

# CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

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## COMMISSIONER OF INCOME TAX vs. SIEMENS AKTIONGESELLSCHAFT

HIGH COURT OF BOMBAY

F.I. Rebello & J.P. Devadhar, JJ.

IT Ref. No. 251 of 1988

19th November, 2008

(2008) 220 CTR (Bom) 425 : (2009) **310 ITR 320** : (2009) 177 TAXMAN 81 : (2008) 15 DTR 233

### Legislation referred to

Section 9(1)(vi), 9, Expln., 90, 260A, 9(1)(vii), 4, Double Taxation Avoidance Agreement between India & Federal Republic of Germany, Art. 3, Double Taxation Avoidance Agreement between India & Federal Republic of Germany, Art. 8A,

### Case pertains to

Asst. Year 1979-80,

### Decision in favour of

Assessee

**Double taxation relief—Agreement between India and Federal Republic of Germany—Royalty vis-a-vis industrial and commercial profits—Even though s. 9 would apply, provisions of DTAA, if more beneficial, would prevail—Assessee having no PE in India, amount of royalty, sought to be assessed as industrial or commercial profit, is not assessable to tax in India—If the consideration received by the assessee for grant of the patents and license is regarded as royalty as the grant admittedly took place outside India, the question of applying deeming provisions of Explanation to s. 9 inserted by the Finance Act, 2007 would not arise and further, assessee having no PE in India, such income would not be taxable in India as industrial and commercial profits in terms of art. III of Indo-German DTAA—Income from activities covered by arts. V to XII by virtue of art. III(3) are specifically excluded from the expression 'industrial or commercial profits' in art. III as they are to be taxed in the manner provided under arts. V to XII—Therefore, income other than of the nature provided in arts. V to XII, if relatable to industrial or commercial profits would fall under art. III, not chargeable to tax in the absence of PE—This view is further fortified by the fact that art. III of the 1960 DTAA has been substituted by DTAA of 1995 and a new art. VIIIA has been inserted explaining the expression 'royalties'**

### Held :

Even in the absence of royalty being defined under the clauses of the agreement, if it amounts to any industrial or commercial profit it would be taxable under cl. III provided there is a PE in India unless it is held that considering the Explanation to s. 9 brought by the Finance Act, 2007 the requirement of PE is now of no consequence. While considering the DTAA the expression "law in force" would not only include a tax already covered by the treaty but would also include any other

tax as taxes of a substantially similar character subsequent to the date of the agreement as set out in art. I(2). Considering the express language of art. I(2) it is not possible to accept the broad proposition urged on behalf of the assessee that the law would be the law as was applicable or as defined when the DTAA was entered into. The question however, would still remain, whether the income by way of royalties other than those included in art. III(3) are subject to tax in India considering the DTAA when there is no PE. The rule of referential incorporation or incorporation cannot be applied when dealing with a treaty (DTAA) between two sovereign nations. Though it is open to a sovereign legislature to amend its laws, a DTAA entered into by the Government in exercise of the powers conferred by s. 90(1) while considering s. 90(2) has to be reasonably construed.

(Para 22)

Though provisions of s. 9 would be applicable, however, considering the provisions of the DTAA if beneficial than provisions of the IT Act, the provisions of DTAA would prevail. Therefore, in the absence of a PE the amounts in respect of which the Tribunal has recorded a finding that the income sought to be assessed is industrial or commercial profit are not assessable to tax in India as admittedly the assessee having no PE. The Finance Act, 2007 has inserted Explanation to s. 9. By this amendment the concept of having residence or place of business connection in India has been done away with. In the present case, if the consideration received by the assessee for grant of the patents and license is regarded as royalty as the grant admittedly took place outside India, the question of applying deeming provisions would not arise. Without going into that issue, such income would not be taxable in terms of the DTAA, as the assessee has no PE in India and the terms of the DTAA are more beneficial to the assessee.—[CIT vs. Visakhapatnam Port Trust](#) (1984) 38 CTR (AP) 1 : (1983) 144 **ITR** 146 (AP), [CIT vs. Davy Ashmore India Ltd.](#) (1991) 190 **ITR** 626 (Cal) and [Union of India vs. Azadi Bachao Andolan](#) (2003) 184 CTR (SC) 450 : (2003) 263 **ITR** 706 (SC) **relied on.**

(Paras 27 & 28)

The issue can also be considered in the light of the argument advanced on behalf of the assessee that considering the expression "royalty" as set out in art. IX, it has a restrictive meaning. The royalty which is the subject-matter of this appeal can only be taxable under art. III provided the predicates therein are satisfied namely, that there is a PE. Article III(3) sets out that the term "industrial or commercial profits" shall not include income in the form of rents, royalties, interests, dividends, management charges, remuneration for labour or personal services or income from the operation of ships or aircraft but shall include rents or royalties in respect of cinematographic films. A reading of this article may prima facie indicate that only royalties from cinematographic films form a part of industrial or commercial profits and all other incomes by way of royalty would not be taxable except to the extent which may be provided by the DTAA. This must also be seen in the context of arts. V to XII where the income from the excluded heads under art. III are taxable. Income from activities covered by arts. V to XII by virtue of art. III(3) are specifically excluded from the expression 'industrial or commercial profits' in art. III as they are to be taxed in the manner provided under arts. V to XII. An inescapable conclusion, therefore, emerges that income other than those provided by the articles and if it is relatable to industrial or commercial profits would be covered by art. III. This income would not be subject to tax in the absence of a PE of the enterprise in the territory of India. It is not possible to accept that income including from royalties, from inventions, trade marks, patents or copyrights or the like are excluded and would not be taxable. The correct interpretation of the DTAA would be to include the royalties from patents, copyrights or trade marks and the like within the expression "industrial" or "commercial" profits. The Tribunal, therefore, has correctly taken a view that though this income would not be royalties within the meaning of DTAA but would fall under the expression 'commercial or industrial profits'. In the absence of a PE such income would not be taxable in India. This is further fortified by the fact that in the subsequent DTAA of July, 1985, art. III of the DTAA of 1960 has been substituted and art. III(3) makes it clear where income is dealt with separately under other articles then those

provisions will apply. A new art. VIIIA has been inserted which explains the expression royalties to include payments of any kind received as consideration for the use of, or the right to use amongst other payments received as consideration for the right to use any copyright, patent, trade mark, etc. Though the word "royalty" was also not defined under the IT Act as it then stood, the expression would have to be understood in its ordinary grammatical meaning which is already set out earlier. The conclusion would be that royalty other than royalty for mine, quarries, etc., if relatable to industrial or commercial profits would be taxable under art. III(1) provided there was a PE of the enterprise in India.

(Paras 29 to 31)

#### Conclusion :

Consideration received by the assessee for grant of the patents and license was as royalty as the grant admittedly took place outside India and therefore the question of applying deeming provisions would not arise and further, assessee having no PE in India, such income would not be taxable in India as industrial and commercial profits in terms of art. III of Indo-German DTAA.

#### In favour of :

Assessee

**Appeal (High Court)—Maintainability—Rule of consistency—Once in respect of the same assessee the issue was in dispute before the Tribunal and the Tribunal having answered the issue and that having not been challenged, it will not be open to the Revenue to raise the said issue again in respect of the same assessee—Tribunal having decided in earlier appeal that similar income of non-resident under the same agreement which was in the nature of fees for technical services was not taxable in India, it was not open to the Department to contend that those were prima facie findings in an issue of TDS, hence not binding on the Court—[Berger Paints India Ltd. vs. CIT](#) (2004) 187 CTR (SC) 193 : (2004) 266 **ITR** 99 (SC) followed**

(Para 32)

#### Conclusion :

Tribunal having decided in earlier appeal that similar income of non-resident under the same agreement was not taxable in India, it was not open to the Department to contend that those were prima facie findings in an issue of TDS, hence not binding on the Court.

#### In favour of :

Assessee

**Income deemed to accrue or arise in India—Fees for technical services—Payment for work done in Germany—Finding of Tribunal is that work had been done in Germany and there was no question of any transfer or license of any existing technical know-how—It was pure and simple consultancy for manufacture of contract products—Payment was in the nature of fees for technical services and income could not be deemed to accrue or arise in India**

(Para 32)

#### Conclusion :

Finding of Tribunal is that work had been done in Germany and there was no question of any transfer or license of any existing technical know-how, it was pure and simple consultancy for manufacture of contract products; payment was in the nature of fees for technical services and income could not be deemed to accrue or arise in India.

In favour of :

Assessee

**Income—Chargeability—Reimbursement of expenses—Payment by way of reimbursement of expenses incurred on behalf of payer is not income chargeable to tax in the hands of payee—CIT vs. Industrial Engineering Projects (P) Ltd. (1993) 109 CTR (Del) 73 : (1993) 202 **ITR** 1014 (Del), CIT vs. Dunlop Rubber Co. Ltd. (1982) 29 CTR (Cal) 25 : (1983) 142 **ITR** 493 (Cal) and CIT vs. Stewarts & Lloyds of India Ltd. (1986) 56 CTR (Cal) 206 : (1987) 165 **ITR** 416 (Cal) **relied on.****

(Para 33)

Conclusion :

Payment by way of reimbursement of expenses incurred on behalf of payer is not income chargeable to tax in the hands of payee.

In favour of :

Assessee

Cases referred to

Bolani Ores Ltd. vs. State of Orissa AIR 1975 SC 17

CCE vs. Hira Cement 2006 (194) ELT 257 (SC)

CIT vs. Indian Textile Engineers (P) Ltd. (1982) 30 CTR (Bom) 234 : (1983) 141 **ITR** 69 (Bom)

Her Majesty The Queen vs. Melford Developments Inc. 82 DTC 6281

Ishikawajima-Harima Heavy Industries Ltd. vs. Director of IT (2007) 207 CTR (SC) 361 : (2007) 288 **ITR** 408 (SC)

Rolls-Royce Ltd. vs. Jeffrey (Inspector of Taxes) (1962) WLR 425 (HL)

Circulars referred to

Circular No. 202, dt. 5th July, 1976

Circular No. 333, dt. 2nd April, 1982

Counsel appeared :

Parag Vyas with P.S. Sahadevan, for the Applicant : P.S. Pardiwala with A.S. Vardhan i/b Crawford Bayley & Co., for the Respondent

## JUDGMENT

### **F.I. REBELLO, J. :**

This reference has been made by the Tribunal to this Court in respect of the asst. yr. 1979-80. The respondent had entered into agreements with Bharat Heavy Electricals Ltd. (BHEL), Bharat Electronics Ltd. (BEL) and Siemens India Ltd. (Siemens).

**2.** The first agreement between the assessee respondent and BHEL was entered into on 21st July, 1974, the second was dt. 28th July, 1975, and the third agreement was entered into earlier on 28th Oct., 1975.

Similarly assessee entered into agreements with BEL on 15th March, 1967, 23rd Feb., 1973 and dt. 17th July, 1975.

The assessee had also entered into agreements with Siemens dt. 22nd Feb., 1973 and 17th July, 1975.

**3.** The issue which arises for consideration in the present reference is whether the amounts received under those agreements by the respondent from the three companies were chargeable to tax in India either having regard to the provisions of the IT Act, 1961 (hereinafter referred to as the Act) or having regard to the provisions of the Double Taxation Avoidance Agreement (DTAA) entered into between the Government of India and the Federal Republic of Germany (hereinafter referred to as the German DTAA).

**4.** The ITO by order of assessment dt. 3rd Sept., 1983 had assessed these amounts as being liable for tax. In the appeal preferred, for reasons cited by the CIT(A), the appeal was dismissed except to the extent of granting relief in the sum of Rs. 49,974 which was by way of commission received from M/s Cable Corporation of India Ltd.

**5.** The respondent assessee preferred an appeal to Tribunal. The Tribunal first dealt with the agreement dt. 23rd Feb., 1973 between Siemens India Ltd. and the assessee. Under this agreement the assessee had agreed to provide to Siemens India Ltd., relevant patents, patent applications and utility models, relevant written material, experience and information regarding certain contract products. The assessee was to be paid a royalty of 3 per cent of the ex-factory selling price of each contract product manufactured and sold or otherwise disposed of by the licensee. The learned Tribunal held that it was royalty within the meaning of cl. (vi) of s. 9(1) of the IT Act. The learned Tribunal however, was pleased to hold considering the DTAA that the payment under consideration cannot be considered as royalty under the DTAA. It held that royalty under DTAA has to be held to be income which is non-business and where the return is from business activity it is not royalty but has to be considered as commercial profit. It, therefore, held that it would fall within the expression commercial profits, however, as there was no PE of the assessee in India it could not be brought to tax in India.

**6.** The next agreement considered was that entered into with BEL on 15th March, 1967. By this agreement the assessee had agreed to furnish to the Indian company assistance for the manufacture of x-ray tubes and shields. By cl. 4.2 the assessee agreed to give to BEL the complete information for the installation, operation and maintenance of special equipments to be supplied by the assessee. In return as consideration BEL had to pay to the assessee a technical assistance fee of 1 per cent of the total aggregate of the net selling price of the contract products and royalty of 3 per cent of the total aggregate of the net selling price. The arguments advanced were similar to what was advanced in respect of the agreement between the assessee and Siemens India Ltd. The Tribunal found that the amount of Rs. 1,93,139 was royalty within the meaning of Explan. 2 to s. 9(1)(vi) of the IT Act, but was not royalty under the DTAA, but merely a part of the commercial

profits of the assessee and as there was no PE, it would not be taxable.

**7.** The agreement with BHEL entered into on 21st June, 1974 was next considered. This agreement covered industrial turbines manufactured by BHEL. The assessee was to prepare a technical report covering the requisition of the additional plant, machinery and equipments for manufacturing and testing of the industrial turbines and also to train adequate number of personnel of BHEL and also to delegate its personnel to BHEL and some other requisitions. In consideration BHEL was to pay the assessee 4 per cent of the selling price of the industrial turbines for the next five years. These payments were described as royalty. Any tax payable was to be paid by BHEL. The learned Tribunal was pleased to hold that the payment is royalty under s. 9(1)(vi) of the Act but not royalty within DTAA but was part of commercial profits but as there was no PE it would not be taxable.

It considered the payments described as technical assistance fee but which had been treated as royalties under the extended definition of s. 9(1)(vi). The argument advanced on behalf of the respondents that they should be considered under s. 9(1)(vii) was rejected. For similar reasons as discussed earlier considering DTAA it held the same to be commercial profits not assessable to tax in the absence of PE though they were royalties under s. 9(1)(vi) of the IT Act.

**8.** The Tribunal then dealt with the agreement with BEL dt. 15th March, 1967 and the payment of Rs. 64,380 under cl. 11.1.1 of the agreement which was called technical assistance. These also were held to be royalties within the IT Act. However, under the DTAA would fall under commercial profits and would not be taxable in the absence of PE.

**9.** In respect of other payments described as technical assistance fee insofar as ground three and the payment received from BHEL for certain additional assistance and for which the assessee billed BHEL in a sum of Rs. 42,41,884, the Tribunal noted that whether these amounts would be taxable, had already come up for consideration before the Delhi Bench of the Tribunal. The question arose when BHEL was asked to deduct tax under s. 195 prior to the remittance of these amounts. The contention of BHEL was that they were not taxable. In the order passed in ITA Nos. 4259 and 4260/Del/1980, dt. 7th Nov., 1981, the Delhi Bench had accepted the contention of BHEL. Similar orders had been passed regarding the taxability of the rest of the amounts. The Tribunal held that they agreed with the finding of the Delhi Bench on the issue and held that these amounts are not taxable in India. The Tribunal further noted that on going through the bills, these payments are not in the nature of royalty, but are merely in the nature of technical fees which are covered by s. 9(1)(vii). As the agreements are prior to 1976, even considering s. 9 the technical fees cannot be brought to tax. The Tribunal also noted that billing would indicate that amount was charged on the basis of man hours spent on work done in Germany. The Tribunal, therefore, held that these amounts cannot be brought to tax.

**10.** The next ground considered was the payment of a sum of Rs. 1,71,759 being the fee levied by the assessee for provision of services of technical personnel to BHEL under the agreement dt. 28th Oct., 1975. The Tribunal noted that these are also matters decided by the Delhi Bench of the Tribunal in ITA No. 2281 of 1979 dt. 3rd June, 1980 and ITA No. 2579 of 1979 dt. 6th Dec., 1980 for reasons stated in those order cannot be said to be subject to taxation.

The last ground considered was the sum of Rs. 64,246 by way of reimbursement of expenditure and whether it could be brought to tax. The Tribunal noted that this is in connection with additional assistance to be rendered by the assessee under the agreement dt. 28th Oct., 1975. The Tribunal noted as it had already held that the additional assistance fees of Rs. 42.41 lakhs is not taxable and consequently held that the reimbursement of expenditure also would not be taxable. The Tribunal accordingly partly allowed the appeal.

**11.** The Revenue moved an application by way of reference. The Tribunal by its order dt. 26th May, 1987 has referred the following questions of law to this Court for its opinion :

"(1) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the definition of the term 'royalty' in Expln. 2 to s. 9(1)(vi) of the IT Act will not apply to the said term as used in art. III(3) of the Agreement for Avoidance of Double Taxation of income between India and the Federal Republic of Germany ?

(2) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that certain sums namely (1) the sum of Rs. 20,89,457 due to the assessee from M/s Siemens (India) Ltd. under the agreement dt. 22nd Feb., 1973 and dt. 17th July, 1975 respectively (2) the sum of assessee from BEL, under the agreement dt. 15th March, 1967 and (c) the sum of Rs. 53,844 due to the assessee from BHEL, under the agreement dt. 21st June, 1974, would not constitute 'royalty' within the meaning of the said term as used in art. III(3) of the agreement for avoidance of double taxation of Germany but would constitute 'industrial or commercial profits' for the purpose of art. III(1) of the said agreement ?

(3) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the sums of Rs. 42,41,884 and Rs. 1,71,759 due to the assessee from BHEL under the agreements dt. 28th July, 1975 and 28th Oct., 1975 respectively were in the nature of 'fees for technical services' within the meaning of s. 9(1)(vii) of the IT Act, and not 'royalty' either within the meaning of Expln. 2 to s. 9(1)(vi) of said Act or within the meaning of the term as used in art. III(3) of the agreement for avoidance of double taxation of income between India and the Federal Republic of Germany ?

(4) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the sums referred to in question No. 3 would constitute 'industrial or commercial profits' for the purposes of art. III(1) of the agreement for avoidance of double taxation of income between India and the Federal Republic of Germany ?

(5) Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the sum of Rs. 84,246 due to the assessee from BHEL under the agreement dt. 28th July, 1975 did not constitute 'royalty' either within the meaning of Expln. 2 to s. 9(1)(vi) of the IT Act or within the meaning of the said term as used in art. III(3) of the agreement for avoidance of double taxation of income between India and the Federal Republic of Germany and in consequently holding the said sum is not chargeable to tax in India ?"

**12.** At the hearing of this reference on behalf of the Revenue it is sought to be contended that this Court must consider the treaty by applying the ambulatory approach of interpretation and not static interpretation. It is submitted that considering art. II(2), the expression "laws in force" as contained in DTAA, the ambulatory interpretation will have to be accepted and the amounts in issue will have to be held to be "royalty" which is taxable in India. Reliance is placed on rulings on ambulatory approach of the Supreme Court of Netherlands and the Supreme Court of Belgium. We do not propose to deal with the said judgments, in the absence of the full texts of the judgment being made available to the Court as such we are not giving the citations.

On behalf of the assessee it is submitted that what will have to be considered are the clauses of the DTAA and not the subsequent amendments. In other words the static interpretation. Reliance is placed on the ruling of the Supreme Court of Canada. In the alternative, it is submitted that even if it is accepted, that amounts are royalty as defined under s. 9(1)(vi) of the IT Act and, therefore, deemed to accrue in India they would not be chargeable to tax in India having regard to the provisions of the DTAA. It is open to an assessee when the provisions of DTAA are more beneficial considering s. 90(2), to contend that the taxability of the income should be governed by the provisions of the DTAA and not by the provisions of the Act. Reliance is also placed on the circular issued by the CBDT being Circular No. 333, dt. 2nd April, 1982 [see (1982) 81 CTR (TLT) 18 : (1982) 137 **ITR** (St) 1]. Reliance is also placed on the judgment of the Andhra Pradesh High Court in CIT vs. Visakhapatnam Port Trust (1984) 38 CTR (AP) 1 : (1983) 144 **ITR** 146 (AP), Calcutta High Court in CIT vs. Davy Ashmore India Ltd. (1991) 190 **ITR** 626 (Cal) and Supreme Court in



Union of India vs. Azadi Bachao Andolan (2003) 184 CTR (SC) 450 : (2003) 263 **ITR** 706 (SC). Reliance is placed on Bolani Ores Ltd. vs. State of Orissa AIR 1975 SC 17 to contend that when a definition in one statute is incorporated into another statute then any subsequent amendment in the former statute would not effect the definition in the latter statute. In respect of payment received from BHEL, it is submitted that BHEL had made an application under s. 195 for the purpose of determining its obligation to deduct tax at source. The AO held that the income was chargeable to tax and, therefore, BHEL was obliged to deduct tax at source. In appeal the Tribunal held that the amounts receivable by the respondents were not chargeable to tax in India. These orders of the Tribunal, had become final and, therefore, it is not now open to the Revenue to urge to the contrary having accepted the decision of the Tribunal. Reliance is also placed on the case of Berger Paints India Ltd. vs. CIT (2004) 187 CTR (SC) 193 (SC) : (2004) 266 **ITR** 99 (SC). The Tribunal in passing these orders in the case of BHEL it is submitted did not clarify or state that the view they have taken is a prima facie view and that it would have no bearing in the assessment of the respondent.

Insofar as sum of Rs. 84,246 it is submitted that this amount is reimbursement by BHEL to the respondents and reimbursement of expenditure can never be regarded as income. Reliance is placed on the judgment in CIT vs. Indian Textile Engineers (P) Ltd. (1982) 30 CTR (Bom) 234 : (1983) 141 **ITR** 69 (Bom), CIT vs. Stewarts & Lloyds of India Ltd. (1986) 56 CTR (Cal) 206 : (1987) 165 **ITR** 416 (Cal), CIT vs. Dunlop Rubber Co. Ltd. (1982) 29 CTR (Cal) 25 : (1983) 142 **ITR** 493 (Cal) and CIT vs. Industrial Engineering Projects (P) Ltd. (1993) 109 CTR (Del) 73 : (1993) 202 **ITR** 1014 (Del).

**13.** We may now refer to some provisions of the DTAA as also the provisions of the Act to the extent they are required. Before answering the issue we may point out that Finance Act, 2007 has inserted Explanation to s. 9(1) after s. 9(1)(vii) with retrospective effect from 1st June, 1976 and which reads as under :

"For the removal of doubts it is hereby declared that for the purposes of this section where income is deemed to accrue or arise in India under cls. (v), (vi) and (vii) of sub-s. (1) such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India."

The income from receipt of royalties as set out in s. 9(1)(vi) are thus now taxable in India whether or not the non-resident has a place of residence, or place of business or business connection in India. In the present appeal though the agreements entered into are before 1st June, 1976, income have received is for several assessment years.

**14.** The relevant provisions of DTAA notified by notification dt. 13th Sept.,1960, read as under :

#### "Article I

The taxes which are the subject of the present agreement are :

(a) in India :

the income tax,

the super tax,

the surcharge,

imposed under the Indian IT Act, 1922 (11 of 1922) (hereinafter referred to as "Indian tax");



(b) .....

(2) The present agreement shall also apply to any other taxes of a substantially similar character imposed in India or the Federal Republic of Germany subsequent to the date of signature of the present agreement.

(Emphasis, italicized in print, supplied)

## Article II

(1).....

(2) In the application of the provisions of this agreement in one of the territories any term not otherwise defined in this agreement shall, unless the context otherwise requires, have the meaning which it has under the laws in force in that territory relating to the taxes which are the subject matter of this agreement.

## Article III

(1) Subject to the provisions of para (3) above, tax shall not be levied in one of the territories on the industrial or commercial profits of an enterprise of the other territory unless profits are derived in the first mentioned territory through a PE of the said enterprise situated in the first mentioned territory. If profits are so derived, tax may be levied in the first mentioned territory on the profits attributable to the said PE.

(2).....

(3) For the purposes of this agreement the term "industrial or commercial profits" shall not include income in the form of rents, royalties, interests, dividends, management charges, remuneration for labour or personal services or income from the operation of ships or aircraft but shall include rents or royalties in respect of cinematographic films."

Under art. V income derived from the operation of aircraft by an enterprise of one of the territories shall not be taxed in the other territory, unless the aircraft is operated wholly or mainly between places within that other territory.

Article VI deals with shipping operations and how the profits derived shall be taxable. Article VII deals with tax on dividends. Article VIII deals with tax on interest on bonds, securities, notes, debentures or any other form in indebtedness.

Article IX deals with income from immovable property which includes any rent or royalty or other income derived from the operation of a mine , quarry or any other extraction of natural resources. Article X is the matter of capital gains arising from the sale, exchange or transfer of a capital asset, whether movable or immovable. Article XI deals with remuneration from public service. There are other articles which we need not deal with.

**15.** Royalty has not been defined in the DTAA in question nor at the relevant time was it defined in the IT Act. The German DTAA was amended by notification dt. 26th Aug., 1985. Article VIIIA of the amended agreement deals with royalties and fees for technical services which are also explained therein. We are not concerned with the amendment as we are concerned with the asst. yr. 1979-80.

**16.** The Finance Act 1976 w.e.f. 1st June, 1976 introduced cls. (v), (vi) and (vii) to s. 9(1). Clause (v) deals with income by way of interest. Clause (vi) defines income by way of royalty. Explanation

2 sets out the meaning of royalty for the purpose of the clause. Clause (vii) deals with income by way of fees for technical services. The proviso which was inserted by Finance Act, 1977 w.e.f. 1st April, 1977 provides 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 of April, 1976 and approved by the Central Government. Explanation 2 defines fees for technical services.

**17.** While answering the reference, we have to consider whether (1) income received by way of royalty; (2) income received by way of technical fees and (3) reimbursement of expenses, are taxable in India considering the provisions of s. 9 of the IT Act as amended w.e.f. 1st June, 1976.

**18.** The Finance Act, 2007 has inserted the Explanation to s. 9(1) with retrospective effect from 1st June, 1976. The Supreme Court in *Ishikawajima-Harima Heavy Industries Ltd. vs. Director of IT* (2007) 207 CTR (SC) 361 : (2007) 288 **ITR** 408 (SC) was dealing with the DTAA entered into between India and Japan. What was in issue was the provisions of s. 9(1)(vii)(b) and s. 9(1)(vii)(c) and whether the income receivable thereto could be taxed in India. While answering the issue and considering the law the Supreme Court observed that :

"For attracting the taxing statute there has to be some activities through the PE. If income arises without any activity of the PE, even under the DTAA the taxation liability in respect of overseas services would not arise in India. Sec. 9 spells out the extent to which the income of non-resident would be liable to tax in India. Sec. 9 has a direct territorial nexus. Relief under a double taxation treaty having regard to the provisions contained in s. 90(2) of the IT Act would only arise in the event a taxable income of the assessee arises in one country State on the basis of accrual of income in another country State on the basis of residence. Thus, if the appellant had income that accrued in India and is liable to tax because in its State all residents it was entitled to relief from such double taxation payable in terms of the double taxation treaty (sic). However, so far as accrual of income in India is concerned, taxability must be read in terms of s. 4(2) r/w s. 9, whereupon the question of seeking assessment of such income in India on the basis of the double taxation treaty would arise."

The Court further observed as under :

"Therefore, in our opinion, the concepts profits of business connection and PE should not be mixed up. Whereas business connection is relevant for the purpose of application of s. 9, the concept of PE is relevant for assessing the income of a non-resident under the DTAA."

The Court then considering s. 9(1)(vii)(c) proceeded to hold as under :

"Reading the provision in its plain sense, it can be seen that it requires two conditions to be met—the services which are the source of the income that is sought to be taxed, has to be rendered in India, as well as utilized in India, to be taxable in India. In the present case, both these conditions have not been satisfied simultaneously, therefore, excluding this income from the ambit of taxation in India. Thus, for a non-resident to be taxed on income for services, such a service needs to be rendered within India, and has to be part of a business or profession carried on by such person in India. The petitioners in the present case have provided services to persons resident in India, and though the same have been used here, they have not been rendered in India."

**19.** Parliament, it appears, took note of this judicial pronouncement as is noted in the Explanatory Notes on Provisions Relating to Direct Taxes for the Finance Act, 2007. It referred to Circular No. 202, dt. 5th July, 1976. With respect to rule for royalty income, it was stated as follows :

"In view of the aforesaid amendment, royalty income consisting of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data,

documentation, drawings or specifications relating to any patent, invention, model, design, secret formula or process or trademark or similar property, will ordinarily become chargeable to tax in India."

Memorandum Explaining the Provisions, further notes that the source rule would mean that irrespective of the situs of the service, the situs of the payer and the situs of the utilisation of services will determine the tax jurisdiction. After noting the judicial opinion it observed that :

"Legislative intent for introduction of cls. (v), (vi) and (vii) was to give legal sanctity to the source rule. This source rule is also recognised in India's DTAA's.

It then proceeds to observe as under :

"For removal of doubts, an Explanation has now been inserted in s. 9 to specifically reaffirm the source rule provided in that section, to clarify that where income is deemed to accrue or arise in India under cl. (v), (vi) or (vii) of sub-s. (1) of s. 9, such income shall be included in the total income of the non-resident, regardless of whether the non-resident has a residence or place of business or business connection in India. In such cases, it is not necessary to establish the territorial nexus between the income deemed to accrue or arise to the non-resident under the said clauses and the territory of India."

By the Explanation it appears that the ratio of the judgment in Ishikawajima-Harima Heavy Industries Ltd. (supra) is sought to be overcome by providing that even if any non-resident has no PE the income from royalty accrued or paid by a resident would be deemed to be taxable in India.

**20.** We now proceed to consider and answer as to what was taxable under the Indo-German DTAA. On a reading of art. II(2) it would be clear that if a term is not defined in the agreement and in the instant case royalty was not defined it will have the meaning which it has under the laws in force in that territory relating to the taxes which are the subject-matter of this agreement. Learned counsel for assessee, has placed reliance on the judgment of the Supreme Court of Canada in Her Majesty The Queen vs. Melford Developments Inc. 82 DTC 6281. Considering a similar clause in art. II(2) of the treaty between Canada and Germany the Supreme Court of Canada was considering the expression "law in force in Canada" relating to the taxes which are the subject of the Convention whether it means the laws as they existed in 1956 or the laws of Canada from time to time in force. The Court observed that :

"Laws enacted by Canada to redefine taxation procedures and mechanisms with reference to income not subjected to taxation by the agreement are not, in my view, incorporated in the expression 'laws in force' in Canada as employed by the agreement. To read this section otherwise would be to feed the argument of the appellant, which in my view is without foundation in law, that sub-s. (2) authorizes Canada or Germany to unilaterally amend the tax treaty from time to time as their domestic needs may dictate."

The ratio of that judgment, in our opinion, would mean that by an unilateral amendment it is not possible for one nation which is party to an agreement to tax income which otherwise was not subject to tax. Such income would not be subject to tax under the expression "laws in force". Income covered by the provisions of the IT Act is subject to tax. The question which calls for consideration is art. III and arts. V to XII of the DTAA. We have already reproduced art. III(1) and art. III(3). Article III(1) provides that tax shall not be levied in one of the territories on the industrial or commercial profits of an enterprise of the other territory unless profits are derived in the first-mentioned territory through a PE of the said enterprise situated in the first-mentioned territory. Sub-cl. (3) of art. III includes only rents or royalties in respect of cinematographic films within the expression 'industrial or commercial profits' but does not include income in the form of rents, royalties which are set out therein.

**21.** On behalf of the assessee what is sought to be contended is that whatever is included in art. III(3) and what is taxable is provided from art. V onwards. It is submitted that if it does not fall within any of those articles then it would not fall under industrial or commercial profits. Royalty, it is submitted, is covered by art. IX and it includes only rent or royalty or other income derived from tax of mine, quarry or any other extraction of natural resources which is to be regarded as income from immovable property. It is, therefore, submitted that royalty in the form which was payable under the agreement was not liable for taxation in terms of art. III. Royalty not being defined, the ordinary meaning found in dictionaries can be first considered. In Jowitt's Dictionary of Law, royalty is defined as under :

"Royalty, a payment reserved by the grantor of a patent, lease of a mine or similar right, and payable proportionately to the use made by the right by the grantee. It is usually a payment of money, but may be a payment in kind, that is, a part of the produce of the exercise of the right—See rent.

Royalty also means a payment which is made to an author of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent."

In Black's Law Dictionary royalty to mean :

"Royalty 1. A payment made to an author or inventor for each copy of a work or article sold under a copyright or patent.

2. A share of the product or profit from real property, reserved by the grantor of a mineral lease, in exchange for the lessee's right to mine or drill on the land—also termed (in sense 2) override."

In that context reference was made by learned counsel for the assessee to the judgment of the House of Lords in *Rolls-Royce Ltd. vs. Jeffrey (Inspector of Taxes)* (1962) WLR 425 (HL). In that case the company was engaged in metallurgical research and the discovery and development of engineering techniques and secret process. As a result it acquired in the course of the years a fund of technical knowledge, or "know-how", of which only a comparatively small part was capable of forming the subject matter of patent rights. For some years the company, as a general rule, used its "know-how" only in its own trade, but subsequently entered into a number of agreements whereby in consideration of lump sum payments and royalties, it undertook to supply the foreign Government or company with technical knowledge, plans, a licence and facilities for the interchange of staff to enable them to manufacture specified types of aircraft engines. The agreements were for various periods. The question was whether in computing the company's profits or gains, the lump sums paid to it under the agreements should or should not be included. The House of Lords held that the sum should be so included as being part of the receipts of the company's trade; the company was not parting with its assets but trading in them as part of the development of its general trade. In this context we may refer to the observation of Lord Radcliffe :

"'know-how' is an ambience that pervades a highly specialised production organisation and, although I think it correct to describe it as fixed capital so long as the manufacturer retains it for his own productive purposes and expresses its values in his products, one must realise that in so describing it one is proceeding by an analogy which can easily break down owing to the inherent differences that separate 'know-how' from the more straightforward elements of fixed capital."

Proceeding further the Court observed as under :

"Although 'know-how' is properly described as fixed capital by way of analogy, it is the kind of intangible entity that can very easily change its category according to the use to which its owner himself decides to put it."

The amounts received were described in the agreement as royalties. The Court observed that they were only royalties in the sense that the measure of these recurrent payments is taken to be so many pounds/ sterling per engine manufactured in China.

This aspect really need not detain us as admittedly, by the Finance Act, 1976, the expression 'royalty' has been explained for the purpose of s. 9 of the IT Act and the issues being considered are for the asst. yr. 1979-80.

**22.** In our opinion, even in the absence of royalty being defined under the clauses of the agreement, if it amounts to any industrial or commercial profit it would be taxable under cl. III provided there is a PE in India unless we hold that considering the Explanation to s. 9 brought by the Finance Act, 2007 the requirement of PE is now of no consequence.

While considering the DTAA the expression "law in force" would not only include a tax already covered by the treaty but would also include any other tax as taxes of a substantially similar character subsequent to the date of the agreement as set out in art. I(2). Considering the express language of art. I(2) it is not possible to accept the broad proposition urged on behalf of the assessee that the law would be the law as was applicable or as defined when the DTAA was entered into. The question however, would still remain, whether the income by way of royalties other than those included in art. III(3) are subject to tax in India considering the DTAA when there is no PE.

We may also note at this stage that the rule of referential incorporation or incorporation cannot be applied when we are dealing with a treaty (DTAA) between two sovereign nations. Though it is open to a sovereign legislature to amend its laws, a DTAA entered into by the Government in exercise of the powers conferred by s. 10(1) [sic-s. 90(1)] while considering s. 10(2) [sic-s. 90(2)] has to be reasonably construed.

**23.** The next question that we have to answer is, if the provisions of DTAA are more beneficial to the assessee whether the taxability of the income should be governed by the provisions of that agreement and not by the provisions of IT Act as amended. In other words would the DTAA prevail over the provisions of the IT Act.

**24.** In CIT vs. Visakhapatnam Port Trust (supra) a learned Division Bench of the Andhra Pradesh High Court considering the German DTAA and s. 9 of the IT Act was pleased to hold that the terms of art. III of the agreement will prevail over s. 9 of the Act. It was so held considering that ss. 4 and 5 of the Act are expressly made subject to the provisions of the Act which means that they are subject to the provisions of s. 90 of the Act.

**25.** Next reference may be made to Circular No. 333, dt. 2nd April, 1982 issued by the CBDT to the following para as to how the Board has understood the law when there be a conflict between a DTAA and the provisions of the IT Act :

"2. The correct legal position is that where a specific provision is made in the DTAA that provision will prevail over the general provisions contained in the IT Act, 1961. In fact the DTAA's which have been entered into by the Central Government under s. 90 of the IT Act, 1961, also provide that the laws in force in either country will continue to govern the assessment and taxation of income in the respective country except where provisions to the contrary have been made in the agreement."

It would thus be clear that CBDT itself has understood that in the case there a beneficial provision under the DTAA that would prevail over the provisions of the respective statute. The same view was also held by the Division Bench of the Calcutta High Court in CIT vs. Davy Ashmore India Ltd. (supra). The learned Division Bench was pleased to hold that the agreement would prevail over the provisions of IT Act. At the same time, the learned Division Bench was pleased to observe that where there is no specific provision in the agreement, it is the basic law i.e. the IT Act, that will

govern the taxation of income.

**26.** In our opinion the issue is no longer *res integra* considering the judgment of the Supreme Court in *Union of India vs. Azadi Bachao Andolan & Anr.* (supra). Dealing with that issue the Court observed as under :

"A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that s. 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a DTAA. When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would operate even if inconsistent with the provisions of the IT 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 s. 4 and the general principle of ascertainment of total income under s. 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 s. 90 towards implementation of the terms of the DTAA's which would automatically override the provisions of the IT 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 the DTAA."

Referring to the circular the Court held that the circular shall prevail even if inconsistent with the provisions of the IT Act, 1961, insofar as assessee's covered by the provisions of the DTAA are concerned.

**27.** It would, thus be clear that though provisions of s. 9 would be applicable, however, considering the provisions of the DTAA if beneficial, than provisions of the IT Act, the provisions of DTAA would prevail. In our opinion, therefore, in the absence of a PE the amounts in respect of which the Tribunal has recorded a finding that the income sought to be assessed is industrial or commercial profit are not assessable to tax in India as admittedly the assessee having no PE.

**28.** We may, however, note that Parliament has taken cognizance of the judicial pronouncement in *Ishikawajima-Harima Heavy Industries Ltd.* (supra) by Finance Act, 2007 and has inserted Explan. 2 to s. 9(1) which we have already reproduced. By this amendment the concept of having residence or place of business connection in India has been done away with. Dealing with this amendment on behalf of the assessee it is sought to be submitted that the amendment would be of no consequence. The submission is that though the object of the Explanation is to get over the judgment of the Supreme Court as is borne out by the Memorandum Explaining the Provisions in the Finance Bill, the said object has not been achieved. The submission is that what the Explanation provides is that it is not necessary for the non-resident to have a business in India or a business connection in India or even to have a residence in India. It is submitted that what the Supreme Court has emphasised is the rendering of services in India. In the present case if the consideration received by the respondent for grant of the patents and license is regarded as royalty as the grant admittedly took place outside India, the question of the deeming provisions applying having regard to the interpretation placed upon them by the Supreme Court would not arise. Without going into that issue, considering the ratio in *Azadi Bachao Andolan & Anr.* (supra) such income would not be taxable in terms of the DTAA, as the assessee has no PE in India and the terms of the DTAA are more beneficial to the assessee.

**29.** The issue can also be considered in the light of the argument advanced on behalf of the assessee that considering the expression royalty as set out in art. IX, it has a restrictive meaning. The royalty which is the subject-matter of this appeal can only be taxable under art. III provided the predicates therein are satisfied namely that there is a PE. Learned counsel for assessee had raised the point before the Tribunal and has also reiterated the same before this Court, that art. III (3) has to be read in consonance with arts. V to XII as they are relevant for understanding the DTAA.

**30.** We have earlier reproduced parts of art. III of the DTAA. Article III(3) sets out that the term "industrial or commercial profits" shall not include income in the form of rents, royalties, interests, dividends, management charges, remuneration for labour or personal services or income from the operation of ships or aircraft but shall include rents or royalties in respect of cinematographic films. A reading of this article may prima facie indicate that only royalties from cinematographic films form a part of industrial or commercial profits and all other incomes by way of royalty would not be taxable except to the extent which may be provided by the DTAA. This must also be seen in the context of arts. V to XII where the income from the excluded heads under art. III are taxable.

Article IX provides that any rent received from operation of a mine, quarry or any other extraction of natural resources shall be regarded as income from immovable property and will be taxed in the territory in which the property is situated. Similarly, royalty included under art. IX is royalty from the operation of a mine, quarry or any other extraction of natural resources. On the argument advanced by the learned counsel, considering this article, such royalty would not be included in the term "Industrial" or "commercial" profits. Similarly, interests, dividends, management charges, remuneration for labour or personal services or income from the operation of shops or aircraft are covered by the various other articles. What this only means is that income from heads under arts. V to XII will be taxed as provided in the manner set out in those articles and as such, would not come within the term "industrial" or "commercial" profits. In other words income from activities covered by arts. V to XII by virtue of art. III(3) are specifically excluded from the expression 'industrial or commercial profits' in art. III as they are to be taxed in the manner provided under arts. V to XII. An inescapable conclusion, therefore, emerges that income other than those provided by the articles and if it is relatable to industrial or commercial profits would be covered by art. III. This income would not be subject to tax in the absence of a PE of the enterprise in the territory of India. It is not possible to accept that income including from royalties from inventions, trade-marks, patents or copyrights or the like are excluded and would not be taxable. In our opinion the correct interpretation of the DTAA would be to include the royalties from patents, copyrights or trade marks and the like within the expression "industrial" or "commercial" profits. The learned Tribunal, therefore, has correctly taken a view that though this income would not be royalties within the meaning of DTAA but would fall under the expression 'commercial or industrial profits'. In the absence of a PE such income would not be taxable in India.

**31.** This is further fortified by the fact that in the subsequent DTAA of July, 1985, art. III of the DTAA of 1960 has been substituted and art. III(3) makes it clear where income is dealt with separately under other articles then those provisions will apply. A new art. VIIIA has been inserted which explains the expression royalties to include payments of any kind received as consideration for the use of, or the right to use amongst other payments received as consideration for the right to use any copyright, patent, trade mark, etc. Though the word "royalty" was also not defined under the IT Act as it then stood, the expression would have to be understood in its ordinary grammatical meaning which we have already set out earlier. The conclusion would be that royalty other than royalty for mine, quarry, etc., if relatable to industrial or commercial profits would be taxable under art. III(1) provided there was a PE of the enterprise in India.

**32.** That leaves us with the second question in respect of the payments that have been held by the Tribunal to be by way of technical services. Reference by the Tribunal is whether the payments under the agreement dt. 27th July, 1975 and 28th Oct., 1975 were in the nature of fees for technical services within the meaning of s. 9(1)(vii) or royalty within the meaning of Explan. 2 to s. 9(1)(vi) of the Act. There are two aspects of the matter. Findings have been recorded that insofar as agreement dt. 15th March, 1967 is concerned, that work had been done in Germany and there was no question of any transfer or license of any existing technical know-how to BHEL. It was pure and simple consultancy for manufacture of contract products. Secondly, the issue whether they were taxable had come up before the Tribunal at Delhi in the matter of deduction of tax at source. The Tribunal recorded a finding that these are not taxable in India. The argument advanced on behalf of the Revenue is that these are prima facie findings and, therefore, not binding on the Court. It is further submitted that merely because an appeal was not preferred would be of no



consequence. Reliance for that purpose is placed on the judgment in CCE vs. Hira Cement 2006 (194) ELT 257 (SC). In that case the Supreme Court held that non-filing of an appeal by itself against the order would not be a ground for refusing to consider the matter on its own merits and when public interest is involved in interpretation of law the Court is entitled to go into the question. In that case the precedent relied upon by the Tribunal was expressly overruled by the Supreme Court.

In the instant case we are concerned with the same assessee on the same question. Recourse had been had to the provisions of the IT Act as to whether the income was assessable to the tax in India and the Tribunal recorded a finding that it was not taxable in India. Gainful reliance can be placed in the judgment of the Supreme Court in CIT vs. Berger Paints (supra). In respect of the same assessee and in respect of the very same agreement if a Tribunal of co-ordinate jurisdiction has decided that issue and if the Revenue has not challenged the same it will not be open to the Revenue in collateral proceedings to contend that the said issue is still open for reconsideration. In our opinion there must be a finality to orders. Once in respect of the same assessee the issue was in issue before the Tribunal of competent jurisdiction and the Tribunal having answered the issue and that having not been challenged it will not be open to the Revenue to raise the said issue again in respect of the same assessee. The only exception would be if the statute expressly provides that such findings are not conclusive. This is not the case here.

**33.** That leaves us with the last contention as to whether the amounts by way of reimbursement are liable to tax. To answer that issue, we may gainfully refer to the judgment of a Division Bench of the Delhi High Court in CIT vs. Industrial Engineering Products (P) Ltd. (supra). The learned Division Bench of the Delhi High Court was pleased to hold that reimbursement of expenses can, under no circumstances, be regarded as a revenue receipt and in the present case the Tribunal had found that the assessee received no sums in excess of expenses incurred. A similar issue had also come up for consideration before the Division Bench of the Calcutta High Court in CIT vs. Dunlop Rubber Co. Ltd. (supra). The learned Division Bench was answering the following question :

"Whether, on the facts and in the circumstances of the case, the amounts received by the assessee (English company) from M/s Dunlop Rubber Co. (India) Ltd. (Indian company) as per agreement dt. 29th Jan., 1957 constituted income assessable to tax ?"

On considering the issue the learned Bench noted that the Tribunal was of the view that what was recouped by the English company was part of the expenses incurred by it. The learned Court upheld the said finding. The learned Bench was pleased to hold that sharing of expenses of the research utilised by the subsidiaries as well as the head office organisation would not be income which would be assessable to tax. A similar view was taken in CIT vs. Stewarts & Lloyds of India Ltd. (supra).

We are in respectful agreement with the view expressed by the Delhi and Calcutta High Courts.

**34.** Considering the above, the reference is answered as under :

- (1) Question No. 1—In the affirmative and against the Revenue.
- (2) Question No. 2—The income would be royalty but falls within the expression 'industrial or commercial profits' within the meaning of art. III of DTAA.
- (3) Question No. 3—In the affirmative and against the Revenue.
- (4) Question No. 4—In the affirmative and against the Revenue.
- (5) Question No. 5—In the affirmative and against the Revenue.

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