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

\+ **{ITA No.980 OF 2009}**

% *Date of order:19th October, 2010.*

MOTHER DAIRY FRUIT, VEGETABLE P. LTD. . . . APPELLANT

Through : Mr. C.S. Aggarwal, Sr. Advocate with Mr. Prakash Kumar,Advocate

VERSUS

THE COMMISSIONER OF INCOME TAX ….RESPONDENT

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

CORAM :-

HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE SURESH KAIT

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J. *(ORAL)*

1. Admit.

2. The following substantial question of law arises for determination:-

> "Whether the Income Tax Appellate Tribunal was justified in law in reversing the order of the Commissioner of Income Tax (Appeals) and thereby upholding the disallowance of ₹ 1,929,632/- made by the assessing officer under Section 40 (a) (iii) of the Act, representing the amount of salaries paid in foreign currency to the employees at Netherlands, who were non-residents, without appreciating the same was not chargeable to tax under the provisions of the Income Tax Act 1961 by virtue of Article 15 of the Double Taxation Avoidance Agreement (DTAA) between Indian and Netherlands?"

3. Filing of paper book is dispensed with.

4. With the consent of the learned counsel for the parties, we ha heard the matter finally at this stage itself.

5. The aforesaid question of law has to be answered in the following factual background.

6. The appellant is a private limited company incorporated under the Companies Act, 1956 on 24th March, 2000 as a fully owned subsidiary of National Diary Development Board (NDDB). NDDB is a body corporate formed under the National Dairy Development Act, 1987 and having its head office at Anand. The main objective of the appellant company was to take over specific assets and liabilities and the running business of the units of NDDB, namely, Mother Dairy and Fruit and Vegetable Project, Delhi and Mumbai with effect from April, 2000 pursuant to an agreement entered into between NDDB and the appellant company. During the instant assessment year the appellant company was engaged in the business of (i) procuring, processing and distribution of milk, (ii) production and sale of ice cream, (iii) production and sale of other milk products like dahi, lassi, butter etc. and (iv) processing/manufacturing and sale of fruits and vegetables products, frozen fruits and vegetables under the brand name Safal.

7. For the instant assessment year 2002-03, the appellant company filed a return of income on 31st October, 2002 declaring income of ₹ 3,64,76,003/-. The appellant company has a marketing office in Rotterdam in Netherlands to support its export business. It remits funds in foreign currency outside India to its Netherlands Office to meet the expenses of that office. Out of the funds remitted to Netherlands office, amounts are utilized to make payments of salary to the employees of that office, which aggregated to ₹ 19,29,632, during the financial year

relevant to the instant assessment year 2002-03. The employe receiving salary are non-residents as per the provisions of the Act and subject to tax in Netherlands as per the Double Tax Avoidance Agreement between India and Netherlands. The sums not being chargeable to tax in India as such no tax was withheld on these payments. The appellant company claimed the same as expense.

8. The Assessing Officer by an order u/s 143 (3) of the Act dated 31st March, 2005 determined the income at ₹ 5,44,86,436/-. In doing so, the Assessing Officer disallowed an amount of ₹ 19,29, 632/- being salary paid to non-resident staff outside India (i.e. in Netherlands), u/s 40 (a) (iii) of the Act.

9. The appellant being aggrieved and dissatisfied from the aforesaid assessment order dated 31st March, 2005u/s 143 (3) of the Act, filed an appeal before the Commissioner of Income Tax (Appeals).

10. The Commissioner of Income Tax (Appeals) by an order dated 6th December, 2005 disposed of the appeal of the appellant. The CIT (A) deleted the addition of ₹ 19,29,632/- on account of disallowance made by the Assessing Officer being salary paid to non-resident staff outside India (i.e. in Netherlands), u/s 40 (a) (ii) of the Act. For the sake of convenience the relevant portion of the order of the Commissioner of Income Tax (Appeals) dated 6th December, 2005 is being reproduced as under:-

> "2.5 I have gone through the facts of the matter in relation to this issue. Reasoning given by the AO and the contentions of the assessee have been duly considered. In the facts and circumstances of the case I agree with the argument of the assessee that the provisions of TDS would not be applicable when the basic requirement is not fulfilled i.e. the sum paid should have been chargeable to

tax in India in accordance with provisions of Section 40 (a) (iii) of the Act read with Section 5 (2) and Section 9 (1) (iii) as contended by the assessee co,. in the preceding para. Reliance placed by the assessee on explanation 1 to Section 5 (2) is quite relevant here as the said income has neither been received in India nor can be said to be accrued or arisen in India. The AR has further clarified that such income is liable to be taxed as per tax laws of Netherlands. As such, it is clear to me that since the payment involved is not chargeable to tax in India under the head 'Salaries', there was no need for the assessee company to have deducted tax. The explanation 1 to Section 5 (20 has further clarified this issue in favour of the assessee when it says,

> "income accruing or arisen outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India."
>
> Accordingly, I am convinced that the disallowance of ₹ 19,29,632/- made by the AO on this count is inappropriate and the same is hereby deleted."

11. It is the Department which felt aggrieved by the aforesaid order of the C(T (A) and approached the Tribunal challenging that order. The Tribunal has allowed the appeal of the Revenue thereby upsetting the decision of the CIT (A) and restoring that of the Assessing Officer. The thinking of the Tribunal is reflected in the following portion of the order passed by it on 30th May, 2008:-

> "17.Hence, we are of the opinion that since we have already observed in para 11 of this order that the provisions of Section 409a)(i) and 40(a)(iii) are

analogous, in view of our detailed discussion the ratio of our decision in the case of Van Oord ACZ India (P) Ltd. (supra) fully applies to the facts and issues under consideration before us. Hence, applying the ratio of this decision in the case (supra) of the Tribunal we are of the opinion that the argument put forth by the assessee based on the case law (supra) i.e. if the payment of the salaries made outside India were not liable to taxation the assessee was not liable to deduct tax at source and no disallowance could be made under sec. 40(a) (iii) of IT Act, is liable to be rejected and accordingly the same is rejected as such. Whereas, in CIT v/s Vijay Ship Broking Corporation 261, ITR 133 (Guj.) referred to by the Id. DR for the Revenue, their Lordships, on identical issue, held at page 176 that as the assessee did not deduct tax at source u/s 195 (1) on the usance interest payable outside India and on which tax had not been paid it was not entitled to deduct, for assessment year 1995-96, the amounts of such usance interest in computing the business income by virtue of the provisions about disallowance contained in Sec. 40(a) (i) of IT Act.

In view of our detailed discussion it is held that as the salaries of ₹ 1,929,632/- has been paid by the assessee Indian Company outside India on which no tax has been deducted at source by the assessee, the AO has rightly disallowed such payments claimed by the assessee as per provisions of section 40A (iii) of the Income Tax Act. Accordingly, the order of the CIT (A) in this regard is reversed and that of the AO is upheld and ground of appeal taken by the Revenue is allowed."

13. It is against this order, present appeal is preferred which has given rise to the question of law formulated by us as above.

14. After hearing the counsel for the parties we are of the opinio that the Tribunal has committed a manifest error in law in reversing the order of the CIT (A). The admitted facts are that the salaries were paid in foreign currency to the employees who are in foreign country i.e. in Netherlands and even these employees are non-residents. It is also admitted at the Bar that the salary paid to these employees were exigible to tax in Netherlands and accordingly, they had paid tax as per the Income-Tax laws of that country. The question is as to whether the salary paid to them was to be taxed in India as well? Answer has to be in the negative having regard to the provisions of Double Taxation Avoidance Agreement between India and Netherlands. Clause (1) and (2) of Article 15 of the DTAA between India and Netherlands clearly provide accurate answer and these are reproduced below:-

> "1. Subject to the provisions of Articles 16,18,19,20 and 21, salaries, wages and other similar remuneration derived by a resident of one of the States in respect of an employment shall be taxable only in that State unless the employment is exercised in the other State. If the employment is so exercised, such remuneration as is derived there from may be taxed in that other State.
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> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of one of the States in respect of an employment exercised in the other State shall be taxable only in the first-mentioned State if:
>
> > (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned; and

> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
> (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State."

15. It is clear from the above that if the employees outside India, who are non-residents, have received salary even from Indian company, said salary will not be chargeable to tax in India. Clause (2) authoritatively mandates that the remuneration of resident of one of the States in respect of employment exercised in the other State shall be taxable only in the first-mentioned State if the conditions mentioned in sub Clause (a), (b) (c) are fulfilled. All these conditions are applicable in the instant case. The employees whom the salaries were paid were non-resident as per Section 6(1) (a) of the Act, as none of them were in India for a period of 182 days or more. The remuneration is also paid by an employer i.e. the respondent assessee who is not a resident of other State i.e. Netherlands. Further, there is no permanent establishment of the respondent assessee in Netherlands which had borne the remuneration.

16. In view of the above, provisions of Section 40 (a) (iii) of the Act were not applicable in the instant case. As per that Section certain amounts are not allowed as deductions in computing the income chargeable under the head 'profits and gains of business or profession. Sub Clause (iii) of clause (a) of Section 40 includes those payments which are chargeable under the head 'salaries' if the same is payable outside India and if the tax is payable thereon, there is no question of deducting tax therefrom under Chapter XVII-B. Chapter XVII relates to

tax deduction at source. Those provision would be applicable only when the salary paid is chargeable to tax in India and the question of deduction of tax at source arises. The question as to whether such salary paid outside India is exigible to tax in India or not would be governed by Section 5 of the Act. This provision reads as under:-

> "5. SCOPE OF TOTAL INCOME.
> ...(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which-
> (a) Is received or is deemed to be received in India in such year by or on behalf of such person; or
> (b) Accrues or arises or is deemed to accrue or arise to him in India during such year.."

17. To cover the case under this provision it is necessary for the department to establish that the employees to whom the said salaries were paid have received their income, either on actual or deemed basis in India or the income in question accrues or arises in India either on actual basis or deemed basis. The non-residents who never worked in India, never received salary from permanent establishment; were non-residents and were paid their remuneration in foreign exchange in a foreign country, would not be required to pay any tax in India as provision of Section 5 would not apply. This conclusion would be clear from the reading of Section 9 (1) (ii) of the Act which enumerates the income deemed to accrue or arise in India that falls under the head 'Salary'. Explanation to this provision provides the following answer:-

> "ii) income which falls under the head "Salaries", if it is earned in India.

Explanation- For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for-

(a) Service rendered in India, and

(b) The rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

Shall be regarded as income earned India."

18. Reading of this provision makes it clear that the salary payment can be said to be earned in India only if the corresponding services are rendered in India. In other words, if the services are rendered outside India, for which salary has been paid, then the income cannot be said to accrue or arise in India. Further, since in the instant case services are rendered outside India in respect of which the employees received salary outside India, it cannot be said that the same accrue or arise in India.

19. We may record here that Mr. C.S. Aggarwal, learned Sr. Counsel appearing for the appellant had referred to the judgment of Bombay High Court in the case of ***CIT*** *Vs.* ***Avtar Singh Wadhawan,*** *247 ITR 260.* That was a case where the assessee had worked outside the India; he received salary outside India from an Indian employer namely Shipping Corporation of India, the Bombay High Court on these facts held that since the place where the services are rendered is relevant for determining chargeability of the tax, no tax would be payable on the salary received on the services rendered outside India. While laying down this principle, the court made following pertinent observation:-

"On the other hand, Section 5(2) indicates the meaning of accrual of income. It states, inter alia, that the total income of any previous year of a non-resident shall

include all income from whatever source derived which is received by him in India or which accrues to him in India. In other words, broadly, in the case of a resident Indian all income which accrue to him whether in or outside India is taxable whereas in the case of a non-resident only income which accrues to him in India or which is received by him in India is taxable. Therefore, consequently, in the case of a non-resident if income accrues outside India, the same is not taxable. Section 6 indicates the meaning of residence in India. Section 6 lays down that for the purposes of the Income-tax Act, an individual is said to be a resident in India if he is in India for a prescribed period. Therefore, Section 6 emphasises physical presence of the person in India. Under Section 9(l)(ii), it is laid down as to what type of income shall be deemed to accrue or arise in India. The above section states that where the salary is earned in India it shall be regarded as income arising in India. There is an Explanation also to the above section which, inter alia, declares that income of the above nature payable for services rendered in India shall be regarded as income earned in India. This Explanation clearly indicates that where salary is payable for services rendered in India, the same shall be regarded as income earned in India. Therefore, the relevant test to be applied is where the services have been rendered".

20. We are quite in agreement with the aforesaid view taken by the Bombay High Court which is squarely applicable here as well.

21. In so far as judgment of the Tribunal in ***Van Oord ACZ*** (supra) is concerned, that is a case where the provisions of section 40 (a) (i) of the Act came into play whereas we are concerned, in the present case, with the applicability of Section 40 (a) (iii) of the Act. We thus answer

the question in favour of the assessee and against the Revenue, as result, this appeal is allowed and order of the Tribunal is set aside.

(A.K. SIKRI)

JUDGE

(SURESH KAIT)
JUDGE

OCTOBER 19, 2010
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