 of the Income-tax Act, 1961. He submitted that the same is also chargeable to tax in the hands of the assessee as per article 11(2) of the relevant treaty as rightly held by the AO for the reasons given in detail in the assessment order. He submitted that PE and HO are now defined in section 92F and the same further supports the case of the Revenue that PE and HO are different entities for taxation purpose. He submitted that it is not a case where treaty is

imposing tax as sought to be contended by Shri Pardiwala. He submitted that article 14(3) of the US treaty further confirms this position as it presupposes that interest is chargeable to tax in India under domestic law.

34. Shri Soli Dastur, learned Senior Advocate, appearing for M/s Antwerp Diamond Bank - NV, submitted that the head office of the assessee bank in this case is in Belgium with branch in India. He submitted that the HO in Belgium advanced money to the Indian branch on which Indian branch paid interest to the HO. He submitted that in the return of income filed for the year under consideration, interest payable to HO was claimed as deduction while computing the income of the Indian branch constituting PE of the assessee bank in India while interest receivable by HO was offered to tax as income in the hands of HO. He submitted that while the AO accepted the interest income offered by the assessee, deduction claimed on account of interest payable while computing the income of PE in India was disallowed by him. He submitted that the learned CIT (Appeals) confirmed the said disallowance following the decision of Special Bench of ITAT in the case of ABN Amro Bank (supra) wherein it was held that interest payable by the PE in India to GE abroad could not be allowed as expenditure while computing profits attributable to PS being payment to self. He submitted that this disallowance made by the AO and confirmed by the learned CIT(A) has been challenged by the assessee in the ground originally raised in its appeal filed before the Tribunal whereas the issue relating to taxability of interest receivable from the Indian PE which was offered in the hands of GE in India has been raised by the assessee by way of additional ground.

35. As regards the interest payable by the PE to GE, Shri Dastur submitted that although the same is not deductible under the domestic law i.e Indian Income Tax Act, 1961, the assessee is claiming the said deduction under the tax treaty between India and Belgium. He invited our attention to article 4 of the treaty to point out that the “resident” is defined therein to mean a “person”. He also invited our attention to article 5 of the treaty whereby a branch of a foreign bank in India is considered as its PE in India. He then referred to article 7(1) which provides that business profits are assessable only in a country of residence unless there is a PE in other contracting State. He contended that Indian branch of the assessee bank thus constitutes its PE in India and only the profit attributable to such PE is taxable in India. He submitted that for computing such profit, PE has to be treated as an independent entity as per article 7(2) of the treaty. He contended that GE and PE thus are to be treated as separate and distinct entities working at arm’s length for the purpose of computing profits attributable to the PE and going by this deeming fiction created in article 7(2), interest payable by PE to GE is to be allowed as deduction for determining the profits of

PE taxable in India. He submitted that the rate at which interest is payable by the PE to GE was approved by RBI and was also accepted by TPO in subsequent years as an arm's length interest rate. He submitted that article 7(3)(b) places restriction on allowing deduction on account of interest payable by PE to GE and as per the said restriction, such deduction is to be allowed only in case of banking company like that of the assessee in the present case. He contended that legal position of allowing the deduction on account of interest payable by PE to GE of a banking company thus is very clear as per the relevant provisions of the treaty and there is no ambiguity on this aspect.

36. Coming to the issue of taxability of interest payable by PE in the hands of GE in India, Shri Dastur submitted that as per article 11(1) of the treaty, such interest is taxable in Belgium. Referring to article 11(2) of the treaty, he contended that it contemplates two different entities so as to attract article 11(2). He then took us through the relevant portion of OECD commentary on article 11(2) and submitted that if the interest payable by PE to GE is not chargeable to tax in India as per domestic law, it cannot be brought to tax under the treaty. Relying on the decision of Hon'ble Andhra Pradesh High Court in the case of *CIT vs. Visakhapatnam Port Trust* 144 ITR 146, he contended that OECD commentary should be relied upon while interpreting the treaties. He submitted that in the case of *Union of India vs. Azadi Bachao Andolan* 263 ITR 706, the Hon'ble Supreme Court at page No. 741 has also referred to and relied on OECD commentary.

37. Shri. Dastur then took us through the relevant portion of the judgment of Hon'ble Calcutta High Court in the case *ABN Amro Bank* (supra) to demonstrate that a similar issue involved in the said case has been decided by the Hon'ble Calcutta High Court in favour of the assessee. He contended that the said decision being the only decision of the High Court directly on the issue, this Special Bench is bound to follow the same. He submitted that keeping in view the said decision, additional ground has been raised by the assessee in its appeal challenging the chargeability of interest payable by PE as income in the hands of GE in India. He submitted that the first step in this regard is to find out whether such interest is assessable under the domestic law. He contended that the Indian branch of the assessee bank (PE) and its Head office abroad (GE) are treated as one and the same entity under the domestic law and payment of interest by PE to GE being a payment to self does not result in any income. For this contention, he placed reliance on the decisions of Hon'ble Calcutta High Court in the case of *Betts Hartley Heuttand Co.Ltd. vs. CIT* 116 ITR 425, Allahabad High Court in the case of *Ramlal Bechairam vs. CIT* 14 ITR 1 and Hon'ble Supreme Court in the cases of *Kikabhai Premchand (Sir) vs. CIT* 24 ITR 506 and *Union of India vs. Azadi Bachao Andolan* 263 ITR 706.

38. Shri Dastur submitted that allowability of interest in the case of PE and taxability of interest in the hands of GE are two separate issues. He contended that the assessee, therefore, can rely on the treaty in support of its case on one issue and can rely on domestic law in support of its case on the other issue. In support of this contention, he relied on the decision of Hon'ble Supreme Court in the case of *Ishikawajima-harima Heavy Industries Ltd. vs. Director of Income-tax* 288 ITR 408. He then referred to article 11(2) of the treaty to point out the expression "person" used therein. He submitted that neither PE nor HO is a person and it is the assessee bank that is a person which is not a resident of India. He then referred to the expression "person paying interest" used in article 11(5) of the treaty and submitted that there being no such person paying interest, there does not arise any interest income which can be taxed under article 11(5). He submitted that article 11(4), on the other hand, clearly applies to the facts of the assessee's case. In this regard, he again relied on the decision of Hon'ble Supreme Court in the case of *Ishikawajima-harima Heavy Industries Ltd. vs. Director of Income-tax* (supra) and submitted that the said decision rendered in the context of article 12(5) is applicable in the present case as the provisions of article 12(5) are similar to that of article 11(4).

39 Shri Dastur then referred to commentary on article 7 of the treaty and also the decision of Hon'ble Supreme Court in the case of *Union of India vs. Azadi Bachao Andolan* 263 ITR 706 at page No. 748 to contend that if the interest payable by the Indian PE is to be brought to tax in India in the hands of GE, corresponding provision has to be made in the Indian Income Tax Act by making the necessary amendment. He contended that no such amendment, however, has been brought in by the legislature to do so. He contended that fiction created in article 7(2) treating the PE in India as an independent entity for computing the profits attributable to the said PE cannot be extended and applied to article 11(2) to bring to tax interest payable by PE in the hands of GE. In support of this contention, he relied on the decision of Hon'ble Supreme Court in the cases of *Ishikawajima-harima Heavy Industries Ltd. vs. Director of Income-tax* (supra), *CIT vs. Vadilal Lallubhai*, *CIT vs. Sakarlal Balabhai* 86 ITR 2 and *CIT vs. Ajay Products Ltd.* 55 ITR 741.

40. Shri Dastur then referred to the decision of Hon'ble Calcutta High Court in the case of ABN Amro Bank (supra) and submitted that section 195 is held to be not applicable in respect of interest payable by PE to GE on the ground that such interest is not chargeable to tax under the domestic law. He contended that this issue involved for consideration of Special Bench thus is squarely covered by the said decision of Hon'ble Calcutta High Court and the same being the only decision of the Hon'ble High Court on the issue, this Special Bench is bound to follow the same. In support of this contention, he relied on the decision of Hon'ble Bombay High Court in the case of *CIT vs. Godavaridevi Saraf (Smt.)* 113 ITR 589,

CIT vs. Nirmalabai K. Darekar 186 ITR 242 and *CIT vs. Thana Electricity Supply Ltd.* 206 ITR 727. He also relied on the decision of Hon'ble Madhya Pradesh High Court in the case of *CIT vs. Vrajlal Manilal and Co.* 127 ITR 512 and the unreported decision of Hon'ble Bombay High Court in Civil Appeal No. 58 of 2009 dated 21-09-2010 (copy filed). He further relied on the decision of Hon'ble Delhi High Court in the case of *Bikha Ram vs. Union of India* 238 ITR 113 and the decision of Mumbai Bench of ITAT in the case of *Datamatics Financial Services Ltd. vs. JCIT* 95 ITD 23 wherein the binding effects of the decision of non jurisdictional High Court on the Tribunal are discussed and explained. He contended that the decision of Hon'ble Calcutta High Court in the case of ABN Amro Bank (supra) thus is binding on this Special Bench and the same should be followed to decide the issue in favour of the assessee.

41. Shri Dastur pointed out that in the case of non banking company, interest payable by PE to GE is not deductible under article 7(3) of the treaty. He contended that if article 11(2) of the treaty is interpreted in a way the Revenue wants, such interest will be taxable in the hands of GE in India without there being deduction for the said interest allowable in the hands of PE. He contended that this will lead to absurd result which cannot be the intention. He contended that article 7 thus will have priority and there is no need to go to article 11 at all. He contended that article 7(7) makes this position further clear.

42. Shri Srivastava, Special Counsel for the Revenue, appearing in the case of M/s Antwerp Diamond Bank NV, submitted that article 7(2) of the treaty lays down the procedure for apportionment of income between head office and Indian branch. He submitted that as per the said scheme of apportionment, what can be allowed as deduction is cost of funds to the head office. He contended that if, however, there is no such cost incurred at HO level, interest payable by the branch to the HO will be only a notional expenditure which cannot be apportioned as per article 7(2) of the treaty. He also contended that whether such interest payment is at arm's length or not is not relevant in this context. He relied on the report on the taxation of multi national banking enterprise in support of this contention and referred to para No. 49 of the said report in particular (copy filed).

43. Shri Srivastava submitted that income arising in India to a non resident is chargeable to tax in India as per the provisions of section 4 and 5(2) of the Incometax Act. He also referred to article 11(1) of the treaty which deals with the taxability of interest arising in India. He submitted that the funds which generated the interest were utilized in India by PE in India and even the interest on the said funds was paid by that PE. He submitted that in article 11(1) of the treaty, only payee is identified but not the payer. He contended that interest payable by PE on the loans utilized in India thus was arising in India and the same is also

to be taxed in India in the hands of the assessee being a non resident at fixed rate as per article 11(2). He contended that if the provisions of sections 4 and (5)(2) are read with article 11(1) of the treaty, the said interest thus is chargeable to tax in India in the hands of the assessee being non resident at the fixed rate. He also contended that the transactions involved in the transfer of amount from HO to branch involve two different tax jurisdiction and it is, therefore, to be treated as debt. He contended that PE and GE are treated as different entities in cross border transactions and if they are not so treated, other provisions relating to payment of royalty, fees for technical services etc. will not be workable. He submitted that if the amount is advanced by Indian branch to overseas branch of the same bank, interest received is chargeable to tax. He submitted that the same is also a payment to self but still it is chargeable to tax. Relying on the decision of the Hon'ble Supreme Court in the case of *Hyundai Heavy Industries Co. Ltd.* 291 ITR 482, he contended that the domestic law also recognizes two entity approach in the case of PE.

44. Shri Srivastava submitted that the provisions of section 5(2) of the Act read with the concept of business connection contemplated in section 9 recognizes the two entity concept even under the domestic law. He relied on the decision of Hon'ble Supreme Court in the case of *CIT vs. Ahmedbhai Umarbhai and Co.* 18 ITR 472 (para 26) to contend that the apportionment of income and separate entity concept have been recognized under the domestic law also. He contended that whenever and wherever apportionment of income is sought to be done, the concept of separate entity or existence of two entities is very much embedded. He contended that once it is accepted that GE and PE are different entities, interest payable by PE becomes income in the hands of GE and since the same is arising in India, it becomes taxable in India as per article 11(2) of the treaty.

45. Shri Srivastava then referred to article 11(6) of the treaty to point out that the same refers back to article 7 in certain situations. He submitted that article 7(1) talks about taxability of enterprise. He submitted that lending of money to PE becomes another activity of GE which is separate from PE activities and income from that activity in the form of interest received from PE is chargeable to tax in India by the principle of force of attraction. He contended that interest in the present case is actually payable by PE to GE and it is not a case of earning of notional interest income. He contended that taxability of such interest depends on accrual and not on the basis that who has paid the same.

46. As regards the OECD commentary relied upon by Shri Dastur, Shri Srivastava submitted that the same talks about notional interest which is not the case here. He submitted that the said commentary in any case is in relation to new article 7 of the treaty which has been introduced only with effect from July, 2010. He invited our attention to

the copy of new article 7 placed on record to point out that it is materially different and deals specifically with GE and other branches. He submitted that the said new article 7 contemplates working of notional profit than actual profit and it is, therefore, not relevant in the present context. He contended that the reliance of Shri Dastur on the OECD commentary which deals with new article 7 thus is clearly misplaced.

47. In support of the Revenue's case that interest receivable by GE from PE is chargeable to tax in India under the domestic law, Shri Srivastava submitted that entire income of a non resident arising in India is taxable in India. He placed reliance on the provisions of section 5(2)(b) to contend that entire interest income arising in India is taxable in the hands of GE in India irrespective of whether the funds fetching the said interest is advanced by GE in India directly or through PE/branch. He contended that this basic chargeability of interest income arising in India in the hands of GE is not taken away by article 7 of the treaty which provides that income attributable to PE in India is chargeable to tax in India. He contended that interest payable by PE thus is chargeable to tax in India under the domestic law as well as under the treaty.

48. In the rejoinder, Shri Dastur submitted that the basic principle which is to be kept in mind in the present context is that nobody can make profit from himself. He referred to the provisions of section 5 to point out that income of a "person" is chargeable to tax in India. He submitted that "person" does not include "branch" and it is only the banking company i.e. GE which is a person in the present case. He contended that article 7 of the treaty treats the PE as a person for the limited purpose of determining the profit attributable to it separately. He contended that income accrues or arises only when there is a deal with some third person and not from the deal with himself. As regards the OECD commentary para No. 28 relied upon by him, Shri Dastur submitted that the same is in respect of article 11 and change in article 7 has nothing to do with the same. He relied on the decision of Hon'ble Supreme Court in the case of *E.D. Sassoon & Co. Ltd. vs. CIT* 26 ITR 27 and submitted that what is accrual of income has been explained by the Hon'ble Supreme Court. He contended that there must be authority to tax income and there is no such authority in the domestic law to tax the interest income receivable by the GE from PE. As regards the decision of Hon'ble Supreme Court in the case of Hyundai Heavy Industries Co. Ltd. (supra) relied upon by Shri Srivastava, he submitted that the issue involved in the said case was limited and specifically related to attribution of profit to PE. He invited our attention to page No. 489 of the report and submitted that profit in the said case was undisputedly earned and the question raised before the Hon'ble Apex Court was only relating to attribution of the said profit. He submitted that similarly the issue as well as relevant facts involved in the case of *CIT vs. Ahmedbhai Umarbhai and Co.* 18 ITR 472 cited by Shri Srivastava were entirely

different and the decision rendered in the said case by the Hon'ble Supreme Court is not applicable in the present case.

49. We have considered the rival submissions in the light of material placed on record before us and the judicial pronouncements cited at the Bar by the learned representatives of both the sides. The assessee in the present case, viz. M/s Sumitomo Mitsui Banking Corporation is a foreign banking company which is incorporated in and controlled from Japan and is a tax resident of that country. It carries on banking business in India through branch offices at Mumbai and New Delhi which constitute its permanent establishment in India in terms of the relevant article of the Indo-Japanese treaty. The other assessee also is a foreign banking company which is a tax resident of Belgium and carries on banking business in India through its branch at Mumbai which constitutes its permanent establishment in India in terms the relevant article of the India-Belgium tax treaty. In the case of both these assessees, advances were given by the overseas head offices to the branches in India on which interest was payable by the branches in India. The dispute that has arisen in their cases is relating to deductibility of interest so payable in the hands of PE in India and chargeability of the said interest to tax in India in the hands of foreign GE. These issues are referred for consideration of the Special Bench in the form of two questions which are already indicated at the beginning of this order. At the outset, we may note that the relevant provisions of the tax treaties entered into by India with Japan and Belgium are similar and in the absence of any material difference therein, we shall be generally referring to the relevant provisions of the Indo-Japanese Tax Treaty for the sake of convenience.

50. As regards the deduction of interest payable to the head office in the hands of Indian PE for the purpose of computing profits attributable to the said PE, there is no dispute that such deduction is not permissible under the Indian Income-tax Act (domestic law) being the payment made to self. Both the Indian PE and the foreign GE of which it is a part are not separate entities for the purpose of taxation under the domestic law and the same being one and the same entity recognized as one assessee under the domestic law, interest payable by Indian PE to foreign GE of which it is a part, cannot be treated as expenditure allowable as deduction being payment to self. This position which is well settled under the domestic law has not been disputed even by the learned representatives of the assessees during the course of hearing before us. They, however, have relied on the relevant tax treaties in support of the assessee's claim for deduction on account of interest payable to GE while computing the profits attributable to PE in India as per article 7(2) and 7(3) read with paragraph No. 8 of the protocol.. It is, therefore, pertinent to refer to the said two articles and paragraph No. 8 of the protocol which are reproduced below:

"7(2) Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(3) In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the Contracting State in which the permanent establishment is situated or elsewhere."

Paragraph No. 8 of the Protocol:

"8. With reference to paragraph 3 of article 7 of the Convention, no deduction shall be allowed in respect of amounts paid or charged (other han reimbursement of actual expenses) by a permanent establishment of an enterprise to the head office of the enterprise or any other offices thereof, by way of:

(a) royalties, fees or other similar payments in return for the use of patents or other rights, or for the use of know-how;

(b) commission or other charges, for specific services performed or for management; and

(c) interest on moneys lent to the permanent establishment; except where the enterprise is a banking institution. "

51. Before we proceed to consider the claim of the assessee for deduction of interest as per article 7(2) and 7(3) read with protocol paragraph No. 8, it is relevant to note that as per article 7(1) of the Indo-Japanese treaty, the profits of an enterprise of Japan is taxable only in Japan unless that enterprise carries on business in India through a permanent establishment situated therein and in such a case where the Japanese enterprise carries on business in India through a PE situated in India, the profit of Japanese enterprise may also be taxed in India but only so much of them as is directly or indirectly attributable to the PE in India. The question, therefore, arises as to how to compute the profits of the Japanese GE that is attributable to the permanent establishment in India. Article 7(2) and 7(3) are relevant in this context which provide that the profits attributable to the PE in India shall be the profits which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same and similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Article 7(3) provides that in

determining the profits of a PE, there shall be allowed as deduction expenses which are incurred for the purpose of PE, including executive and general administrative expenses so incurred, whether in the contracting state in which the PE is situated or elsewhere. As per paragraph No. 8 of the protocol, it has been agreed with reference to paragraph No. 3 of article 7 of the convention that no deduction shall be allowed in respect of amounts paid (other than reimbursement of actual expenses) by a PE of an enterprise to the HO of the enterprise or any other offices thereof, inter alia, by way of interest on moneys lent to the PE except where the enterprise is a banking institution.

52. A combined reading of article 7(2) and 7(3) of the treaty and paragraph No. 8 of the protocol thus makes it clear that for the purpose of computing the profits attributable to the PE in India, the said PE is to be treated as a distinct and separate entity which is dealing wholly independently with the general enterprise of which it is a part and deduction has to be allowed for all the expenses which are incurred for the purpose of PE whether in India or elsewhere barring the amount paid by a permanent establishment to the head office of GE or any other offices thereof, inter alia, by way of interest on moneys lent to the permanent establishment except where the enterprise is a banking institution. In the case of a banking enterprise like the assessee in the present case, profit attributable to the PE in India thus is to be computed treating the same as a distinct and separate entity which is dealing wholly independently with the GE of which it is a part and deduction is to be allowed for all the expenses which are incurred for the purpose of PE, whether incurred in India or elsewhere, including the interest paid or payable by a PE to the Head Office or any other offices of the GE by way of interest on moneys lent to the PE. In the present case, the interest in question is payable by the PE in India to the head office of the GE abroad on the moneys lent to it and the same being undisputedly the expenditure incurred for the purpose of PE, we have no hesitation to hold that the same is allowable as deduction while computing the profits of the PE in India for the purpose of taxation in India as per article 7(2) and 7(3) of the treaty read with paragraph No. 8 of the protocol. As a matter of fact, the AO has not disputed this position and even Shri Girish Dave has not raised any material contention at the time of hearing before us to dispute this position.

53. The AO, however, has disallowed the claim of the assessee for deduction on account of interest payable to the head office of the GE abroad in the hands of PE by invoking the provisions of section 40(a)(i). As per the said provision, any interest which is payable outside India or in India to a foreign company and on which tax is deductible at source, shall not be allowed as deduction in computing the income chargeable under the head “profits & gains of business or profession” if such tax has not been deducted or after deduction has not been paid within the

prescribed period as per the provisions of section 195. As required by section 195, any person responsible for paying to a foreign company any interest or any other sum chargeable under the provisions of the Act is required to deduct at the time of credit of such income to the account of the payee or at the time of payment thereof whichever is earlier, income-tax thereon at the rates in force. The provisions of section 195 thus are attracted when interest paid to a foreign company is chargeable to tax under the Income-tax Act, 1961 and the case of the assessee in this regard is that interest payable by PE not being chargeable to tax in India as per the domestic law in the hands of the HO abroad, there is no requirement of deduction of tax from such interest and there is no question of making disallowance on account of deduction claimed for such interest by invoking the provisions of section 40(a)(i). The question thus is whether the interest payable by the Indian PE is chargeable to tax in India in the hands of Foreign GE and this has been raised as question No. 2 for the consideration of this Special Bench.

54. As rightly submitted by Shri Pardiwala, questions No. 1 and 2 referred to this Special Bench are interlinked and unless and until question No. 2 is answered, question No. 1 cannot be decided because the decision on question No. 2 is having direct bearing on the final answer to question No.1. If question No. 2 is decided in favour of the assessee holding that interest payable by Indian PE to the overseas head office of the assessee bank is not chargeable to tax in India, the provisions of section 195 would not be attracted and there being no failure on the part of the assessee to deduct tax at source from the said interest, the question of disallowance of the said interest by invoking the provisions of section 40(a)(i) will not arise. The disallowance made by the AO by invoking the said provisions accordingly would be unsustainable. If the issue involved in question No.2 is decided against the assessee, then the applicability of section 195 to the facts of the assessee's case will have to be examined independently on merits and the ultimate decision on this issue will have a direct bearing on the issue involved in question No. 1 which has to be decided accordingly. We therefore now proceed to consider and decide question no. 2 referred to this special bench.

55. The first and foremost aspect which is relevant in the context of the issue involved in question No.2 is whether interest payable by the Indian PE is chargeable to tax in India in the hands of GE of which the PE is a part. In our opinion, this issue first of all has to be considered and examined from the point of view of relevant provisions contained in the Income-tax Act, 1961 so as to ascertain whether interest payable by the Indian branch of the assessee bank to its overseas HO is chargeable to tax in India as per the domestic law or not. Only when it is found that the said income is chargeable to tax in India as per the domestic law, one can refer to the relevant treaties to look for any benefits available to the assessee vis-à-vis the Income-tax Act since as per the specific provisions

contained in section 90(2), provisions of DTAA override the provisions of the Act in so far they are more beneficial to the assessee. It is also to be taken into consideration that the provisions contained in tax treaties are not the charging provisions inasmuch as they do not bring to tax income which otherwise is not taxable as per the domestic law. This position is clear from the decision of Hon'ble Supreme Court in the case of Azadi Bachao Andolan (supra) wherein it was held that no provision of double taxation agreement can possibly fasten a tax liability where the liability is not imposed by the Act. It was held that if a tax liability is imposed by the Act, the agreement may be resorted to for negativing or reducing it.

56. In so far as the taxability of interest payable by PE in India in the hands of GE under the domestic law is concerned, it is relevant to note that the PE in India and the GE abroad of which the said PE is part are not independent persons under the domestic law i.e. Indian Income-tax Act and they are not assessed to tax separately in India. The taxable entity is only one i.e. the overseas GE which is the assessee bank in the present case who is a non resident in India and the PE in India is part of that entity which is a taxable entity in India even in respect of income attributable to the PE in India. There is thus only one person assessable to tax i.e. GE and PE is not an independent person who is assessed to tax separately in India. It is a part of the GE and its income is chargeable to tax in the hands of GE which alone is the person assessable to tax in India.

57. In the case of *Kikabhai Premchand (Sir) vs.CIT* (supra) it was held by the Hon'ble Supreme Court that under the Income-tax Act, all that the State can tax is income, profits and gains in the relevant accounting year. It was held that it is well recognized that in revenue cases regard must be had to the substance of the transaction rather than to its mere form. In the case before the Hon'ble Supreme Court, the business was owned and run by the assessee himself and it was held in these facts and circumstances by the Hon'ble Supreme Court that it was wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of fictional sale introduce a fictional profit which in truth and in fact was non-existent. It was held that cut away this fiction and one easily reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the fact of it is not only absurd but against all cannons of Mercantile and Income-tax Law.

58. A somewhat similar situation arose before the Hon'ble Calcutta High Court in the case of *Betts Hartley Heuttand Co.Ltd. vs. CIT* (supra) wherein the assessee was non resident company with its head office in London. Its business in Calcutta was mainly that of purchasing Tea for its constituents abroad. In the relevant assessment year, the assessee had charged from its constituents in respect of Tea purchased actual cost,

commission or brokerage and also a sum of Rs. 10 paise per pound of Tea on account of shipping, sampling and other miscellaneous charges. In respect of dispatch to the head office, the assessee did not charge any commission but charged all other items of expenses. The AO, however, held that the amount of commission which was not charged on sale to the head office as income accrued to the assessee's head office in London and estimated the profit attributable to purchase operations of the assessee's London office in India through the assessee at 1.5% of the value of Tea to compute such income assessable to tax in India u/s 9(1). On appeal, the AAC accepted the contention of the assessee that the sales to its head office having been effected on a principal to principal basis, there was no profit assessable u/s 9(1) of the Income-tax Act, 1961. Accordingly he directed the deletion of the addition made by the AO on this issue to the income of the assessee. The Tribunal, however, held that the London Office did not earn more because of its business connection through the assessee in India and by not paying commission, this earning accrued or arose to the assessee because of its business connection in India. The Tribunal accordingly set aside the order of the AAC on this issue and restored the addition made by the AO as profit in respect of purchase operation carried on in India on behalf of the London office. On reference, the question raised before the Hon'ble Calcutta High Court was whether on the facts and circumstances of the case, the Tribunal was right in holding that the amount in question was includible in the computation of assessee's income as profit in respect of sales made to its head office in London within the meaning of section 9(1) of the Income-tax Act, 1961. Their lordships answered the said question in the negative and in favour of the assessee holding that when the transaction between the London head office of the assessee and its unit in India was a transaction as between principal and principal, it cannot be held that any income arose in favour of the assessee either directly or indirectly since the gain in London office was offset by the loss incurred in the Indian branch. It was held that in law there cannot be a valid transaction of sale between the branch office of the assessee in India and its head office in London. It was held that it is a elementary proposition that no person can enter into a contract with oneself and debiting or crediting one's account cannot alter this legal position. It was held that if one unit of a business does not debit any commission to another unit of the same business then it is difficult to follow how any saving has been effected by the business.

59. The position under the domestic law as emanating from the above judicial pronouncements thus is clear that one cannot make profit out of himself and if the payment of interest made by the Indian PE to the foreign GE of which it is a part is payment to self, it cannot give rise to any income which is chargeable to tax in India as per the domestic law. Shri. Dave, however, has relied on the decision of Hon'ble Supreme Court in the case of Hyundai Heavy Industries (supra) as well as certain articles of the Indo-Japanese treaty in support of the Revenue's case that

the PE in India has to be treated as a separate entity and the interest payable by the said PE has to be brought to tax in India in the hands of GE as income.

60. First we shall deal with the arguments of Shri Girish Dave based on the relevant provisions of the Indo-Japanese treaty. He has, inter alia, relied on article 23 of Indo-Japanese treaty which provides that the laws in force in either of the contracting State shall continue to govern the taxation of income in respective contracting state except where express provisions to the contrary are made in the convention. According to him, article 11 read with article 7 of the treaty contains such express provision and make the interest payable by the PE in India to the GE abroad the income of the GE chargeable to tax in India. Before we consider this argument of Shri Girish Dave in the light of the relevant provisions of the article 7 and 11 of the Indo-Japanese treaty, it is pertinent to discuss certain basic aspects of the matter which are relevant in this context.

61. Section 90(2) of the Income-tax Act, 1961 provides that where the Central Government has entered into an agreement with the Government of any country outside India or specific territory outside India, as the case may be, 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. This specific provision contained in section 90(2) makes it abundantly clear that in relation to the assessee like the one in the present case to whom the double tax avoidance treaty entered into by the Indian government applies, the provisions of Income-tax Act shall apply to the extent they are more beneficial to him. It, therefore, follows that if the provisions of the domestic law are more beneficial to the assessee than the provisions of the relevant tax treaty, the provisions of the domestic law shall override and prevail over the provisions of the treaty. Article 23 of the Indo-Japanese treaty, therefore, cannot be interpreted in a way as sought by Shri Girish Dave because if such interpretation is assigned to article 23 and the interest income which is otherwise not taxable in India as per the domestic law is held to be taxable relying on the provisions of the treaty, the same will run contrary to the provisions of section 90(2). Such interpretation, therefore, cannot be assigned to article 23 and the only interpretation which, in our opinion, can be assigned to the said article so as to make the provisions thereof in consonance with section 90(2) of the domestic law is that if there is an express provision made in the convention giving benefit to the assessee which is contrary to the domestic law, then the provisions of treaty can be relied upon which shall override and prevail over the provisions of the domestic law to give any benefit expressly given to the assessee under the treaty. The decision of Hon'nle Supreme Court in the case of Azadi Bachao Andolan (supra) fully supports this view.

62. Even if it is assumed for the sake of argument that the interpretation sought to be assigned by Shri Girish Dave to article 23 is acceptable, the question that arises is whether there is any such express provision made in the Indo-Japanese treaty which is contrary to the domestic law and which makes the interest payable by PE in India the income of the foreign GE which is taxable in India. Shri Girish Dave in this regard has relied on the provisions of article 11 of the Indo-Japanese treaty especially paragraph No. 2 and 6 thereof. The said paragraphs along with paragraph 1 of article 11 are reproduced hereunder:

> ARTICLE 11 – 1. Interest arising in a Contracting State and paid to a resident of the other contracting State may be taxed in that other Contracting State.
>
> 2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that Contracting State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the interest.
>
> 6. The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein or performs in that other Contracting State independent personal services from a fixed base situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply.

63. We have carefully gone through the above provisions of the treaty along with other provisions which are relevant in this context as well as commentaries available on this point which are found to be helpful in interpreting the relevant provisions of the treaty. As per article 11(1), if the interest is arising in a contracting State and paid to a resident of other contracting State, then it is taxable in that other contracting State. The said interest income, however, may also be taxed in the contracting State in which it arises as per article 11(2) according to the Laws of that contracting State provided that if the recipient of such interest is the beneficial owner of the interest, the tax so charged shall not exceed 10% of the gross amount of interest. In the present case, there is no dispute that the head office of the assessee bank in Japan is the beneficial owner of the interest and that is how the said interest has been taxed by the AO in the hands of the assessee at a fixed tax rate of 10%. It is, however, to be noted that such interest can be taxed in India in the hands of GE at a maximum rate of 10% as per article 11(2) according to the Laws of India. As already held by us, interest payable by the PE in India to the GE of which it is a part is a payment to self and the same,

therefore, does not give rise to income in India that is taxable as per the domestic law.

64. As stated in the preliminary remarks on OECD commentary on article 11 concerning the taxation of interest, the formula reserving the exclusive taxation of interest to one State, whether the State of the beneficiary's residence or the State of source, could not be sure of receiving general approval. It is stated that a compromise solution, therefore, has been adopted by providing that interest may be taxed in the State of a residence, but leaves to the State of source the right to impose a tax if its laws so provide, it being an implicit in this right that the State of source is free to give up all taxation on interest paid to non resident. The State of source thus has to exercise its right to bring to tax interest income arising in that State to the non resident or to the resident of the other State by making specific provision to that effect in the domestic law. In the present context, there is no such provision made in the Indian Income-tax Act, 1961 to bring to tax in India interest payable by the Indian PE to the foreign GE of which it is a part, which otherwise is not taxable being payment to self.

65. Shri Girish Dave has contended before us that the deeming fiction created in article 7(2) of the treaty treating the PE in India as separate and independent entity should be extended to article 11 to the treaty. According to him, if the PE in India and the head office abroad are treated as two separate entities, there will be no difficulty in bringing to tax interest paid by Indian PE as income of the GE in India as per article 11(2). Before we deal with this argument relating to the extension of deeming fiction created in article 7(2) and application thereof to article 11 also as sought by Shri Girish Dave, we consider it proper to first deal with article 11(6) of the Indo-Japanese treaty which has been referred to by both the sides in different context and in different manner seeking interpretation thereof in support of their respective case. The said article 11(6) reads as under:

> "The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein or performs in that other Contracting State independent personal services from a fixed base situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply.

66. It is to be noted that the provisions of article 11(6) of the Indo-Japanese convention are pari-materia to that of article 11(4) of the OECD model convention. The purpose and scope of article 11(4) of the OECD model convention has been explained in para 24 and 25.1 of the OECD

commentary on Model Tax Convention on Income and on Capital (condensed version) issued in July 2010 as under:

> "24. Certain States consider that dividends, interest and royalties arising from sources in their territory and payable to individuals or legal persons who are residents of other States fall outside the scope of the arrangement made to prevent them from being taxed both in the State of source and in the State of the beneficiary's residence when the beneficiary has a permanent establishment in the former State. Paragraph 4 is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". It does not stipulate that interest arising to a resident of a Contracting State from a source situated in the other State must, by a kind of legal presumption, or fiction even, be related to a permanent establishment which that resident may have in the latter State, so that the said State would not be obliged to limit its taxation in such a case. The paragraph merely provides that in the State of source the interest is taxable as part of the profits of the permanent establishment there owned by the beneficiary which is a resident in the other State, if it is paid in respect debtclaims forming part of the assets of the permanent establishment or otherwise effectively connected with that establishment. In that case, paragraph 4 relieves the State of source of the interest from any limitation under the Article. The foregoing explanations accord with those in the Commentary on Article 7.
>
> 25.1 A debt-claim in respect of which interest is paid will be effectively connected with a permanent establishment, and will therefore form part of its business assets, if the "economic" ownership of the debt-claim is allocated to that permanent establishment under the principles developed in the Committee's report entitled Attribution of Profits to Permanent Establishments (see in particular paragraphs 72-92 of Part I of the report) for the purposes of the application of paragraph 2 of Article 7. In the context of that paragraph, the "economic" ownership of a debt-claim means the equivalent of ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens (e.g. the right to the interest attributable to the ownership of the debt-claim and the potential exposure to gains or losses from the appreciation or depreciation of the debt-claim).

67. Keeping in view the purpose and scope of article 11(4) of the OECD Model Convention, the provisions of which are pari materia to the provisions of article 11(6) of the Indo-Japanese treaty, we are of the view that the same is not applicable to the facts of the present case inasmuch

as the situation as contemplated to make it applicable does not exist in the present case. In the present case, the amount is advanced by the head office of the assessee bank to its PE in India and the same represents liability of the PE in India as reflected in the balance sheet of that PE. Interest paid by the PE on such liability, therefore, cannot be regarded as interest paid in respect of debt claims forming part of the assets of the Permanent Establishment. It also cannot be said that the economic ownership of the debt claim is allocated to that Permanent Establishment so as to say that it is effectively connected with the Permanent Establishment. It is no doubt true that article 7 makes inroads in article 11 as a result of the provisions contained in article 11(6) as contended by Shri Girish Dave. However, the situation contemplated in article 11(6) should be found to be in existence in a case to bring the interest to article 7 in order to treat the said income as business profit attributable to the PE indirectly by force of attraction. In the present case, such situation does not exist and article 11(6), therefore, in our opinion, has no application.

68. Now we shall deal with the contention of Shri Girish Dave seeking extension of the deeming fiction created in article 7(2) to treat the Permanent Establishment in India of the assessee bank as a separate and independent entity for the purpose of application of article 11 especially paragraph 2 thereof. It is relevant here to refer to the provision of article 7(2) which is reproduced hereunder:

> "Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

69. The provisions of article 7(2) are subject to the provisions of article 7(3) and if the same are read together in harmonious manner, we are of the view that it becomes clear that the profits attributed to the PE are the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar condition and dealing wholly independently with the enterprise of which it s PE. The said fiction, in our opinion, therefore, is applicable only for the purpose of determining the profits attributable to the PE and this limited application contemplated in the treaty cannot be extended and applied to compute the income of the GE. It is no doubt true that if the accounts of two entities are prepared symmetrically and the methods of attributing profits or expenses applied are the same, such accounts are more acceptable to the tax authorities having jurisdiction

over both these entities because the same will result in the deduction allowed in the hands of one entity as income in the hands of other entity. The relationship between a PE and the GE of which the said PE is part, however, is entirely different and the effects of article 7 should be considered keeping in view this peculiar relationship between the PE and GE.

70. The purpose and function of article 7 is to determine whether the source State may tax the profit of an enterprise carried on by a resident of other contracting State through a PE in the source State and if so, how much of the profits the source State may tax. The resident State has to determine the profits attributable to the PE considering it as a separate entity mainly for the purpose of granting double taxation relief according to the relevant treaty and not for the purpose of determining the total taxable income of the enterprise carried on by such resident. Article 7 provides for taxation of the profits attributable to the PE in the PE State which is source State and for determining such profits attributable to the PE, it is treated as independent entity. There is thus a departure from preparation of the accounts of PE and GE symmetrically to the extent that independent fiction is applied only to the PE treating the PE and the enterprise of which it is a part as two separate entities only for the purpose of determining the profits attributable to the PE and not for the purpose of determining the total profits of the enterprise as a whole.

71. While explaining the peculiar relationship between a PE and the enterprise of which it is a part, a comparison is often made to a Yolk and its egg. The PE is considered as yolk and the enterprise as a whole is considered as the egg. This comparison is made to show that whatever is in the yolk is necessarily in the egg itself and there is no need to account for the egg separately. On the other hand, not every thing that is in the egg is part of the yolk and it is, therefore, not necessary to account for the yolk separately in cases where the resident State avoid total taxation using the credit method or the tax exemption method. This position can further be explained by giving an example as follows:

> Suppose there is a PE in one State which is a part of a GE having HO in another State. During the relevant year, loan has been advanced by HO to PE on which interest of Rs.3 crores has been provided by the PE. The total profit of the HO excluding the said interest say is Rs.95 crores. The profits attributable to the PE without taking into consideration the said interest is Rs.5 crores. In such a case, the total profit of the GE representing consolidated figures of HO and PE will be Rs.100 crores as the interest payable by PE and receivable by HO will get squared of. In so far as taxation is concerned, the profit attributable to PE will be Rs.2 crores on which the PE State will impose tax as business profit. The remaining amount of Rs.98 crores will be taxed in the hands of GE State i.e. resident State.

> Suppose we take another situation where the only difference is that HO has advanced the sum to a third party in the other State i.e. PE State on which it has received interest of Rs.3 crores, while the PE has taken a loan from third party on which interest of Rs.3 crores has been paid. In such a case, the profit attributable to the PE will remain the same at Rs.2 crores on which the PE State will impose tax. The profit of GE which represents the consolidated figure of HO and PE will also remain unchanged at Rs.100 crores as the interest received from third party of Rs.3 crores will be credited to the consolidated profit & loss account and the interest paid by PE to third party amounting to Rs.3 crores will be debited in the consolidated profit & loss account. The total profit of the GE thus will remain the same even in this situation at 100 crores out of which Rs. 2 crore will be taxed in PE State being profit attributable to PE and the balance amount of Rs.98 crore will be taxed in GE State i.e. resident State. However, it will have to pay in addition to the tax payable on the profit attributable to the PE of Rs.2 crores, tax on interest of Rs.3 crores received from third party of the other State in that State i.e. PE State as per article 11(2) of the treaty. The GE, however, will be able to claim credit for such tax paid in its country as per article 23B of the relevant treaty. The GE thus at enterprise level will neither gain nor lose anything as far as its tax liability is concerned. The PE State, however, will lose in the first situation tax on interest payable by the PE to the head office because the same being payment to self is not taxable under the domestic law.

72. As already discussed by us with reference to OECD commentary, article 11(2) gives an option to the source State to tax interest arising in that State to the person resident of another State if he is the beneficial owner of such interest, at the rate not exceeding 10% according to the laws of that State. This option thus has to be exercised by the source State by making suitable provisions in the domestic law providing expressly for taxing the interest payable by PE in that State to the GE in another State. This position has been recognized in the commentary on 'Model Convention on Income and on Capital' (condensed version) published by OECD in July, 2010 in para no. 29 which states that some States consider that the separate and independent enterprise fiction that is mandated by article 7(2) should not be restricted to the application of article 7, 23A and 23B but should also extend to the interpretation and application of other article of the convention, so as to ensure that permanent establishments are, so far as possible, treated in the same way as subsidiaries. These states also consider that notional charges for dealings which, pursuant to article 7(2), are deducted in computing the profits of the PE should be treated, for the purposes of other article of the convention, in the same way as payments that would be made by

subsidiary to its parent company. It is suggested in the commentary that these states may therefore wish to include in their tax treaties provisions according to which charges for internal dealings should be recognized for the purposes of article 11. It is, however, cautioned that the tax will be levied in accordance with such provisions of the treaty only to the extent provided for under domestic law. We have already noted that no such provisions are made either in the Indo-Japanese treaty or even in the domestic law i.e. Income-tax Act, 1961 to expressly provide for taxation of interest payable by the PE in India to the GE of which it is a part which constitutes a payment to self.

73. The OECD commentary 'Model Tax Convention on income and on capital (condensed version)' released in July, 2010 has also considered in paragraph no. 28 the effect of the separate and independent enterprise fiction that is mandated by article 7(2). It is stated in this context that the said fiction is restricted to the determination of profits that are attributable to a Permanent Establishment and it does not extend to create notional interest income for the enterprise which a contracting State could tax as such under its domestic law by arguing that such income is covered by another article of the convention. It is also clarified that the separate and independent enterprise fiction does not extend to article 11 and for the purpose of that article, one part of an enterprise cannot be considered to have made an interest payment to another part of the same enterprise.

74. In the assessment order, the AO has relied on the provisions of section 9(1)(v)(c) of the Income-tax Act to hold that interest payable by PE in India being income deemed to accrue or arise in India is chargeable to tax in India. In our opinion, such interest payable by the PE to GE being payment to self does not give rise to any income that is chargeable to tax in India as held, inter alia, by the Hon'ble Supreme Court in the case of *Kikabhai Premchand (Sir)* (supra) and the question of bringing the said income to tax by relying on the provisions of section 9(1)(v)(c) therefore, does not arise.

75. The AO has also relied on the Board Circular No. 740 issued on 17-04-1996 clarifying that the branch of the foreign company or concern in India is a separate entity for the purpose of taxation and interest paid or payable by such bank abroad will be liable to tax in India and would be governed by the provisions of section 115A. The provisions of section 115A read as under:

"115A(1) Where the total income of –

(a) a non-resident (not being a company) or of a foreign company, includes any income by way of –

(i) dividends (other than dividends referred to in section 115-O; or

(ii) interest received from Government or an Indian concern on monies borrowed or debt incurred by Government or the Indian concern in foreign currency; or

(iii) income received in respect of units, purchased in foreign currency, of a Mutual Fund specified under clause (23D) of section 10 or of the Unit Trust of India,

The income-tax payable shall be aggregate of –

It is clearly manifest from the above provisions that section 115A is applicable inter alia, in respect of income received by a non resident (not being a company) or a foreign company from Government or an Indian concern on moneys borrowed or debt incurred by Government or the Indian concern in foreign currency. The said provision, however, has no application to the facts of the present case. In any case, if the interest income in question is not chargeable to tax under the provisions of the domestic law as already held by us, the same cannot be brought to tax by way of a board circular.

76. As regards the decision of Hon'ble Calcutta High Court in the case of *ABN Amro Bank NV* (supra) relied upon by the learned representatives of the assessees, Shri Dave and Shri Srivastava have mainly raised two fold contentions. According to them, the said decision being the decision of non jurisdictional High Court, is not binding on this Special Bench. Secondly, they have made an attempt to demonstrate that the said decision is per incurim keeping in view that many relevant and vital aspects are not considered while holding that interest receivable by a foreign bank from its Indian branch was not taxable in the hands of foreign bank in India. Shri Dave has also made an attempt to invite our attention to the various findings and observations recorded by the Hon'ble Calcutta High Court in its judgment delivered in the case of ABN Amro Bank NV (supra) which according to him, are self contradictory and inconsistent. The learned counsels for the assessee, Shri Pardiwala and Shri Dastur, on the other hand, have contended that the decision of Hon'ble Calcutta High Court being the only decision of the High Court directly available on the point, should be followed by the Special Bench even though the same is the decision of the non jurisdictional High Court. Without going into all these arguments raised by the learned representatives of both the sides, we consider it sufficient to observe that the issues raised before us have been considered and decided by us on merits independently after taking into consideration the various submissions made by both the sides and the relevant material placed on record. This issue, therefore, is not being decided by us by simply following the decision of Hon'ble Calcutta High Court in the case of ABN Amro Bank NV (supra). Nevertheless, we can certainly say that the said

decision of Hon'ble Calcutta High Court taking a similar view in the matter supports our view.

77. In the case of *Hyundai Heavy Industries Co. Ltd.* (supra) relied upon by Shri Dave, the Hon'ble supreme Court no doubt has held that the Permanent Establishment of a foreign enterprise in India is a separate profit centre. It also cannot be disputed that the legal jurisdiction and fiscal jurisdiction are two different concepts and when a foreign enterprise carries on business through a Permanent Establishment in India, it brings itself within the fiscal jurisdiction of India to such an extent that India can tax the profits derived by the foreign enterprise from India directly or indirectly through Permanent Establishment. In the present case, we, however, are concerned with the interest payable by the Indian PE to the foreign GE and the basic question is whether such interest payable by the PE to the GE of which it is a part can give rise to any income chargeable to tax in India in the hands of GE. As already held by us, there are no express provisions in the Indo-Japanese tax treaty to bring the said income to tax in India in the hands of GE and in any case, the said interest payable by the PE to the GE of which the PE is a part is a payment to self which cannot give rise to any income chargeable to tax in India as per the domestic law. The decision of Hon'ble Supreme Court in the case of *Hyundai Heavy Industries Co. Ltd.* (supra), in our opinion, thus is not of any help to the Revenue in the present context and the reliance of Shri Girish Dave thereon is clearly misplaced.

78. Shri Girish Dave has also submitted that the Indo-Japanese treaty having been entered into by the Government of India in exercise of the powers conferred by section 90 of the Income-tax Act, 1961, the same has become a part of domestic law and as per article 23 of the said treaty, the issue relating to taxability of the Japanese Bank in India has to be decided as per the provisions of the treaty even though the same is contrary to the provisions of the domestic law. We have already discussed and considered the effect of article 23 of the Indo-Japanese treaty. As held by us, the said provision of the treaty cannot be relied upon to bring to tax certain income in the hands of foreign enterprise in India which otherwise is not taxable as per the domestic law. In this regard, we have referred to the provisions of section 90(2) of the Indian Income-tax Act which provide that the provisions of the domestic law override and prevail over the provisions of treaty if the same are beneficial to the assessee. We have also relied on the decision of Hon'ble Supreme Court in the case of Azadi Bachao Andolan (supra) wherein it was held that treaty cannot impose tax which is otherwise not provided in the domestic law.

79. As regards the reference made by Shri Girish Dave to the balance sheet of Indian Branches of the assessee bank wherein capital and loans given by the head office are reflected separately to show that head office is a distinct and separate entity from the Indian Branches, we have already considered and highlighted the peculiar relationship between the

head office of the assessee bank being a foreign GE and its Indian Branches being PE in India. We have also highlighted how as a result of this peculiar relationship, there is a departure from symmetric approach generally followed by two entities in preparing their accounts. As a result of this peculiar relationship, the Indian branch of a foreign bank which represents its PE in India, in our opinion, cannot be treated at par with a subsidiary of a foreign company in India and this position has been recognized even by the OECD in its 'Report on the attribution of profits to permanent establishments Parts I (General Considerations), II (Banks) and III (Global Trading) published in December 2006. As mentioned in the said report, there are a number of aspects to the recognition (or not) of dealings between a PE and the rest of the enterprise of which it is a part. One of such aspects is that a PE is not the same as a subsidiary and is not in fact legally or economically separate from the rest of the enterprise of which it is a part. In the context of a PE and its head office, as contrasted with a parent company and its subsidiary, it is the enterprise as a whole which legally bears the risk.

80. As regards the decision of Federal Court of Appeal (FCA), Canada in the case of *Cudd Presssure* (supra) relied upon by Shri Girish Dave, it is observed that the issue involved in the said case was whether a US resident corporation could, in the computation of the profits attributable to its Canadian PE, deduct 'notional rent' charged by it in relation to the Canadian PE's use of specialized equipment in the performance of the lucrative contract in Canada. It was decided by the lower court that the notional rent was not deductible in computing the Canadian PE's taxable business income from Canadian sources on the basis of factual finding that an arm's length separate and distinct entity in the situation of Cudd's Canadian PE would not have rented the specialized equipment, but would have purchased it instead. It was held relying on the relevant provisions of domestic Law that the taxpayer could only have claimed depreciation for the use of the specialized equipment against the income of its Canadian PE. The Federal Court of Appeal did not find any error in the finding of fact recorded by the lower court and keeping in view the said finding, Roberston J.A., who wrote the leading judgement, upheld the decision of the lower court. The other Judge McDonald, J.A. also reached the same conclusion but discussed the issue of deductibility of notional expenses in more details. It was held by him in this context that deduction of notional rent was not allowable as deduction also for the reason that the amount of such notional rent was never included as income in the hands of head office. It was held by him that to allow deduction in this circumstance would mean that the tax was being avoided on rental income both in Canada and in United States. The facts involved in the case of *Cudd Pressure* (supra) thus were entirely different from the facts of the present case. Moreover, the present case is not a case where there is avoidance of tax by the assessee in both the countries as already discussed and explained by us. The observations and

comments made in the minority view and relied upon by Shri Dave in the case of *Cudd Pressure* (supra), in our opinion, therefore, cannot render any support to the Revenue's stand on the issue under consideration in the present case.

81. In the case of *ABN Amro Bank* (supra) decided by Hon'ble Sindh High Court of Pakistan and cited by Shri Girish Dave, the issue involved was whether the Tribunal was correct to confirm the taxation of interest income received by the branch in Pakistan of a foreign bank from its Head Office and branches located outside Pakistan disregarding the principle of mutuality and the same was decided by the Court on the basis of domestic law of Pakistan which contained a specific provision in section 105(5)(a) as under:

> "Taxation of a permanent establishment in Pakistan of a non-resident person. – (1) The following principles shall apply in determining the income of a permanent establishment in Pakistan of a non-resident person chargeable to tax under the head "Income from Business", namely:–
>
> (a) The profit of the permanent establishment shall be computed on the basis that it is a distinct and separate person engaged in the same or similar conditions and dealing wholly independently with the non-resident person of which it is a permanent establishment."

The PE of a non-resident in Pakistan thus is treated as a distinct and separate person under the domestic law by making express provision and keeping in view the said provision made in the domestic law, it was held by the Hon'ble Sindh Court that the doctrine of mutuality does not and cannot apply to a situation to which section 105(1)(a) applies. As already discussed by us, there is no such provision contained in the Indian Income Tax Act and in the absence thereof, the interest payable by the Indian PE to its foreign GE of which it is a part can not be said to have given rise to income which is chargeable to tax in India as per the domestic law being payment to self as per the principle of mutuality.

82. In the case of *Dresdner Bank AG vs. Addl. CIT* (supra) cited by Shri Girish Dave, the issue before the Division Bench of this Tribunal was whether, under the Indian Income-tax Act, 1961, the profits arising out of dealings of the foreign companies Indian Branch office, with its head office and with other foreign branches, is taxable in India or not. In this regard, the doctrine of mutuality was pressed into service on behalf of the assessee in support of its case that such internal dealings between the Indian branch office of a foreign bank and its head office and other foreign branches being the transactions with self, no income could be said to have arisen that is chargeable to tax in India. The same, however, was not accepted by the Division Bench for the reasons elaborately given in

its order before finally concluding the issue in paragraph No. 71 of the order as under:

> "For all these reasons, we are not persuaded by the learned counsel's arguments that since no one can be expected to make profits out of transactions with himself, intra organization transactions are to be ignored for the purpose of computing profits accruing or arising, to an Indian PE of a foreign company, under section 5(2)(b) of the Act. In our understanding, for the purposes of computing profits of a PE, the intra organization transactions are to be taken into account as long as these transactions are real and bona fide transactions. It is not the assessee's case that the interest income from the head office is without any consideration or without sufficient consideration. In other words, fact of or correctness of interest earnings from head office are not in dispute. Therefore, in our considered view, the interest earnings from the head office are to be taken into account for the purposes of computing profits arising in or accruing in India. We, therefore, reject the contentions of the assessee."

In the case of *Dresdner Bank AG* (supra), a reference was made to the decision of Calcutta Special Bench of the Tribunal in the case of *ABN Amro Bank NV* (supra) which was in favour of the assessee and the same was considered by the Division Bench in paragraph No. 72 of its order as under:

> "As we part with this issue in appeal before us, we add that we are alive to the fact that our decision hereinabove can possibility result in an incongruity inasmuch as while a foreign bank operating in India will be taxable in India in respect of the interest it earns from its head office and branches abroad, no deduction will be available, in the light of Special Bench decision in ABN Amro Bank N.V.'s case (supra) to the foreign banks in respect of interest incurred to head office and branches abroad. In fact, it was for this reason that we did seek comments of the parties on as to why this appeal should not be referred to a larger Bench and let the law be settled in a holistic manner by taking into account all aspects of the intra organization dealings, and unfettered by the earlier decisions of this Tribunal. Learned counsel's emphatic opposition to this suggestion was on the ground that the assessee bank has already wound up its operations in India and it does not want to delay finalization of its tax liability as the constitution of larger Bench will result in, that the case before us only deals with an income situation under the Act while ABN Amro Bank N.V.'s case deals with an expense situation under the tax treaty, and, that, the issue decided by the Tribunal in ABN Amro Bank

> N.V.'s case (supra) does not arise in this appeal at all. Learned Departmental Representative also, equally emphatically, submitted that the issue before us does not need to be referred to a larger Bench. It was also submitted that there have been no judicial precedents, either from Tribunal or even the higher judicial forums, on the scope of 'income accruing or arising in India' under section 5(2)(b) and, therefore, there is no question of any fetters of the earlier decisions. It was in this backdrop that the matter was decided by us on merits. This decision, therefore, should only be treated as an authority for the issue actually decided by us. Subject to these observations and for the reasons set out above, the plea of the assessee is rejected."

83. In the case of *American Express Bank Ltd.* (supra) cited by Shri Pardiwala, the issue that arose before the Division Bench of this Tribunal was whether the interest received by the assessee from its non resident branches could be taxed in India and on this issue, reliance was placed on behalf of the assessee on the decision of Kolkatta Special Bench of ITAT in the case of *ABN Amro Bank NV* (supra) while the Revenue relied on the decision of Division Bench in the case of *Dredsner Bank Ltd* (supra). The Division Bench in its order passed in the case of *American Express Bank Ltd*. took note of the ratio laid down by the Special Bench in the case of *ABN Amro Bank* (supra) as well as by the decision of the coordinate bench in the case of *Dredsner Bank* (supra) and found conflict therein. The Division Bench, therefore, preferred to follow the decision of Special Bench in the case of *ABN Amro Bank* (supra) for the following reasons given in paragraph No. 35 of its order :

> "The comparative study of both the judgments shows that there is conflict between the ratio laid down by the decision of Special Bench in the case of *ABN Amro Bank* (supra) and the decision of Division Bench in the case of *Desdner Bank* (supra). It is not in our domain to make any comment on the decision of the Division Bench. However, there is no dispute to the legal position that in the case of conflict between the decisions of Special Bench and Division Bench, it is the decision of Special Bench which would prevail. In the present case, admittedly, there is no treaty between India and USA in the year under consideration. Accordingly, in view of the Special Bench, it is the local law i.e. the provisions of Income Tax Act, 1961 which would be applicable. Therefore, following the decision of Special bench, it is held that income received/receivable by the Indian branch from head office is not chargeable to tax. The order of learned CIT(A) is therefore, upheld on this issue."

While we fully agree and endorse the view taken by the Bench in the case of *American Express Bank Ltd.* (supra) to the extent that decision of Special Bench would prevail over that of the Division Bench and the

Division Bench has to follow the decision of Special Bench as a matter of judicial discipline and propriety, it is to be noted that the Division Bench in the case of *Dredsner Bank* (supra) has taken pains to present the other view on this complex issue and that too in the peculiar circumstances of that case as discussed in paragraph No. 72 of its order which has been reproduced herein above. Nevertheless, we are of the view that the judicial discipline and judicial propriety are of paramount importance and the same cannot be dispensed with while discharging the judicial duty, whatsoever peculiar the circumstances are or howsoever complex the issue is.

84. Shri Srivastava, Special Counsel for the Revenue, has strongly relied on the provisions of section 4 read with section 5(2) of the Income-tax Act in support of the Revenue's case that the interest payable by PE in India being the income arising in India to the foreign GE which is a non resident is chargeable to tax in India. We have already considered this aspect of the matter. As noted by us, the GE alone is the taxable entity in India and the Indian PE which is a part of that GE is not a separate and distinct taxable entity in India as per the domestic law. The GE and the PE which is a part of that GE thus is one and the same entity for the purpose of taxation in India and as held by the Hon'ble Supreme Court in the case of *Kikabhai Premchand (Sir)* (supra), the interest payable by PE to GE cannot give rise to any income which is taxable in India since one cannot make profit out of himself. As rightly contended by Shri Dastur, the basic principle which is to be kept in mind in this context is that nobody can make profit from himself and the income accrues or arises only when there is a deal with some third person and not from the deal with himself.

85. As regards the arguments raised by Shri Srivastava relying on the provisions of article 11(2) of the treaty, it is observed that the same is mainly a reiteration of what has been argued by Shri Girish Dave and we have already dealt with the submissions made by Shri Girish Dave elaborately before finally rejecting the same. As regards the contention raised by Shri Srivastava relying, inter alia, on the decision of Hon'ble Supreme Court in the case of Hyundai Heavy Industries Company Ltd. (supra) that the domestic law also recognizes two entity approach in the case of PE, we are of the opinion that the same cannot be disputed. However, this two entity approach is recognized only to the extent of determining the profit attributable to the PE in India and that too mainly relying on the relevant provisions of the treaty. As already held by us, this separate entity approach adopted in the case of PE by way of a deeming fiction is applicable only for the purpose of determining the profit attributable to the PE in India and the same cannot be extended and applied for the purpose of determining income of foreign GE taxable in India. Shri Srivastava has submitted that interest received by the Indian branch from the overseas branch of the same bank is chargeable

to tax in India inspite of the fact that the same is also a payment to self. He, however, has not thrown any light as to how and on what basis such income is chargeable to tax in India. If at all such income has been offered to tax by the assessee on mistaken basis, it cannot follow that payment made to self does give rise to income which is chargeable to tax unless the issue is examined and decided in the light of relevant provisions of the law and the relevant tax treaty whichever is applicable.

86. According to Shri Srivastava, whenever there is apportionment of income, the concept of separate entities or existence of two entities is very much embedded. We find it difficult to accept this contention of Shri Srivastava. In our opinion, question of apportionment of income does not always arise only in the case of two entities which are separately chargeable to tax. Moreover, the relation between GE and PE, as already discussed by us, is so peculiar that the GE and PE which is a part of that GE are one and the same entity for the purpose of taxation and the PE is treated as separate entity only for the purpose of determining the profit attributable to it in India as per the deeming fiction created in the relevant article of the treaty. As regards the contention raised by Shri Srivastava relying on article 11(6) of the Indo-Japanese treaty and the principle of force of attraction, we have already discussed this aspect while dealing with the argument of Shri Girish Dave. As held by us, article 11(6) of the Indo-Japanese treaty is not applicable in the present context for the various reasons given by us. Shri Srivastava has also contended that the entire interest income arising in India is taxable in the hands of GE in India irrespective of whether the funds fetching the said interest are advanced by GE in India directly or through Indian PE. In the present case, the funds, however, are not advanced by the GE to a third party and the same having been advanced directly to the PE, it is a transaction between the two parts of the same entity and the interest paid by PE to GE being payment to self, no income can be said to have arisen or accrued which is chargeable to tax in India.

87. Shri Srivastava has submitted before us that article 7(2) of the treaty lays down the procedure for apportionment of income between Head Office and Indian Branch. According to him, as per the said scheme of apportionment, what can be allowed as deduction is the actual cost of funds to the Head Office. He has contended hat if there is no such cost incurred at HO level, interest paid by the branch to the HO will be only a notional expenditure which cannot be apportioned as per article 7(2) of the treaty. We are unable to accept this contention of Shri Srivastava keeping in view the specific provisions contained in article 7(2) of the treaty. As per the said provisions, the profits attributable to the Permanent Establishment are the profits which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a

permanent establishment. The profits attributable to the PE thus are required to be determined treating the same as a distinct and separate enterprise which, inter alia, deals wholly independently with the enterprise of which it is a Permanent Establishment. As per this deeming fiction, the profits attributable to the Permanent Establishment thus are required to be determined as if it is dealing wholly independently with the enterprise of which it is a part and what would be allowable as deduction in such case is the cost of funds to the PE borrowed from GE and not the cost of funds to GE which is totally irrelevant.

88. Keeping in view all the facts of the case and the legal position emanating from the interpretation of the relevant provisions of domestic law as well as that of the treaty as discussed above, we are of the view that although interest paid to the head office of the assessee bank by its Indian branch which constitutes its PE in India is not deductible as expenditure under the domestic law being payment to self, the same is deductible while determining the profit attributable to the PE which is taxable in India as per the provisions of article 7(2) & 7(3) of the Indo-Japanese treaty read with paragraph 8 of the protocol which are more beneficial to the assessee. The said interest, however, cannot be taxed in India in the hands of assessee bank, a foreign enterprise being payment to self which cannot give rise to income that is taxable in India as per the domestic law. Even otherwise, there is no express provision contained in the relevant tax treaty which is contrary to the domestic law in India on this issue. This position applicable in the case of interest paid by Indian branch of a foreign bank to its Head Office equally holds good for the payment of interest made by the Indian branch of a foreign bank to its branch offices abroad as the same stands on the same footing as the payment of interest made to the Head Office. At the time of hearing before us, the learned representatives of both the sides have also not made any separate submissions on this aspect of the matter specifically. Having held that the interest paid by the Indian branch of the assessee Bank to its head office and other branches outside India is not chargeable to tax in India, it follows that the provisions of section 195 would not be attracted and there being no failure to deduct tax at source from the said payment of interest made by the PE, the question of disallowance of the said interest by invoking the provisions of section 40(a)(i) does not arise. Accordingly we answer question No.1 referred to this Special Bench in the negative i.e. in favour of the assessee and question No.2 in affirmative i.e. again in favour of the assessee.

89. Before parting, we may clarify that there may arise a situation where interest is payable by PE to GE and also there is interest receivable by PE from GE in the same year. A similar situation may arise where there are internal dealings of the Indian Branch of a foreign bank with its head office as well as other overseas branches. In such a situation, the issue may arise whether only the net interest would be

allowable as deduction while determining profits attributable to the PE in India. This issue, however, has neither been referred to this Special Bench nor any arguments have been advanced by both the sides thereon specifically during the course of hearing. We may further clarify that the issue referred to this Special Bench in question No. 2 has been raised by Antwerp Diamond Bank NV in its appeal by way of an additional ground. Although the said issue which is also involved in the case of Sumitomo Mitsui Banking Corporation and which is referred to this Special Bench in question No. 2 has been decided by us in principle, the application of Antwerp Diamond Bank NV for admission of additional ground raising the said issue will be considered by the Division Bench while disposing of the relevant appeal on merits.

90. We may also clarify that all the judicial pronouncements cited by the learned representatives of both the sides and the relevant portion of commentaries referred to in support of their respective stand have been considered and deliberated upon by us while arriving at our conclusions. Some of them, however, are not specifically mentioned or discussed in the order as the same have been found to be not directly relevant to the issue or the proposition therein is found to be repetitive in nature which has already been considered by us. We take this opportunity to place on record our appreciation for the assistance provided by the learned representatives of both the sides by making elaborate submissions which has helped us to analysis the legal position emanating from the interpretation of the relevant provisions of the domestic law as well as the relevant tax treaties and apply the same to the facts of the cases before us.

91. The matter will now go before the respective Division Bench for disposing off the appeals keeping in view our decision rendered above.

Pronounced on 30/03/2012.