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

\+ **INCOME TAX APPEAL NOS. 486/2011, 491/2011 & 492/2011**

Reserved on : 21st October, 2011.
% **Date of Decision** : 4th January, 2012.

DIRECTOR OF INCOME TAX .... Appellant
Through Mr. Sanjeev Sabharwal, Advocate.

VERSUS

RIO TINTO TECHNICAL SERVICES …..Respondent
Through Mr. Salil Kapoor, Mr. Ankit Gupta, Mr. Sanat Kapoor & Mr. Vikas Jain, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA, J.:

Revenue has preferred these appeals under Section 260A of the Income Tax Act, 1961 (Act, for short) and vide order dated 8th August, 2011 the following substantial questions of law were framed:-

> "(1) Whether learned ITAT erred in holding that the assessee's activities are not FTS within the definition of FTS stated in Articles 12 of the Double Definition of FTS stated in Articles 12 of the Double Taxation Avoidance Agreement?
>
> (2) Whether learned ITAT erred in holding that Articles 7 of the Indo-Australia DTAA will be applicable and hence such income has to be construed as business income?
>
> (3) Whether provisions of Section 115A read with Section 44D of the Income Tax Act, 1961 are not applicable in the facts present case?"

2. The respondent assessee-Rio Tinto Technological Resources TY Limited, during the years in question i.e. the Assessment Years 1999-2000, 2000-01 and 2001-02 had operated in India through its division Rio Tinto Technical Services. The respondent-assessee had filed returns on 2nd February, 1999, 17th November, 2000 and 22nd October, 2001 declaring loss of Rs.2,00,970/-, positive income of Rs.23,88,700/- and Rs.12,50,930/- in respect of the three assessment years mentioned above. The three returns were taken up for regular assessment under Section 143(3) of the Act and the Assessing Officer vide assessment orders dated 25th February, 2002, 21st March, 2003 and 27th January, 2004 held that the payments received by the assessee from Rio Tinto India Private Limited and Rio Tinto Orissa Mining Limited (RTIPL and RTOML respectively, for short) were taxable as fee for technical services under Section 9(1)(vii) read with Section 115A of the Act and the gross receipts without any deduction were taxable at the rate of 20% in view of Section 44D of the Act. It was held that Articles 7 and 12 of the Double Taxation Avoidance Agreement between India and Australia (DTAA, for short) were not applicable. The income of the assessee for the three years was enhanced to Rs. 30,05,20,535/-, Rs. 1,41,46,440/- and Rs.36,53,188/- for the Assessment Years 1999-2000, 2000-01 and 2001-02, respectively. This income or the gross receipts

were held as taxable at the flat rate of 20% without deduction expenses.

3. The assessee was unsuccessful in the first appeal.

4. However, the Income Tax Appellate Tribunal (the tribunal, for short), by their common order for the three assessment years dated 19th March, 2010 has accepted the stand and stance of the assessee. Paragraph 4.3 of the said order, which is the operative portion and gives the ratio of the findings recorded by the tribunal, for the sake of convenience is reproduced below:-

> "4.3 Thus, applying these provisions to the facts to the present case, it is noticed that the assessee having admitted that it has PE in India and the income of the assessee is taxable in India and the assessee having opted to be taxed as per the provisions of the DTAA it is Article 7 of the DTAA which applies to the assessee's case in so far as the assessee has a PE in India. Thus, as per Article 7(2) of the DTAA, the PE of the assessee would have to be treated as a wholly independent enterprise, which is liable to be taxed in India. Once it is held that the assessee is liable to be taxed as per Article 7 of the DTAA, sub-clause (3) of Article 7 of the DTAA would come into play and deduction in accordance with the subject to the law relating to the tax in India would apply. Since it is held that Article 7 of the Act would no more be applicable as Article 7(2) of the DTAA specifies that the PE of the assesse is to be treated as a wholly independent enterprise and it is the profits of such PE in India which are to be taxed. Since Article 7 of the DTAA is applied, Section 44D and Section 115A of the Act also will not apply in so far as they relate to foreign companies, whereas clause (2) of Article 7 of the DTAA specifies that the PE in India is to be treated as a wholly independent enterprise in India. In such a situation, sub-clause (3) of Article 7 of DTAA would come into play and the income of the assessee would have to be assessed by applying the regular provisions of the Indian Tax Laws. In short, the assessee herein would be liable to be assessed as an entity separately assessable in its own

> independent capacity in India and the provisions of Sections 28 to 43C of the Act would be available to the assessee. What is to be understood here is that it is the business profits which are chargeable under Article 7 of the DTAA. So as to what the business of the assessee is, is also to be considered. The business of the assessee is as per the contracts entered into by the assessee with the various persons. The contracts are inclusive contracts of technical nature, as also drilling, etc., as extracted earlier. Thus, it cannot be said that he activities of the assessee is purely technical service. The drilling and excavation and testing cannot be de-linked from the evaluation and the feasibility studies. It is a consolidated activity. Thus, the activities of the assessee cannot be held to fall within Article 12 of the DTAA also. In these circumstances, the assessee having opted to be taxed under the DTAA, this option cannot be denied to the assessee and as per sub-clauses (2) and (3) of Article 7. The assessee is to be taxed as an independent enterprise in India and the regular provisions of the Indian tax Laws would apply to the exclusion of Section 9(1)(vii), section 44D and 115A of the Act. In these circumstances, the orders of the lower authorities are reversed and the appeals of the assessee are allowed."

5. A dissection of the said paragraph shows that the tribunal has held as follows:-

(i) The assessee had a permanent establishment (PE, for short) in India. This is a very important fact and is not disputed or denied by the Revenue or the assessee.

(ii) Assessee had opted to be taxed under DTAA and in terms of Article 7(2), the PE in India was to be treated as an independent enterprise, that was liable to be taxed in India.

(iii) Once income is held to be taxable under Article 7, then paragraph 3 of the said Article has to be given full effect to and accordingly (1) deduction in accordance with and subject to the law

relating to tax in India will apply; (2) Section 9(1)(vii) of the Act is n applicable; (3) Section 44D and Section 115A will also not apply, but provisions of Section 28 to 43C of the Act are applicable and the assessee is entitled to deduct expenses before computing taxable income.

(iv) The contracts under which payments have been made were inclusive contracts of technical services and drilling and excavation etc. and, therefore, the activities of the assessee were not of purely technical nature. The activities of the assessee were consolidated activities of multifarious character and include drilling, excavation and testing.

(v) In view of "composite activities" Article 12 of DTAA is not applicable.

6. In order to appreciate the controversy, it is important to examine and interpret Articles 7 and 12 of the DTAA and Sections 90, 9(1)(vii) and 44D of the Act. These have been reproduced below:

> "**AGREEMENT BETWEEN THE GOVERNMENT OF THE REPUBLIC OF INDIA AND THE GOVERNMENT OF AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME**
>
> **Article 7**--BUSINESS PROFITS
>
> (1) The profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on

business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:
(a) that permanent establishment; or
(b) sales within that other Contracting State of goods or merchandise of the same or a similar kind as those sold, or other business activities of the same or a similar kind as those carried on, through that permanent establishment.

(2) Subject to the provisions of paragraph (3), where an enterprise of one of the 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 or with other enterprises with which it deals.

(3) In the determination of the profits of a permanent establishment, there shall be allowed as deductions, in accordance with and subject to the limitations of the law relating to tax in the Contracting State in which the permanent establishment is situated, expenses of the enterprise, being expenses which are incurred for the purposes of the business of the permanent establishment (including executive and general administrative expenses so incurred), whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(5) Where the correct amount of profits attributable to a permanent establishment is incapable of determination by the taxation authority of one of the Contracting States or the ascertaining thereof by that authority presents exceptional difficulties, nothing in this Article shall affect the application of any law of that State relating to the determination of the tax liability of a person, provided that the law shall be applied, so far as the information available to that authority permits, in accordance with the principles of this Article.

(6) For the purposes of the preceding paragraphs of this Article, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(7) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.

(8) Nothing in this Article shall affect the operation of any law of a Contracting State relating to tax imposed on profits from insurance with non-residents provided that if the relevant law in force in either Contracting State at the date of signature of this Agreement is varied (otherwise than in minor respects so as not to affect its general character) the Contracting States shall consult with each other with a view to agreeing to any amendment of this paragraph that may be appropriate.

(9) Where:
(a) a resident of one of the Contracting States is beneficially entitled, whether directly or through one or more interposed trust estates, to a share of the business profits of an enterprise carried on in the other Contracting State by the trustee of a trust estate other than a trust estate which is treated in that other State as a company for tax purposes; and
(b) in relation to that enterprise, that trustee would, in accordance with the principles of Article 5, have a permanent establishment in that other Contracting State,
the enterprise carried on by the trustee shall be deemed to be a business carried on in that other Contracting State by that resident through a permanent establishment situated therein and that share of business profits shall be attributed to that permanent establishment.

Article 12---ROYALTIES

(1) Royalties arising in one of the Contracting States, being royalties to which a resident of the other Contracting State is beneficially entitled, may be taxed in that other State.

(2) Such royalties may also be taxed in the Contracting State in which they arise, and according to the law of that State, but the tax so charged shall not exceed:
(a) in the case of:
(i) royalties referred to in sub-paragraph (3)(b);
(ii) payments or credits for services referred to in sub-paragraph (3)(d), subject to sub-paragraphs (3)(h) to (I), that are ancillary and subsidiary to the application or enjoyment of equipment for which payments or credits are made under sub-paragraph (3)(b); or
(iii) royalties referred to in sub-paragraph (3)(f) that relate to equipment mentioned in sub-paragraph (3)(b):
10 per cent. of the gross amount of the royalties; and
(b) in the case of other royalties:

(i) during the first five years of income for which this Agreement has effect:
(A) where the payer is the Government or a political sub-division of that State or a public sector company: 15 per cent. of the gross amount of the royalties; and
(B) in all other cases: 20 per cent. of the gross amount of the royalties; and
(ii) during all subsequent years of income: 15 per cent. of the gross amount of the royalties.

(3) The term " royalties " in this article means payments or credits, whether periodical or not, and, however described or computed, to the extent to which they are made as consideration for:
(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;
(b) the use of, or the right to use, any industrial, commercial or scientific equipment;
(c) the supply of scientific, technical, industrial or commercial knowledge or information;
(d) the rendering of any technical or consultancy services (including those of technical or other personnel) which are ancillary and subsidiary to the application or enjoyment of any such property or right as is mentioned in sub-paragraph (a), any such equipment as is mentioned in sub-paragraph (b) or any such knowledge or information as is mentioned in sub-paragraph (c);
(e) the use of, or the right to use:
(i) motion picture films;
(ii) films or video tapes for use in connection with television; or
(iii) tapes for use in connection with radio broadcasting;
(f) total or partial forbearance in respect of the use or supply of any property or right referred to in sub-paragraphs (a) to (e); or
(g) the rendering of any services (including those of technical or other personnel) which make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or design;
but that term does not include payments or credits relating to services mentioned in sub-paragraphs (d) and (g) that are made:
(h) for services that are ancillary and subsidiary, and inextricably and essentially linked, to a sale of property;
(i) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;
(j) for teaching in or by an educational institution;
(k) for services for the personal use of the individual or individuals making the payments or credits; or

(l) to an employee of the person making the payments or credits or to any individual or firm of individuals (other than a company) for professional services as defined in article 14.

(4) The provisions of paragraphs (1) and (2) shall not apply if the person beneficially entitled to the royalties, being a resident of one of the Contracting States, carries on business in the other Contracting State, in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the property, right or services in respect of which the royalties are paid or credited are effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

(5) Royalties shall be deemed to arise in a Contracting State when the payer is that State itself or a political sub-division or local authority of that State or a person who is a resident of that State for the purposes of its tax. Where, however, the person paying the royalties, whether the person is a resident of one of the Contracting States or not, has in one of the Contracting States or outside both Contracting States a permanent establishment or fixed base in connection with which the liability to pay the royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

(6) Where, owing to a special relationship between the payer and the person beneficially entitled to the royalties, or between both of them and some other person, the amount of the royalties paid or credited, having regard to what they are paid or credited for, exceeds the amount which might have been expected to have been agreed upon by the payer and the person so entitled in the absence of such relationship, the provisions of this article shall apply only to the last mentioned amount. In that case, the excess part of the amount of the interest paid or credited shall remain taxable according to law, relating to tax, of each Contracting State, but subject to the other provisions of this Agreement.

Income Tax Act, 1961

Section 9-- Income deemed to accrue or arise in India.

(1) The following incomes shall be deemed to accrue or arise in India –

X X X X

(vii) income by way of fees for technical services payable by--

(a) the Government ; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day April, 1976, and approved by the Central Government.

Explanation 1.--For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Explanation 2.--For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recepient or consideration which would be income of the recipient chargeable under the head "Salaries".

Section 44D-- Special provisions for computing income by way of royalties, etc., in the case of foreign companies.-- Notwithstanding anything to the contrary contained in sections 28 to 44C, in the case of an assessee, being a foreign company,--

(a) the deductions admissible under the said sections in computing the income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern before the 1st day of April, 1976, shall not exceed in the aggregate twenty per cent. of the gross amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent,

invention, model, design, secret formula or process or trade mark or similar property;

(b) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern after the 31st day of March, 1976.

Explanation.--For the purposes of this section,--

(a) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9 ;

(b) "foreign company" shall have the same meaning as in section 80B ;

c) "royalty" shall have the same meaning as in the Explanation 2 to clause (vi) of sub-section (1) of section 9 ;

(d) royalty received from Government or an Indian concern in pursuance of an agreement made by a foreign company with Government or with the Indian concern after the 31st day of March, 1976, shall be deemed to have been received in pursuance of an agreement made before the 1st day of April, 1976, if such agreement is deemed, for the purposes of the proviso to clause (vi) of sub-section (1) of section 9, to have been made before the 1st day of April, 1976.

Section 90. Agreement with foreign countries.--(1) The Central Government may enter into an agreement with the Government of any country outside India--

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country ; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

> (d) for recovery of income-tax under this Act and under the corresponding law in force in that country,
>
> and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
>
> (2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
>
> Explanation.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company, where such foreign company has not made the prescribed arrangement for declaration and payment within India, of the dividends (including dividends on preference shares) payable out of its income in India."

7. Section 90(2) mandates that where the Central Government has entered into a DTAA 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 the agreement applies, the provisions of the Act apply to the extent they are more beneficial to the assessee. In other words, where an Article in a DTAA and a provision of the Act apply to the assessee, then the Article of the DTAA or the provision the Act will apply depending upon which one of the two is more beneficial/advantageous to the assessee. The first requirement, therefore, is to see whether provisions of the Act apply to a particular transaction undertaken/income earned by an assessee, which is taxable in India under the Act. In case the transaction/income is not taxable under the

Act, the income earned would not be taxed. In case the sa transaction or income of an assessee is taxable under the Act, then the provisions of DTAA, if applicable, may be resorted to if they are more beneficial and advantageous to the assessee i.e. if they negate or reduce the tax liability. In ***Azadi Bachao Andolan vs. UOI*** (2003) 263 ITR 706 (SC) after referring to the said section it has been held:-

> "**21.** The provisions of Sections 4 and 5 of the Act are expressly made "subject to the provisions of this Act", which would include Section 90 of the Act. As to what would happen in the event of a conflict between the provision of the Income Tax Act and a notification issued under Section 90, is no longer res integra.
>
> XXXXX
>
> **28.** A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that Section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement. When that happens, the provisions of such an agreement, with respect to cases to which they apply, would operate even if inconsistent with the provisions of the Income Tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under Section 4 and the general principle of ascertainment of total income under Section 5 of the Act, then there was no purpose in making those sections "subject to the provisions of the Act". The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under Section 90 towards implementation of the terms of DTACs which would automatically override the provisions of the Income Tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of DTAC."

8. At the outset, we may notice one fact that there is no dispute that the assessee had a PE in India as defined in Article 5 of the DTAA.

This judgment proceeds on the said admitted fact, which is extreme[ly] relevant and material.

9. Articles 7 and 12 of DTAA make a distinction between income earned by way of "royalties" and "business profits". The term "royalty" has been defined in Article 12 paragraph 3, which consists of sub-paragraph a to l. As noticed above, the tribunal has held that Article 12 of DTAA is not applicable as the payments received were of composite character for diverse work and were not covered by the term "royalty" as defined in paragraph 3 of Article 12. This is clear from the observations recorded by the tribunal on the nature of activity undertaken by the PE of the assessee in India mentioned in paragraph 4.3. On this aspect we have adversely commented and reversed the findings of the tribunal, in a subsequent portion of this decision.

10. Paragraph 4 of Article 12 states that paragraphs 1 and 2 of Article 12 will not apply if "royalty" arises through a PE situated in the contracting State where business is carried on, of which the assessee is not a resident. Paragraph 4 states that in such cases Article 7 or 14 would apply. Tribunal is, therefore, right in holding that Article 12 of DTAA is not applicable but the reason is paragraph 4 of Article 12. Once an assessee has a PE in the contracting state of which he is not resident, then paragraphs 1 and 2 of the said Article do not apply.

11. Thus, for the reasons different than those, mentioned by t tribunal we hold that Article 12 of the DTAA is not applicable. Sequitor is Article 7 of the DTAA is applicable. Interpretation and provisions of Article 7 have been examined while answering question No.3. Question Nos. 1 and 2 are accordingly answered.

12. Article 7 deals with business profits and will apply, once it is held that Article 12 is not applicable. Paragraph 3 of Article 7 is the edifice which is to be examined to answer the substantial question No.3 mentioned above. A careful examination of the said paragraph shows that to determine the profits of a PE, the assessee is to be allowed deductions "in accordance with and subject to limitations of the law" relating to tax in the contracting State, i.e., in the present case Income Tax Act in India. It further stipulates that expenses incurred for the purpose of the business of a PE would include executive and general administrative expenses so incurred regardless whether they have incurred in any contracting State, i.e., India/Australia or elsewhere. However, the material words in paragraph 3 of Article 7 are "the assessee shall be allowed as deduction, in accordance with and subject to limitation of the law relating to tax (i.e., the Income Tax Act, 1961) in the contracting State (i.e., India) in which the permanent establishment is situated". What is stipulated and stated in paragraph 3 of Article 7 is that the expenses incurred by the assessee can be

claimed as a deduction but only in accordance with and subject limitation stipulated in the Act. The provisions of the Act, therefore, relating to deduction of expenditure, become applicable for computing business profits under Article 7(3). The limitations and conditions stated and stipulated in the Act with regard to deductions accordingly get attracted and retain their supremacy and are not obliterated/diluted in view of paragraph 3 of Article 7. In other words, paragraph 3 of Article 7 gives paramouncy and accepts that the deductions can be only claimed in accordance with and subject to limitations of the Act and not otherwise.

13. The net effect of the aforesaid conclusion is that to compute business profits under Article 7(3) of the DTAA, we have to examine whether a particular expense/expenses can be allowed as a deduction from the income earned in accordance with and is subject to the limitations relating to the deduction available to the assessee under the Act. This necessarily requires examination and consideration of the provisions of the Act to find out whether for computing taxable income, an expense can be claimed as a deduction under the Act. If deduction can be claimed under the Act, then the said deduction is permissible and has to be allowed but if an expense cannot be claimed as a deduction because of the stipulations in the Act in respect of the

earned income, then the said expenditure is not to be allowed as deduction/expense.

14. Second part of paragraph 3 to Article 7 protects and states that the assessee is entitled to claim deduction of expenses both in India as well as administrative and general expenses whether they are incurred in the contracting State in which the PE is situated or outside the said contracting State. However, the first part and the second part of paragraph 3 of Article 7 have to be read harmoniously giving full effect to the two parts, as if there is no conflict between them. The first part, as noticed above, is a part which states when deduction of an expense can be allowed, i.e., deduction should be in accordance with and subject to the limitation of law of the contracting State where PE is situated. This condition must be satisfied before the advantage or benefit of second part of paragraph 3 can be taken by the assessee, i.e., the expenses of which deduction can be claimed are not restricted to merely expenses in the contracting State but also executive and general administrative expenses which were incurred outside the contracting State. To this extent paragraph 3 of Article 7 will override and will have primacy over any stipulation in the Act, if any, that executive and general administrative expenses outside India cannot be taken into consideration.

15. In view of the reasoning given above, it is not possible to agr with the conclusion and the findings recorded by the tribunal that once Article 7 applies, Section 44D read with Section 115A is not applicable. The tribunal has overlooked and not given due credence and importance to paragraph 3 of Article 7 of the DTAA. The said paragraph as noticed above, states that the provisions relating to the tax enactment on the question of deduction of expenditure are fully protected; are to be enforced and are applicable. Deduction can only be claimed in accordance with and subject to the limitations of the Act in the contracting State, i.e., India or Australia, as the case may be. In this manner, Paragraph 3 of Article 7 has given primacy to the provisions stipulated in the domestic tax legislation while computing business income under Article 7(3) in case the assessee has a PE in the non-resident country.

16. In view of the aforesaid reasoning, we have to examine the provisions of the Act to find out whether the assessee is entitled to deduction of expenses and if so, to what extent or there is any prohibition or bar for claiming a deduction under the Act. This "question" is in built or a part of question No.3.

17. Business income in India is taxable under Chapter IV-D "profits and gains of business or profession". Sections 28 to 44DB are under the said heading. Each Section and provision of the said part has to be

considered and examined to find out whether a particular deduction expenditure can be claimed when income is taxable under the head "income from business". Section 44D has been quoted. The said Section begins with a non-obstante or overriding expression and states that Sections 28 to 44C would not be applicable and deductions under the said Sections cannot be allowed and are not admissible in case an assessee is a foreign company and has earned income by way of "royalty" or "fee from technical services" from Indian Government or Indian concern. For the purpose of Section 44D, the expression "fee for technical services" and "royalty" have the same meaning as defined in Explanation 2 to clause (vii) and (vi) of sub-section 1 of Section 9 of the Act. The term "foreign company" has also been defined in clause (b) to the Explanation to Section 44D to mean a company, which is not a domestic company as per Section 80B of the Act. It is not in dispute before us that the assessee was a foreign company.

18. The next question, which arises for consideration is whether the income earned by the assessee is "fee for technical services" within the meaning of Explanation 2 to clause (vii) of sub-section 1 of Section 9.

19. The tribunal in their findings recorded in paragraph 4.3 has held that the contracts are inclusive contracts of technical nature as well as of drilling etc. It has been further observed that it cannot be said that the activities of the assessee were of purely technical nature.

20. In paragraph 4, the tribunal has extracted a portion of t agreement between the assessee and RPIL and RITS. The said portion reads as under:-

> "The evaluation of the resources will begin with a geological mapping, drilling and editing programme and be followed by iron ore quality testing and resource modeling.
>
> Specifically, the objectives of the pre-feasibility phase 2 programme are to:
>
> - Improve the knowledge of the ore body and ore characteristics by a bulk sampling and drilling programme;
> - Investigate preliminary metallurgical and treatment characteristics, define options and estimate costs;
> - Investigate infrastructure requirements and existing capacities, define option and estimate costs;
> - Carry out a preliminary environmental assessment;
> - Identify major issues which might prevent the project proceeding;
> - Identify major options for further study;
> - Prepare the Phase 2 Pre-feasibility study report encapsulating all of the above listed elements, including preliminary mining plan, flow sheets, and costs, and indicative financial analysis."

21. Immediately after extracting the portion of the one of the contracts, the tribunal in paragraph 4.1 has observed as under:-

> "4.1 A reading of portion extracted above shows that the primary objective is technical work for the evaluation of iron ore resources and the corresponding feasibility study for transportation of ore by rail and the development and handling of ship loading capacities as the specified process. The evaluation of the resources was to begin with geological mapping, drilling and editing programme, to be followed by iron ore quality testing of the resources modeling. Thus, this is not a case where a simple technical or consultancy service is provided, but it includes specific activities which are required to be done on site, i.e., by various activities such as the geological mapping, drilling, testing or quality, quantifying the possible quantity and resources,

> examining the environmental hazards. For the performance of the contract, it is noticed, the assessee has obtained necessary permission from the RBI, which is the sanctioning authority for opening a project office in India. It is an accepted fact that the asssessee has opened its project office in India and has entered into a contract to do business in line with the permission granted by RBI. It is also an accepted fact that he assessee does have a permanent establishment (PE) in India."

22. The tribunal has not specifically examined Explanation 2 to Section 9(1) (vii) and whether or not the said explanation is applicable and the income earned by the assessee is covered by the said explanation. The expression "fees for technical services" has been defined in Explanation 2 to Section 9(1)(vii) to mean any consideration including lumpsum payment for rendering managerial, technical or consulting services and includes provisions of service of technical or other personnel. Section 44D read with Explanation 2 to Section 9(1)(vii) envisages different and separate treatment for taxation purposes of income regarded as "fee for technical services" as noticed above.

23. The tribunal has also erred in holding that the extracted portion of the agreement establishes and shows that the consideration received was for a composite contract. Further, even in a case of a composite contract for supply of goods/equipment/machinery and for providing technical services, bifurcation, if already made in the contract, has to be considered and accordingly the income has to be taxed. In absence

of bifurcation, an estimated allocation is justified and has to be ma for the purpose of tax.

24. The payment in the present case is for furnishing of evaluation report. The fee paid is for the said purpose. To collect and collate the information and furnish evaluation report, the assessee was required and it was necessary to undertake certain tests, mapping and studies. Drilling for tests as to evaluate is to gain information and knowledge. The payment which is received is for furnishing of information and not "business" income or composite income including "business" income as held by the tribunal. The assessee may be carrying on manufacturing or trading activities but can enter into a contract to furnish technical information for a fee to a third party. Technical information which is furnished may be a result of the knowledge, experience and expertise gained by the assessee as a result of business or trading activity; or tests, mapping etc. may be required for furnishing the said information, but this is immaterial. The fee received from the third party in such cases is fee for technical services, if it satisfies and is covered by the Explanation 2 to Section 9(1)(vii). The payment made is to acquire technical information. Therefore it is "fee for technical services". It will be immaterial whether the assessee had acquired and gained the said technical information because of business or trading activity or after conducting tests, mapping etc. The

nature and character of the information furnished and for which the f or consideration is paid is the relevant criteria for deciding whether or not Explanation 2 to Section 9(1)(vii) is applicable. In the present case, as per the clauses quoted above, the fee was paid to acquire technical and managerial information.

25. At this stage, it will be appropriate to notice and decide the contention of the assessee that Explanation 2 to Section 9(1)(vii) is not applicable in view of the exclusion i.e., the expression " fee for the technical services, but does not include consideration for any construction, assembly, mining or like project undertaken by the assessee". The aforesaid exclusion states that the consideration received by an assessee for construction, assembly, mining or like project has to be excluded and is not fee for technical services. The use of the word "project" in the expression is relevant and significant. Construction, assembly or mining projects are normally and in common parlance not regarded as services relating to fee for technical services. Explanation 2 to Section 9(1)(vii) makes and draws a distinction between income earned by way of fee for technical services, which have been defined to mean any managerial, technical or consultancy services, including provision on services of technical and other personnel, in contradistinction to income earned from manufacturing or trade activity. The legislature by the said expression

has clarified and as a matter of abundant caution stated th construction, assembly or like project undertaken by the recipient should not be regarded and treated as consideration for fee for technical services. The reasoning and justification is obvious; construction, assembly or mining activities may not strictly fall within and be regarded as the manufacturing, or trading activity, when interpreted in a narrow manner. The intention of the legislature is that the narrow interpretation is not warranted. The aforesaid expression, therefore, is merely clarificatory and declaratory of what is fairly obvious and clear. It removes doubts and ensures that any debate on this score is avoided. It does not seek to curtail the scope and ambit of managerial, technical or consultancy services which are taxable as fee for technical services. Use of the word "project" in the said expression requires and mandates that there should be construction project, assembly project or a mining project or a like project undertaken by the recipient and the consideration paid should be on the said account. It is apparent and the clauses of the agreement do not disclose that the assessee had undertaken any mining project or a construction project. There is no such finding recorded by the tribunal also.

26. Learned counsel for the petitioner assessee had relied upon decision of the Supreme Court in ***Union of India and Another versus A. Sanyasi Rao and Others***, (1996) 219 ITR 330 and has submitted

that Section 44D is a draconian provision and should be read down an option available to an assessee and is not a mandatory provision. It is submitted that taxation on gross income basis is unconscionable.

27. Constitutional validity of the said provision is not challenged before us and cannot be examined in an appeal under Section 260A of the Act. We have to decide the appeal on the basis that this Section is constitutionally valid, though courts can read down a section while interpreting a provision in case of ambiguity/doubt to ensure that the provision does not fall foul of the constitutional limits. It may be relevant to note that taxation of non-resident on gross receipt basis was one of the contentions or defences raised by the Revenue in ***A. Sanyasi Rao case*** (supra) to defend the presumptive provision under challenge in the said case. The Supreme Court dealt with the said defence, observing as under:-

> "Counsel for the Revenue brought to our notice sections 44B, 44BB, 44BBA and 44D and contended that there are other similar provisions in the Act. We should state that they relate to non-residents carrying on business in India and are not much relevant in construing sections 44AC and 206C of the Act."

28. It is clear from the aforesaid quote that the Supreme Court had drawn a distinction between not resident assessees and assessees who are resident in India, as far as taxation on gross receipt basis is concerned. It may be also noted that the rate of tax under Section 44D is 20%, whereas rate of tax at the normal rates in the years in question

was much higher. In some cases, Section 44D may work to t advantage of an assessee and to the disadvantage of the Revenue and in other cases to the advantage of the Revenue and to the disadvantage of the assessee. This contention is rejected.

29. In view of the aforesaid findings, the questions of law mentioned above are answered as under:

(1) Question No. 1 is answered in negative and it is held that Article 12 of the DTAA is not applicable.

(2) Question No. 2 is also answered in negative and it is held that Article 7 of the DTAA applies but on interpretation of the said Article, specially paragraph 3, we have to examine the provisions of the Indian Income Tax Act to find out whether or not deduction of expenses is permitted or allowed.

(3) Question No. 3 is answered in negative and it is held that Section 44D is applicable as the income earned by the assessee is taxable as "fee for technical services".

The appeals are accordingly disposed of. No costs.

(SANJIV KHANNA)
JUDGE

(R.V. EASWAR)
JUDGE

JANUARY 4, 2012
VKR