

CTR ENCYCLOPAEDIA ON INDIAN TAX LAWS

[A] COMMISSIONER OF INCOME TAX vs. VISAKHAPATNAM PORT TRUST

HIGH COURT OF ANDHRA PRADESH

Seetharam Reddy & Jagannadha Rao, JJ.

RC No. 53 of 1978

Decided on 17th June, 1983

TC8R.757, TC30R.223, TC39R.1187

SOURCE : (1984) 38 CTR (AP) 1 : (1983) 144 ITR 146 (AP) : (1983) 15 TAXMAN 72

Legislation referred to

Sections 4, 5, 9, 90,

Case pertains to

Asst. Year 1968-69, 1969-70, 1970-71, 1971-72, 1972-73, 1973-74, 1974-75

Decision in favour of

Assessee

Appeal (Tribunal)—Additional ground—Admissibility—Tax was not deducted under s. 195—However, contention that no tax was deductible at source in view of DTAA between India and Germany could be raised before the Tribunal

Double taxation relief—Agreement with Germany—Permanent establishment—If there was a conflict between the terms of the Agreement and the taxation statute, the Agreement alone would prevail—Relationship between the German company and the Poona company is on principal to principal basis—Even assuming that all the profits of the German company are to be deemed to have accrued or arisen in India by virtue of s. 9, the terms of Art. III of the Agreement prevail over s. 9 of the Act—In effect, the industrial or commercial profits of the German company are not, therefore, liable to tax under s. 9 except to the extent permitted by Art. III—Words ‘permanent establishment’, postulate the existence of substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country—It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country—There is nothing in the contract between the German company and the port trust assessee which contemplates that the German company is to establish in India any establishment of a permanent or enduring nature either wholly or substantially which would amount to a virtual projection of the German company in India—German company had no control nor could it interfere with the performance of the sub-contract by the Poona company—Poona company could not, therefore, be treated as an ‘agent’ of the German company—Interest agreed to be paid along with each of the instalments of unpaid purchase money was agreed to be part of the sale consideration itself and cannot be treated as an independent ‘source’ of income—As a result, the assessee is immune from liability either

wholly or partly to income-tax in view of the provisions of the Double Taxation Avoidance Agreement between the Federal Republic of Germany and India

Held

The German Federal Supreme Tax Court has held that the existence of the 'Mutual Agreement Procedure' does not prevent the Court from proceeding with the case. Art. XVIII of the Agreement underlines a procedure which is in addition to and not in substitution of the remedies before the domestic Courts or Tribunals. Hence, the assessee was entitled to rely on the Agreement before the Tribunal.

(Para 19 & 21)

It is true that under s.9(1)(i) all income accruing or arising whether directly or indirectly, through or from any 'business connection' in India, or other income mentioned in that section shall be deemed to accrue or arise in India. But the charging provision, s. 4, as well as s. 5 defining the 'total income' of either a resident or a non-resident are expressly made 'subject to the provisions of the Act', including agreements made under s. 90. Thus if there was a conflict between the terms of the Agreement and the taxation statute, the Agreement alone would prevail.—[Ostime \(Inspector of Taxes\) vs. Australian Mutual Provident Society](#) (1969) 71 ITR 480 (CA) : TC30R.294 **relied on**.

(Paras 26 & 27)

Coming to the part played by B even there, no "business connection" is established. The relationship between the German company and the Poona company is on principal to principal basis.—[CIT vs. Hindustan Shipyard Ltd.](#) (1977) 109 ITR 158 (AP) **relied on**.

(Para 29)

Even assuming that all the profits of the German company are to be deemed to have accrued or arisen in India by virtue of s.9, the terms of Art. III of the Agreement prevail over s.9 of the Act. In effect, the industrial or commercial profits of the German company are not, therefore, liable to tax under s.9 except to the extent permitted by Art. III.

(Para 31)

It is common practice for an enterprise which carries on trade or business in one country to expand its operations, without incorporation or further incorporation into another country, for it then has a branch there, or a permanent establishment which can be regarded as having sufficient presence in that country to make them taxable there in the same manner as the residents of that country. The words 'permanent establishment, postulate the existence of substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.

(Paras 39 & 40)

Applying the above tests to sub-cl. (aa) of Art. II(1)(i) of the Agreement, there is nothing in the contract between the German company and the port trust assessee which contemplates that the German company is to establish in India any establishment of a permanent or enduring nature either wholly or substantially which would amount to a virtual projection of the German company in India. Nor has any material been brought to the Court's notice in this behalf. The agreement was purely for the supply of parts and for sending of an expert engineer to supervise the erection of the reclaimer by the port trust. Sub-cl. (aa) is not attracted. The contract between the parties did not

contemplate any work of installation or assembly or the like to be performed by the German company. It was limited to the supply of the items from Germany and to the delegation of an expert engineer to supervise the installation or assembly work to be conducted by the port trust. It was the port trust that got the reclaimer assembled, installed and erected and that, in fact, the port trust paid Rs. 3,97,034.66 to the workers. There was no evidence that the German company even reimbursed the expenditure of the port trust in this regard.

(Paras 41, 43, 44 & 46)

The contract itself, in cls. 7 and 17, contemplates the employment of a sub-contractor or sub-supplier. The Poona company was so employed later. It is admitted that it is not subsidiary of the German company. The Poona company however, is neither a party to the contract nor is there any reference to it in the contract. As submitted on behalf of the port trust, there was neither any identity of interest nor identity of character nor of personality, nor was there any unity in profit making between the Poona company and the German company. They were in the position of principal to principal and were dealing with each other at arm's length. The German company had no control nor could it interfere with the performance of the sub-contract by the Poona company. The Poona company could not, therefore, be treated as an 'agent' of the German company, and, therefore, the 'assembly' and 'installation', in so far as the work relating to the steel-plate at Pimpri is concerned could not be attributed to the German company so as to attract the provisions of cl. (bb) of Art. II(1)(i).

(Para 55)

The German Engineer, who was deputed to India to 'supervise' the assembly and installation operations of the reclaimer did not carry on any construction, installation or assembly project or the like on behalf of the German company in India. He was only delegated to India for supervision. The work of construction, installation or assembly was actually done by the port trust and not by the German engineer. It was not, therefore, permissible to equate the situation with one where the German engineer instead of merely supervising the above operations, was himself in charge of those operations on behalf of the German company. The Tribunal was, therefore, right in holding that the role of the engineer did not result in bringing the German company within cl. (bb). Therefore, the German company cannot be brought within cl. (bb) of Art. II(1)(i) by reason of any of the submissions made on behalf of the Department.

(Paras 55, 57 & 58)

Further, cl. (dd) requires that the agents shall exercise a general authority in India to negotiate and enter into contracts on behalf of the German enterprise. There is no material placed to show that the Poona company had any such general authority as above stated. Therefore cl. (dd)(i) cannot be invoked on behalf of the Revenue.

(Para 59)

The words 'subject to the provisions of paragraph (3) in Art. III (1) would indicate that while 'industrial or commercial income' of the foreign enterprise are not taxable in India, the rents, royalties, interest, dividends, etc., derived by the foreign enterprise from sources in India are taxable. Obviously, sub-cl. (3) cannot be construed as excluding these items from the taxable income of the permanent establishment by applying sub-cl. (3) to the latter part of Art. III. Sub-cl. (3) has relevance only to the first part of Art. III(1). Further, the items rents, royalties, dividends, interest, etc., are taxable only when they satisfy the conditions mentioned for their liability to tax as envisaged in the various specific Articles such as Arts. V, VI, VII, VIII, etc. Art. VIII refers to the taxability of interest in India.

(Para 64)

Where, as here, parties enter into an agreement to accept a portion of the purchase money immediately and the balance to be paid in certain instalments along with interest on the instalment of purchase money, the agreement though it vested the property agreed to be sold in the purchaser, does not have the effect of converting the price due into a loan. The intrinsic nature of the money due to the vendor is as unpaid, purchase money and not as debt. The parties may however, agree to convert the unpaid purchase money as a debt. An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan.—[Bombay Steam Navigation Co. \(1953\) Pvt. Ltd. vs. CIT](#) (1965) 56 ITR 52 (SC) : TC16R.881 **applied**.

(Para 71)

The interest agreed to be paid along with each of the instalments of unpaid purchase money was agreed to be part of the sale consideration itself and cannot be treated as an independent 'source' of income. The words 'any other form of indebtedness from sources' in the other territory can only mean interest arising or accruing as a separate 'source' of income. It cannot include interest payable on the unpaid purchase money agreed to be part of the sale consideration. There is nothing in the initial contract or any novation converting the interest payable with the instalments as a 'loan'. Hence the interest specified in cl. 12(a) of the contract is not liable to income-tax. As a result, the assessee is immune from liability either wholly or partly to income-tax in view of the provisions of the Double Taxation Avoidance Agreement between the Federal Republic of Germany and India.

(Paras 75 & 77)

Conclusion

As the German company neither had a 'permanent establishment' in India within the meaning of Double Taxation Avoidance Agreement nor the interest paid to it on deferred purchase price of equipment arose out of any "indebtedness within the meaning of the Agreement, no tax liability arose in India in view of the Agreement, between India and Germany.

Income deemed to accrue or arise in India—Business connection—Supply of machinery from Germany—An agreement providing for guarantees, deputing of technical and other personnel for supervision of the erector and for sending a supervising engineer, did not establish a 'business connection' with the Port Trust—Such persons were dealing with each other on a principal to principal basis—German company had no control nor could it interfere with the performance of the sub-contract by the Poona company—Poona company could not, therefore, be treated as an 'agent' of the German company, and, therefore, the 'assembly' and 'installation', in so far as the work relating to the steel-plate at Pimpri is concerned could not be attributed to the German company so as to attract the provisions of cl. (bb) of art. II(1)(i)—Work of construction, installation or assembly was actually done by the Port Trust and not by the German engineer—Tribunal, was, therefore, right in holding that the role of the Engineer did not result in bringing the German company within cl. (bb)—No income could be deemed to accrue or arise in India to German company

Held

Under s. 9(1)(i) all income accruing or arising whether directly or indirectly, through or from any 'business' connection' in India, or other income mentioned in that section shall be deemed to accrue or arise in India. But the charging provision s. 4, as well as s. 5 defining the 'total income' of either a resident or a non-resident are expressly made 'subject to the provision of the Act',

including agreements made under s. 90. Thus, if there was a conflict between the terms of the agreement and the taxation statute, the agreement alone would prevail.—[Ostime \(Inspector of Taxes\) vs. Australian Mutual Provident Society](#) (1960) 39 ITR 210 (HL) : TC30R.294#1 **relied on**.

An agreement providing for guarantees, deputing of technical and other personnel for supervision of the erector and for sending a supervising engineer, did not establish a 'business connection' with the Port Trust. Such persons were dealing with each other on a principal to principal basis.

The income arising or accruing to a foreign company through or from any 'business connection' in India which is deemed to arise or accrue in India, being part of the total income specified in s. 5 and chargeable to income-tax under s. 4 is also subject to the provisions of the agreement to the contrary. Therefore, even assuming that all the profits of the German company are to be deemed to have accrued or arisen in India by virtue of s. 9, the terms of art. III of the agreement prevail over s. 9. In effect, the industrial or commercial profits of the German company are not, therefore, liable to tax under s. 9.

The contract itself, in cls. 7 and 17 in the instant case, contemplates the employment of a sub-contractor or sub-supplier, the Poona company was so employed later. It is admitted that it is not a subsidiary of the German company. The Poona company is neither a party to the contract nor is there any reference to it in the contract. There was neither any identity of interest nor identity of character nor of personality nor was there any unity in profit making between the Poona company and the German company. They were in the position of principal to principal and were dealing with each other at arm's length. The German company had no control nor could it interfere with the performance of the sub-contract by the Poona company. The Poona company could not, therefore, be treated as an 'agent' of the German company, and, therefore, the 'assembly' and 'installation', in so far as the work relating to the steel-plate at Pimpri is concerned could not be attributed to the German company so as to attract the provisions of cl. (bb) of art. II(1)(i). The German engineer, who was deputed to India to 'supervise' the assembly and installation operations of the claimer did not carry on any construction, installation or assembly project or the like on behalf of the German company in India. He was only delegated to India for supervision. The work of construction, installation or assembly was actually done by the Port Trust and not by the German engineer. It was not, therefore, permissible to equate the situation with one where the German engineer instead of merely supervising the above operations, was himself in charge of those operations on behalf of the German company. The Tribunal, was, therefore, right in holding that the role of the Engineer did not result in bringing the German company within cl. (bb).

Counsel appeared

M.S.N. Murthy, for the Revenue : B.V. Subrahmanyam & M. Venkateshwarlu, for the Assessee

JAGANNADHA RAO, J.:

Question relating to the interpretation of International Tax Agreements containing international tax language fall for consideration in this reference.

2. The question of law referred to us at the instance of the CIT, Andhra Pradesh, Hyderabad, is as follows:

"Whether, on the facts and in the circumstances of the case, the assessee is immune from liability either wholly or partly to tax on the basis of the Double Taxation Avoidance Agreement between Germany and India?"

3. The Tribunal, Hyderabad, has consolidated 21 reference applications as common question are involved and it has drawn up a single reference application.

4. The assessee is the Visakhapatnam port trust (hereinafter called the "port trust "). The port trust is under the Ministry of Shipping and Transport, Govt. of India. The Visakhapatnam Port exports a large amount of iron ore. In order to speed up the export operations, the port trust felt it necessary to instal a plant known as "Bucket Wheel Reclaimer". The purpose of this was to remove iron ore mechanically from the wharfs and put it on a conveyor belt which takes the ore directly into the ship. Global tenders were called for by the port trust in June, 1967. A German company known as M/s Maschinenfabrik Buckau R. Wolf (hereinafter called the "German company" tendered a contract for supply of the Bucket Wheel Reclaimer on 26th June, 1967. After several negotiations the contract was finalised on 12th Sept., 1968.

5. The terms of the lengthy contract dt. 12th Sept., 1968, may be briefly noticed. The German company, (i) undertook to supply and deliver to the port trust one Bucket Wheel Reclaimer as per drawing, and (ii) to delegate one engineer-erector for supervising the total erection and one special fitter for installation of electrical equipment. It is not in dispute that the engineer-erector delegated was Mr. Bremer and that no special fitter was delegated. The peiod of contract was 13 1/2 months and shipments were to be so effected that the material would arrive at the Visakhapatnam Port in ten months. The price payable was as follows (in DM & Rup(a) Reclaimerees separately):

(a) Reclaimer	Weight (Tons)	Value (DM)	Payable DM	&	in Rupees
(i) Supply items including ballast	326	1,889,687	1,399,860 + DM	.	9,19,000
(ii) Erection costs & Travelling expenses	—	101,726	90,000 + DM	.	22,000
.	326	1,991,413	1,489,860 + DM	.	9,41,000
(b) Spares	16	210,416	210,416 + DM	.	.
.	342	2,201,829	1,700,276 + DM	.	9,41,000

The terms of payment in cl. 12 were in several parts:

(i) DM 1,700,276=(DM 1,399,860 + DM 210,416) DM 1,610,276 + DM 90,000 was payable in Germany. 5 per cent of the above amount was payable at the conclusion of the contract, 10% by opening letters of credit in four weeks and 85 per cent (DM 1,445,240) in 20 equal semi-annual instalments each of DM 72,262, of which the first instalment was payable as soon as the port trust certified that the unit was ready. For the credit remaining after payment of each of these instalments, interest was to be paid by the port trust at 6 per cent p.a. The deferred payment was to be guaranteed by the State Bank of India. The interest portion for the deferred payment was DM 451,637. Of course, the figures were to be redetermined according to the formula agreed in the price variation clause which depended on such variable factors like "the mixed material price" and the "standard wage" in Germany which would vary from time to time .

(ii) Rs. 9,19,000 : This amount was payable to the German company towards the supply of certain items. But the invoices had to be made out by the person appointed by the German company, vide para 12(b) and the address and the bank account would be informed to the port trust by the German company, 10 per cent of this amount was to be paid at the time of signing the contract, 40 per cent in six months and 50 per cent when the German company informed that the items were ready.

(iii) Rs. 22,000 was to be paid for the erection supervising staff. Out of this, 20 per cent was to be paid at the commencement of the erection and 80 per cent in monthly instalments as demanded by the German engineer.

(iv) In case of delayed payments, cl. 12(c) provided that the German company shall be entitled to claim interest on arrears at 6 per cent p.a.

Thus, there were two different types of interest charged at 6 per cent p.a. which are specified in the contract and we are concerned with the tax on the interest in cl. 12(a).

The German company had to supply the mechanical equipment, the structural steelwork, the lubrication system, the rubber belting, the electrical equipment, ballast and spares.

Clause 10 of the contract provided that the German company could delegate the erection work to the supervising staff as stated earlier. The port trust was to provide suitable skilled and unskilled labour, scaffolds, etc., water and electricity and the port trust alone had to pay for these items.

Clause 11 provided the price variation formula and it was to be applied to, (i) for DM 1,610,276 (DM 1,399,860 for items of supply and DM 210,416 for spares) ; (ii) for DM 90,000 (erection=wages and travelling expenses). Total : DM 1,700,276. But in respect of (iii) Rs. 9,41,000 = (Rs. 9,19,000 + Rs. 22,000), the price variation formula was to be mutually agreed after the German company appointed its agent.

6. The contract proceeds on the basis that the German company is to send all the parts. But cls. 7 and 17 do contemplate the employment of a sub-contractor or sub-supplier. What work is to be given to the sub-contractor is also not mentioned in the contract. All that we get is that Rs. 9,19,000 is set apart to be paid to the sub-contractor upon the direction of the German company.

7. Later, an Indian company incorporated under the Indian Companies Act known as the Buckau-Wolf India Engineering Works Ltd., Pimpri, near Poona (hereinafter called the Poona company), came into the picture. It is common ground that the Poona company is not a subsidiary of the German company nor is it, in any manner whatsoever, controlled by the German company. This Poona company was employed to fabricate a single thick steel sheet. Such of the items (items 13 to 17 of the contract) which the German company manufactured in Germany and despatched to Bombay Port were to be firmly imbedded on the steel plate (Boom) by the Poona company and delivered at Visakhapatnam where the items which would be directly sent by the German company to the Visakhapatnam Port were to be put on the said plate under the supervision of the German engineer, Mr. Bremer.

8. The assembling at the Visakhapatnam Port was to be done at the expense of the port trust . This is also clear from the fact that cl. 10 of the contract provided that the port trust had to provide suitable skilled and unskilled labour, scaffolds, etc., water and electricity and pay for these items of expenditure. The port trust has filed a lot of documentary evidence to prove that the port trust itself, as a fact, paid for all the assembling and erection expenses at Visakhapatnam as per the contract which came to Rs. 66,613.72+Rs. 72,856+Rs. 33,137.40 and Rs. 2,22,448.26=Total of Rs. 3,97,034.66

9. In cl. 11, the word "erection" was said to mean "wages and travelling expenses". "Erection" according to the contract meant the payment of wages, i.e., to Mr. Bremer, the German Supervising Engineer and his travel expenses. These were covered partly in DM 90,000 to be paid in Germany (including travel outside India) and Rs. 22,000 for erection (i.e., wages and travelling expenses) in India. The German company's engineer-erector, Mr. Bremer was, according to it, only in charge of supervision. Documentary evidence has been filed by the port trust which shows that the amount payable in DM including DM 90,000 is to be paid in Germany as per the terms of the contract. After the contract was signed on 12th Sept., 1968, letters of credit were opened in Germany to enable the German company to receive from a German bank (the Deutsche Bank, Cologne) payments of the price in instalments for each export consignment, by sea or air. Eight export consignments of the component parts of the Bucket Wheel Reclaimer including spare parts were despatched on 15th May, 1969 (to Bombay), 20th Aug., 1969 (to Bombay), 13th Sept., 1969

(to Visakhapatnam), 22nd Dec., 1969 (to Bombay), 6th Nov., 1969, (to Visakhapatnam), 6th Nov., 1969 (to Visakhapatnam). These are covered by bills issued by the German company and these bills refer to the import licence dt. 5th June, 1968, taken out by the port trust and irrevocable letters of credit dt. 17th May, 1969 and 22nd May, 1969, State Bank of India, Visakhapatnam. All the bills specify that the price is to be noted for delivery (C.I.F. Bombay or Visakhapatnam) "without assembly" or "without erection". The shipping documents on record show that the port trust paid the instalments of the price as they fell due in 20 instalments in German currency in Germany. The port trust itself paid the customs duty and the landing charges and carriage expenses from Visakhapatnam Port to the erection site from Bombay Port to Pimpri, Pimpri to Poona and Poona to Viskhapatnam.

10. On a consideration of the terms of the contract and the mode of payment made by the port trust, and other facts of the case, the ITO was of the view that the port trust should have deducted tax at source in accordance with the provisions of s.195 of the IT Act, 1961, (hereinafter referred to as "the Act".) The assessee raised various objections but they were overruled by the ITO who passed an order under s.195(2) of the Act directing the assessee to pay the tax as well as the interest under s.201(1A) in a sum of Rs. 2,83,44,178.

11. The assessee carried the matter in appeal before the AAC. The assessment years involved were 1968-69 to 1974-75. In the appeal it was argued that s.195(2) of the Act did not apply as the property in the money and goods passed in Germany. It was alternatively contended that the entire amount should not be taxed inasmuch as the machinery portion was supplied in Germany for which the payment was also made in Germany. The AAC substantially accepted the contentions of the assessee but held that so far as the interest paid along with the twenty semi annual instalments was concerned, it was liable to be taxed in accordance with the provisions of s.195 of the Act. Accordingly, he directed that the interest should be grossed-up i.e., the interest portion of the payment was held to fall within the mischief of s.195 of the Act.

12. The assessee preferred appeals to the Tribunal insofar as the interest was concerned. The question of interest arose only in respect of the asst. yrs. 1970-71 to 1974-75. There was no question of interest for the asst. yrs. 1968-69 and 1969-70. Thus the appeal for the asst. yrs. 1968-69 and 1969-70 were indeed redundant. The assessee had also filed seven appeals against the order of the AAC regarding certain basic issues decided against the assessee. The Revenue filed seven appeals against the finding of the appellate authority that only interest was liable to be charged to tax. That was how, in all, the Tribunal had 21 appeals before it.

13. For the first time before the Tribunal the assessee raised the question that the tax was not payable in India in view of the Indo-German Double Taxation Avoidance Agreement (hereinafter called "the Agreement" for brevity). The Tribunal thought it fit to consider the question of the applicability of the Agreement inasmuch as it would be unnecessary to decide all other questions in the event of the assessee obtaining the benefit of the said agreement. There was no objection on behalf of the Revenue before the Tribunal for considering the applicability or otherwise of the said Agreement to the facts of the case.

14. The Tribunal firstly rejected the preliminary objection raised by the Department regarding the jurisdiction of the Tribunal relying upon Art. XVIII of the Agreement.

The Tribunal then considered the rival contentions on facts and summarised its findings as follows:

(i) that the actual installation work or erection work or assembly work was not undertaken by the German company to be done at their cost;

(ii) payment in respect of the sub-contract had nothing to do with the assembly, erection or installation of the Bucket Wheel Reclaimer;

- (iii) the German company merely supervised the installation;
- (iv) the port trust did not recover any money from the German company in respect of any part of the erection job;
- (v) the activity which was carried on by the German company in relation to the supply and delivery of the Bucket Wheel Reclaimer cannot be designated as amounting to the German company having a permanent establishment in India within the terms and spirit of the Agreement;
- (vi) Interest is not de hors the contract and it is part of the purchase money and it is not a separate source by itself and it forms part of the industrial and commercial profits which are covered by the Agreement;
- (vii) there is no indebtedness independent of the terms of the contract and interest is not on any debt but it is on account of the terms of the contract itself.

15. Before this Court, the learned counsel for the Department, Sri M. Suryanarayana Murthy, contended that the Tribunal had no jurisdiction to apply the Agreement in view of the Art. XVIII contained therein. He also submitted that s. 9(1)(i) of the IT Act was attracted as the German company and the Poona company had "business connection" and that the Indo-German Agreement did not override s.9. He further submitted that Art. II(1)(i)(aa), (bb) and (dd) (1) applied to the facts of the case and thereby the German company had a "permanent establishment" in India, and the income was taxable by applying the latter part of Art. III. We shall deal with the various aspects of this question a little latter. He also argued that the interest payable in DM on the 20 instalments to the German company is an independent source of income taxable under Art. VIII.

16. On the other hand, the learned counsel for the assessee (port trust) Sri B.V. Subrahmanyam, contended that Art. XVIII of the Agreement did not oust the jurisdiction of the Tribunal to apply the said Agreement. He submitted further that s.9 was subject to the Agreement and that the German company had no "permanent establishment" in India either by itself or through the Poona company or through Mr. Bremer as contended by the Revenue. He then argued that interest payable along with the instalments was part of the consideration for the contract itself and was not an independent source of income on any indebtedness of the port trust.

17. In our view, the points that arise for consideration are the following:

"(1) Whether, under Art. XVIII of the Agreement, the remedy of moving the Competent Authority specified therein was in substitution of the ordinary remedies of appeal, etc., available under the Income-tax statutes of the respective countries?

(2) Whether the Poona company is liable to income-tax in India on the basis that income is deemed to accrue or arise in India, directly or indirectly, through or from any 'business connection' in India or otherwise through an agent, the Poona company, in view of s.9(1)(i) of the IT Act, 1961, and, if so, what is the effect of the first part of Art. III of the Agreement on such income?

(3) Whether the German company can be said to have a 'permanent establishment' in India by itself or through the Poona company or through Mr. Bremer so as to attract the levy of income-tax with reference to the latter part of Art. III r/w Art .II(1)(i) of the Agreement?

(4) Whether, the interest payable to the German company along with each of the twenty instalments in DM can be classified as interest arising out of any indebtedness within Art. VIII of the Agreement?"

18. As the case turns upon the meaning of either technical expressions or clauses which have been

evolved in model conventions since the time of the League of Nations, it would be useful to briefly trace the history of the model forms.

Model forms applicable to all countries were first prepared by the fiscal committee of the League of Nations in 1927. Later, the said committee conducted meetings at Mexico during 1943 and in London in 1946 and proposed minor variations. The model conventions were published in Geneva in April, 1946, by the fiscal committee of the U.N. Social & Economic Council. Later the fiscal committee of the Organisation for European Economic Co-operation (O.E.E.C), published a draft on 6th July, 1963 (vide Halsbury's Laws of England, 4th Edn., Vol.23, para 1040). In the meantime in Sept., 1961, the Organisation for Economic Co-operation and Development (O.E.C.D), was established to succeed the O.E.E.C. and the draft dt. 6th July, 1963, submitted to the O.E.E.C. was confirmed by the O.E.C.D. These are called the O.E.C.D. models (vide Simon's Taxes, 3rd Edn., Butterworths, p. 351, para F(4.401). They have been further modified in 1974 and 1977 by either the O.E.C.D. or in individual cases by the contracting countries. The O.E.C.D. provided its own commentaries on the technical expressions and the clauses in the model conventions. Lord Radcliffe in *Ostime vs. Australian Mutual Provident Society* (1960) (AC) 459 : (1960) 39 ITR 210 (HL) : TC30R.294, has described the language employed in these Agreements as the "international tax language". For a complete but brief history of the tax treaties from 1970 in various countries and the League of Nations and U.N.—see Dr. M.B. Rao's Books on Double Tax Treaties between Developing and Developed Countries (Milend Publications, New Delhi, 1983). Dr. Rao quotes M.B. Carroll to say that international tax law is "in a state of perpetual becoming".

We shall now take up the first point relating to the jurisdiction of the domestic Courts or Tribunals. Art. XVIII of the Agreement reads thus:

"XVIII. Where a resident of one of the territories shows proof that the action of the taxation authorities of the other territory resulted or will result in double taxation contrary to the provisions of the present Agreement, he shall be entitled to present his case to the Competent Authority of the territory of which he is a resident. Should his claim be deemed worthy of consideration, the Competent Authority to which the claim is made shall endeavour to come to an agreement with the Competent Authority of the other territory with a view to avoiding double taxation."

19. The above article is called the "Mutual Agreement Procedure" and corresponds to Art. XXV of the O.E.C.D. Model (Simon's Taxes p.369) and it has come up for consideration in various countries. From the article by John Avery Jones and others "The Legal Nature of the Mutual Agreement Procedure under the O.E.C.D. Model Convention-I" [British Tax Review (1979) p. 333], we have obtained useful material on this question which is mentioned below:

The German Federal Supreme Tax Court has held that the existence of the 'Mutual Agreement Procedure' does not prevent the Court from proceeding with the case. (German Federal Supreme Tax Court 1-2-1967, I-220-64 B.St. B1, 1967 III 495). The same view has been taken by the Swiss Federal Tribunal (Swiss Federal Tribunal, 17-3-1967, BGE 93 I-189). This was in 1967 even before the words "irrespective of the remedies provided by the domestic law of those States" were introduced in the O.E.C.D. Model. The commentary on the O.E. C.D. Model (Commentary to Art. 25, para 6), also makes it clear that this procedure is in addition to and not in substitution of the remedies in the domestic Courts or tribunals (Robert Verhoeven, Counsellor, Ministry of Finance, Belgium in his commentary on the O.E.C.D. Model published in Bulletin of Income-tax No. 553, July, 1977 and 25/11) (5).

20. In Simon's Taxes, already referred to, it is stated at p.163 (F.1-263) as follows:

"This step may be taken in addition to any legal form of appeal in the country concerned, and may be taken before any additional tax has been imposed."

Even where the taxpayer initially invokes the Mutual Agreement Procedure, in case the said

authorities fail to agree or their agreement is not satisfactory to the taxpayer, all countries (except Sweden) are agreed that there will be no objection to the taxpayer then moving the Courts, within the prescribed time, if any (British Tax Review). In Canada (No. 76-15) and the United States (Rev. Proc. 70-18) the Government tax publications suggest that taxpayers should protect their rights of appeal before the Courts while applying for the Mutual Agreement Procedure [British Tax Review (1979), P.333]

21. We respectfully agree with the rulings mentioned above. We are also of the opinion that Art. XVIII underlines a procedure which is in addition to and not in substitution of the remedies before the domestic Courts or tribunals. Hence the assessee was entitled to rely on the Agreement before the Tribunal. The first point is, therefore, held in favour of the assessee.

22. The second point turns upon the effect of Art. XVI of the Agreement on s. 9(1) of the Act.

Art. XVI of the Agreement reads as follows:

"The laws in force in either of the territories will continue to govern the assessment and taxation of income in the respective territories except where express provision to the contrary is made in this Agreement"

23. What is express provision to the contrary that is made in the Agreement?

24. Now Art. III(I) of the Agreement in so far as it is material on this point reads as follows:

"Subject to the provisions of paragraph (3) below, 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 permanent establishment..."

In para 3 of Art. III are enumerated certain specified items of income, i.e., rents, royalties, interest, dividends, etc., which are excluded from the "industrial or commercial profits" of the foreign enterprise.

25. It is contended that in this case the German company must be taken to have derived its profits in India even though the money might have been paid in West Germany and further that the Poona company which has prepared the steel plate and has assembled items 13 to 17 thereupon must be taken to have a "business connection" with the German company and that the income must be taken to have been derived in India.

26. It is true that under s. 9(1)(i) of the Act all income accruing or arising whether directly, or indirectly, through or from any "business connection" in India, or other income mentioned in that section shall be deemed to accrue or arise in India. But the charging provisions, s.4, as well as as of the Act defining the "total income" of either a resident or a non-resident are expressly made "subject to the provisions of the Act", including Agreements made under s.90.

27. A similar view was taken by the House of Lords in *Ostime (Inspector of Taxes) vs. Australian Mutual Provident Society* (supra), where it was held that if there was a conflict between the terms of the Agreement and the taxation statute, the Agreement alone would prevail. Later, however, s.497 of the U.K Income and Corporation Taxes Act, 1970, provided expressly for legislation by way of statutory instrument in the form of an Order-in-Council declaring the arrangements specified in the order to have effect, "notwithstanding anything in any enactment."

28. The decision of the Supreme Court in *Turner Morrison & Co. Ltd. vs. CIT* (1953) 23 ITR 152 (SC), relied upon for the Department is, in our opinion, not relevant in the context of the Double Taxation Avoidance Agreements which override the liability of a non-resident principal or an Indian

agent who may be otherwise liable to tax under ss. 4 and 5 r/w s.9. Similarly, we hold that the ruling in P.C. Ray & Co. (India) Pvt. Ltd. vs. A.C. Mukherjee, ITO (1959) 36 ITR 365 (Cal) : TC5R.355, of the Calcutta High Court is also not relevant.

29. Coming to the part played by Mr. Bremer, we are of the view that even there, no "business connection" is established. It may be noted that Chinnappa Reddi, J. (as he then was), sitting with Punnayya, J. in CIT vs. Hindustan Shipyard Ltd., (1977) 109 ITR 158 (AP) held that an Agreement providing for guarantees, deputing of technical and other personnel by a Polish company to the Hindustan Shipyard for supervision of the erector and for sending a supervising engineer, did not establish a "business connection" with the shipyard. It was held that they were dealing with each other on a principal to principal basis. So is the relationship between the German company and the Poona company as shown by us under the third point.

30. Therefore, the legal position on the second point may be summarised as follows:

The provisions of 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. By necessary implication they are subject to the terms of the Double Taxation Avoidance Agreement, if any, entered into by the Govt. of India. Therefore, the income arising or accruing to a foreign company through or from any "business connection" in India which is deemed to arise or accrue in India, being part of the total income specified in s. 5 and chargeable to income-tax under s. 4, is also subject to the provisions of the Agreement to the contrary.

31. Therefore, even assuming for a moment that all the profits of the German company are to be deemed to have accrued or arisen in India by virtue of s.9 of the Act, the terms of Art. III of the Agreement prevail over s. 9 of the Act. In effect, the industrial or commercial profits of the German company are not liable to tax under s.9 of the Act except to the extent permitted by Art. III. We shall deal with these exceptions separately under points Nos. 3 and 4.

32. The second point is, therefore, held against the Department and in favour of the assessee.

33. We shall now deal with the exceptions mentioned in Art. III of the Agreement separately under points Nos. 3 and 4.

34. The third point that arises is whether the German company can be said to be deriving profits in India through a "permanent establishment" which can be taxed in India in view of the latter part of Art. III of the Agreement?

35. That leads us to Art. II(1)(i) of the Agreement. Art. II(1)(i) reads as follows:

(to the extent that it is relied upon before us):

"Art. II. (1) In the present Agreement, unless the context otherwise requires.....

(i) the term 'permanent establishment' means a fixed place of business in which the business of the enterprise is wholly or partly carried on;

(aa) the term "fixed place of business" shall include a branch, an office, a factory, a workshop, a warehouse, a mine, quarry or other place of extraction of natural resources, and a permanent sales exhibition;

(bb) an enterprise of one of the territories shall be deemed to have a fixed place of business in the other territory if it carries on in that other territory a construction, installation or assembly project or the like;.....

(dd) a person acting in one of the territories for or on behalf of an enterprise of the other territory shall be deemed to be a permanent establishment in the first-mentioned territory, but only if

1. he has and habitually exercises in the first-mentioned territory a general authority to negotiate and enter into contracts for or on behalf of the enterprise, unless the activities of the person are limited exclusively to the purchase of goods or merchandise for the enterprise or.
2. he habitually maintains, in the first-mentioned territory a stock of goods or merchandise....
3. he habitually secures orders in the first-mentioned territory...."

Was the German company having a "permanent establishment" in India?

The words "permanent establishment" are one of those technical expressions which are invariably used in all international Double Taxation Avoidance Agreements as these are based on standard O.E.C.D. models.

36. In view of the standard O.E.C.D. Models which are being used in various countries, a new area of genuine "international tax law" is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings world wide relating to similar treaties (British Tax Review, 1978 p.394). The maintenance of uniformity in the interpretation of a rule after its international adaptation is just as important as the initial removal of divergencies (per Scott L.J., in *Eurymedon Corstar vs. Eurymedon* (1938) 1 All ER 122 (CA). Therefore, the judgments rendered by Courts in other countries or rulings given by other tax authorities would be relevant.

37. The Supreme Court of Belgium (judgment of the Supreme Court of Belgium on French-Belgium Treaty) has held that a Belgian subsidiary of a French parent-company was not the parent's "permanent establishment", notwithstanding the very tight control exercised by the parent-company over the sales-territory and product lines allocated to the subsidiaries notwithstanding the considerable amount of management and financial reporting which was required of the subsidiary. This decision of the Belgium Supreme Court, if regarded as persuasive in other countries, is of immense relief to multinational corporations (MNC) which often do lay down strict guidelines for the operations of their subsidiaries [vide Michael Edwardes-Ker's Book, *The International Tax Treaty Service* published by In-Depth Publishing Ltd., 1978 Dublin (13)].

38. The Swiss Bundesgericht (judgment of the Swiss Bundesgericht dt. 17th Sept., 1977 on Swiss-Spanish Treaty) had to interpret the Swiss-Spain Treaty and decide whether the "representative-office" of a Spanish bank constituted a "permanent establishment" in Switzerland. The Bundesgericht, whilst it cited the commentary of the 1963 O.E.C.D. Model, held that it was not such a "permanent establishment" of the Spanish bank in Switzerland (British Tax Review, 1978 p.394).

39. Similarly, the U.S. Revenue Ruling (No. 72-1-418 on U.S.-German Treaty) has decided while dealing with the U.S. German Tax Treaty that a German bank's representative office in U.S. did not constitute a "permanent establishment" of the German bank in the U.S. (British Tax Review, 1978 p. 394).

A "permanent establishment" connotes a projection of the foreign enterprise itself into the territory of the taxing State in a substantial and enduring form: (vide F.E. Koch's Book on the Double Taxation Conventions published by Stevens & Sons, London, 1947, Vol. I, at p. 51, quoting Mitchell B. Carroll before the sub-committee of the Committee of the U.S. Senate Foreign Relations). It is common practice for an enterprise which carries on trade or business in one country to expand its operations, without incorporation or further incorporation into another country, for it then has a branch there, or a permanent establishment which can be regarded as having sufficient presence in

that country to make them taxable there in the same manner as the residents of that country. (Harvey Mc. Gregor, Old Exemptions-New Credits. The Rights of Permanent Establishment under the Double Taxation Agreements between U.K. and U.S.A-1 (British Tax Review, 1977, Pt. 6, P.327).

40. In our opinion, the words "permanent establishment" postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.

41. First we shall take up sub-cl.(aa).

Applying the above tests to sub-cl. (aa) of Art. II(1)(i), there is, in our view, nothing in the contract between the German company and the port trust which contemplates that the German company is to establish in India any establishment of a permanent or enduring nature either wholly or substantially which would amount to a virtual projection of the German company in India. Nor has any material been brought to our notice in this behalf. The Agreement was purely for the supply of parts and for sending of an expert engineer to supervise the erection of the Reclaimer by the port trust . We have no difficulty whatsoever in holding that sub-cl. (aa) is not attracted.

42. The submission for the Department under sub-cl. (bb) is in several parts which we shall now consider.

(A) It was urged that by virtue of the deeming provision in sub-cl. (bb) the German company was to be treated as having a "permanent establishment" in India as it was, according to the Department, duty bound to manufacture and instal and assemble the Reclaimer as a single unit in India and, therefore, the German enterprise must be deemed to have had a "permanent establishment" in India.

43. We are of the firm opinion that the contract between the parties did not contemplate any work of installation or assembly or the like to be performed by the German company. As already stated, the contract was limited to the supply of the items from Germany and to the delegation of an expert engineer to supervise the installation or assembly work to be conducted by the port trust .

44. Apart from this, we are of the view that cl. 10 of the contract entered into between the parties is absolutely clear and that it clinches the issue. It states that it is the duty of the port trust to provide suitable "skilled" and "unskilled" labour, one crane with a boom, scaffolds and tackles for erection and other consumables required for erection and to secure the necessary quantity of water and electricity that may be required during their operations, and also to provide for the transportation of various items. As already stated, the port trust has produced voluminous evidence to show that it was the port trust that spent Rs. 3,97,034.66 towards the expenditure for wages for the workmen, etc. Our attention has not been drawn to any material which will show that the German company has conducted these operations or has paid for them either wholly or partly, or that it has reimbursed the port trust . This is also clearly found by the Tribunal against the Department. This submission, therefore, clearly lacks factual foundation.

45. Reliance is then placed on the eight bills issued by the German company which refer to the price being payable C.I.F. Bombay or Visakhapatnam "without assembly" or "without erection". It is argued that these operations of assembly and installation must, therefore, be taken to have been conducted in India by the German company.

46. In our opinion, the above words in these bills do not raise a presumption that these operations have been conducted by the German company. The question must depend solely on the evidence

as to who has actually got the operations of assembly or installation or erection made or paid for it. The material on record in this reference is only one way, namely that it was the port trust that got the Reclaimer assembled, installed and erected at Visakhapatnam and that, in fact, the port trust paid Rs. 3,97,034.66 to the workers. There is absolutely no material in favour of the Department on this question. There is no evidence that the German company even reimbursed the expenditure of the port trust in this regard. This contention is, therefore, liable to be rejected.

47. According to the learned counsel for the Department, the contract between the parties used the word "erection" and, therefore, it must be presumed that the German company was in charge of the "erection" of the Reclaimer.

48. Firstly, on a reading of the entire contract as a whole, we have no doubt that the word "erection" has been used in this contract in a limited sense as meaning the expense involved in respect of the salary payable to Mr. Bremer and for his travelling expenses. Secondly, this is also made explicit in cl. 11 of the contract. The word "erection" is clearly described as being equivalent to "wages and travelling expenses". Thirdly, the word "wages" here cannot be understood to mean the wages of the workmen at Visakhapatnam for which the responsibility is in that regard, as already pointed out by us, rested on the port trust alone under cl.10 of the contract. Therefore, there is no force in this submission either.

(B) It is then vehemently contended that even so, the German company would fall under cl. (bb) inasmuch as, according to the Department, the said company carried the work of construction, installation or assembly or the like through its agent (i.e., Poona company) and that the German company must, therefore, be deemed to have had a "permanent establishment" through such agent in India.

49. This submission is based on an assumption that the word "it" in cl. (bb) can be applied not only to the German company but also to its agent. It is based on a further assumption that the Poona company is an agent of the German company.

50. In our view the Agreement has made specified provision in cl. (dd), in respect of agents who satisfy certain conditions. When such a special provision is made in respect of agents in cl. (dd), it is highly doubtful if the respective Governments in India and Germany intended that sub-cl. (bb) is to cover once again the case of an agent so as to render the conditions imposed in cl. (dd) otiose.

51. In any event, the Poona company cannot, as we shall presently show, be said to be in the position of an Indian agent of the German company, and our conclusion is based on the following reasons:

52. In *Lakshminarayan Ram Gopal and Sons Ltd vs. Government of Hyderabad* (1954) 25 ITR 449 (SC), their Lordships of the Supreme Court pointed out the distinction between an agent, a servant and an independent contractor and quoted the following passage from Halsbury's Laws of England (Hailsham Edn., Vol I p.193, para 345) as follows :

"An agent is to be distinguished on the one hand from a servant and on the other from an independent contractor. A servant acts under the direct control and supervision of his master, and is bound to conform to all reasonable orders given to him in the course of his work; an independent contractor, on the other hand, is entirely independent of any control or interference and merely undertakes to produce a specified result employing his own means to produce that result. An agent, though bound to exercise his authority in accordance with all lawful instructions which may be given to him from time to time by his principal, is not subject in his exercise to the direct control or supervision of the principal."

53. Further in *Pritchett & Gold and Electrical Power Storage Co. Ltd vs. Currie* (1916) 2 Ch D 515

(CA) and Mahomed Shafi vs. Fazal Din AIR 1930 Lah 1062, it was held that the relationship between a contractor and his sub-contractor is similar to that between one principal and another.

54. In the light of these principles of law applicable to the cases of a servant, agent and sub-contractor, let us examine the facts of the case.

55. The contract itself, in cls. 7 and 17, contemplates the employment of a sub-contractor or sub-supplier. The Poona company was so employed later. It is admitted before us that it is not a subsidiary of the German company. The Poona Company is neither a party to the contract nor is there any reference to it in the contract. Even in cl. 11 (c) relating to price variation, the German company stipulated that its own agent in India or (the contractor's Indian agents) will be appointed to negotiate the said question. Clause 12(b) also deals with appointment of an agent. The contract itself, therefore, draws a clear distinction between "agents" of the German company on the one hand and a "sub-contractor" on the other. [Contrast cls. 7,17 with cls. 11 (c) and 12(b)]. There is also no proof that the Poona company is to transmit the profit it made to the German company or that it had drawn any commission. As submitted on behalf of the port trust, there is neither any identity of interest nor identity of character nor of personality, nor is there any unity in profit-making between the Poona company and the German company. They were in the position of principal to principal and were dealing with each other at arm's length. The German company had no control nor could it interfere with the performance of the sub-contract by the Poona company. We are of the opinion that the Poona company cannot, therefore, be treated as an "agent" of the German company, and, therefore, the "assembly" and "installation", in so far as the work relating to the steel-plate at Pimpri is concerned, cannot be attributed to the German company so as to attract the provisions of cl. (bb) of Art. II(1)(i).

(C) The further submission of the learned counsel for the Department under cl.(bb) is that the German Engineer, Mr. Bremer who was deputed to India to "supervise" the assembly and installation operations of the Reclaimer brings the German company within the mischief of cl. (bb).

56. The German Federal Finance Court (British Tax Review, 1972, p. 265 quoting Bundesfinanzhof of 4th March, 1970, IR 140/66) while interpreting the U.K.-German Treaty was dealing with the case of a British company having no permanent establishment in the Federal Republic of Germany and which supplied technical information and advice or know-how to two German enterprises against payment. The German tax authorities regarded these profits as earnings from independent work performed in Germany in the sense of s.18 of the (German) Income Tax Law, and subjected to restricted tax liability in pursuance of s.49(1) No.3 and the relevant corporation tax provisions. But the Court decided that the know-how fees were not to be regarded as earnings from independent work based on the personal activities of a taxpayer but as profits derived from an industrial enterprise. The British company having no permanent establishment in Germany, these profits were not taxable.

57. In our opinion, Mr. Bremer did not carry on any construction, installation or assembly project or the like on behalf of the German company in India. He was only delegated to India for supervision. As already pointed out, the work of construction, installation or assembly was actually done by the port trust and not by the German engineer. It is not, therefore, permissible to equate the situation with one where the German engineer, instead of merely supervising the above operations, was himself in charge of those operations on behalf of the German company. The Tribunal was, therefore, right in holding that the role of Mr. Bremer does not result in bringing the German company within cl. (bb). In this context it may be noted that the very same Indo-German Agreement came up for consideration before the Tribunal, Delhi, and the said, Tribunal had also taken a view similar to the one taken by the Hyderabad Tribunal, when it held that the mere "supervision" done by the German engineer in that case, viz., Mr. Ritacher, on behalf of M/s Carl Schenck of West Germany in respect of erection and commissioning of a plant at Hyderabad did not amount to the German manufacturer having a "permanent establishment" in India (vide Bharat Heavy Electricals Ltd. vs. ITO (1982) 65 Tax (6) p.12 (Tribunal decision)).

58. We are, therefore, of the opinion that the German company cannot be brought within cl. (bb) of Art. II(1)(i) by reason of any of the submissions made on behalf of the Department.

The next argument of the learned counsel for the Department is that the German company falls within cl. (dd) inasmuch as the Poona company must be treated as an agent of the German company within sub-cl. (1) of cl. (dd). No submission has, however, been made under sub-cl. (2) and (3) of cl. (dd).

59. We have already held while dealing with cl. (bb) that the Poona company cannot be treated as an agent of the German company but that it is in the position of an independent contractor dealing, at arm's length, with the German company on a principal to principal basis. Further, cl. (dd) requires that the agents shall exercise a general authority in India to negotiate and enter into contracts on behalf of the German enterprise. There is no material placed before us to show that the Poona company had any such general authority as above stated. Therefore cl. (dd)(i) cannot be invoked on behalf of the Revenue.

60. For all the above reasons we are unable to accept any of the submissions made on behalf of the Department under Art. II(1)(i) of the Agreement. Therefore, the third point is held against the Department.

61. Now we shall deal with the last point regarding interest. We have to see whether the interest paid by the port trust in DM along with each of the 20 instalments under cl. 12(a) of the contract, namely, DM 451, 637 is liable to income tax in India.

62. This leads us once again to a consideration of the relevant portions of Art. III in relation to Art. VIII of the Agreement:

"Art. III(1)—Subject to the provisions of paragraph (3) (below) 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 permanent establishment—

(3) For the purposes of this Agreement the term 'industrial or commercial profits' shall not include income in the form of rents, royalties, interest, 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."

63. The items enumerated in sub-cl. (3) are referred to in the later Articles. Art. V deals with the conditions for taxation of income from the operation of aircraft, Art. VI in respect of shipping operations, Art. VII, dividends Art. VIII, interest, and so on.

64. The first question that arises for consideration is with regard to the construction of sub-cl. (3) in relation to the first part of Art. III(1) and in relation to the second part of Art. III(1).

The words "subject to the provisions of paragraph (3)" in Art. III(1) would, in our view, indicate that while "industrial or commercial income" of the foreign enterprise are not taxable in India, the rents, royalties, interest, dividends, etc., derived by the foreign enterprise from sources in India are taxable. Obviously, sub-cl. (3) cannot be construed as excluding these items from the taxable income of the permanent establishment by applying sub-cl. (3) to the latter part of Art. III. Sub-cl. (3) has relevance only to the first part of Art. III(1). Further, in our opinion, the items : rents, royalties, dividends, interest, etc., are taxable only when they satisfy the conditions mentioned for their liability to tax as envisaged in the various specific Articles such as Arts. V, VI, VII, VIII, etc. Art. VIII refers to the taxability of interest in India.

65. In all O.E.C.D. models, these items in sub-cl.(3) in Art. III are normally dealt with separately in

the Agreement [Simons Taxes, 3rd Edn., para F. 1.212 (para,147)]. Lord Radcliffe has also held in Ostime's case (supra) (at pp.481-482 of the report), that except and in so far as Art. VI dealing with dividends (in the Australian Treaty) makes certain special stipulations about double taxation of dividends, the taxation of these items is not otherwise permissible—see also Harvey McGregor's article [British Tax Review, 1978, p.394], dealing with this interpretation and the unjust departure therefrom by some countries).

66. Therefore, we have to look to the first part of Art. III and cl. (3) of Art. III, and then refer to Art. VIII alone and decide whether the interest paid along with the 20 instalments satisfies the provisions of Art. VIII, so as to attract income-tax in India.

Article VIII reads

67. Interest on bonds, securities, notes, debentures or any other form of indebtedness derived by a resident of one of the territories from sources in the other territory may be taxed in both countries.

68. Does the "interest" payable on these 20 instalments in DM in Germany under cl.12(a) of the contract fall within the words any form of "indebtedness" mentioned in Art. VII of the Agreement, so as to create an independent source of income liable to income-tax in India?

69. The law relating to interest arising out of "indebtedness" is well settled. A "debt" is a sum of money which is now payable or will become payable in the future by reason of a present obligation, debitum in praesenti, solvendum in futuro : "Webb vs. Stenton (1883) 11 QBD 518, 527 (CA). A liability depending upon a contingency is not a debt in praesenti or in futuro till the contingency happened. But if there is a debt, the fact that the amount is to be ascertained does not make it any the less a debt if the liability is certain and what remains is only the quantification of the amount. The expression "debt" may take colour from the provisions of the concerned Act. It may have different shades of meaning : Kesoram Industries & Cotton Mills Ltd. vs. CWT (1966) 59 ITR 767 (SC). If money is due to a person and is not paid for but has been withheld from him by the debtor after the time when payment is to have been made, in breach of his legal rights, it is a compensation whether it is liquidated under agreement or statute. The compensation is properly described as interest. Westminster Bank Ltd. vs. Riches (1947) 28 Tax Cases 159 : (1947) 15 ITR (Supp) 86 (HL). Therefore, when interest is paid not as part of the compensation but is given for the deprivation of the use of the money, it is an independent source of income and is taxable : Dr. Shamlal Narula vs. CIT (1964) 53 ITR 151 (SC), and similarly if the right to interest arises because the person is kept out of his money, the interest received is chargeable to tax as income. The same principle would apply if interest is payable under the terms of an agreement and the Court or the arbitrator gives effect to the terms of the agreement and awards interest : T.N.K. Govindaraju Chetty vs. CIT (1967) 66 ITR 465 (SC).

70. But where the interest is merely in name but constitutes part of the compensation or part of the damages, it is not "interest" chargeable to income-tax. As an integral part of such compensation it may be either slumped-up with the other elements in the gross sum or may be separately stated but treated as part of the gross sum. IRC vs. Ballantine (1924) 8 Tax Cases 595 (C. Sess). Mere description of the amount as interest which in fact is part of the compensation does not have the effect of altering the true character of the compensation. Simpson vs. Executors of Bonner Maurice as Executor of Edward Kay (1929) 14 Tax Cases 580 (CA). That, in fact, is also the position with regard to unpaid purchase money coupled with a liability to pay interest along with each of the instalments.

71. Where as here, parties enter into an agreement to accept a portion of the purchase money immediately and the balance to be paid in certain instalments along with interest on the instalment of purchase money, the agreement though it vested the property agreed to be sold in the purchaser, does not have the effect of converting the price due into a loan. The intrinsic nature of

the money due to the vendor is as unpaid purchase money and not as debt. The parties may, however, agree to convert the unpaid purchase money as a debt, *Radha Kissen vs. Keshardeo* AIR 1957 SC 743: An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan : *Bombay Steam Navigation Co. (1953) Pvt. Ltd. vs. CIT* (1965) 56 ITR 52 (SC) : TC16R.881.

72. When, therefore, there is no agreement initially or any novation between the parties to treat the unpaid purchase money as a debt repayable with interest, even though the purchaser incurred the obligation of paying the sale proceeds to the seller, he does not become, in any sense, a debtor of the seller. If there is no agreement initially or by way of novation to treat the balance of sale consideration as paid off in full and no novation to treat the balance of consideration as a loan, the amount received by the seller cannot be regarded as interest on money lent.

73. The word "source" means something from which income arises. The seller would have, in a contract for sale of goods, got any way interest on sale proceeds under s.61 of the Sale of Goods Act even if the purchaser had not utilised the money : *Lakhmichand Muchhal vs. CIT* (1961) 43 ITR 315 (MP). The interest in such a case is received as part of the purchase price itself, that is to say, as part of the consideration for sale of goods on deferred payment basis and not as a separate source: *CIT vs. Saurashtra Cement & Chemical Industries Ltd.* (1975) 101 ITR 502 (Guj), the mere nomenclature employed by the parties notwithstanding. When the payment of interest is as part and parcel of the agreement to pay the unpaid purchase money on a deferred payment basis, there is no indebtedness (*Chittela Vankata Subba Reddi vs. Jayanthi Adinarayana—A.S. No. 446 of 1964, dt. 2nd Aug., 1968* (per Kondaiah J., as he then was), affirmed in L.P.A. No. 267 of 1968 dt. 14th March, 1969).

74. Bearing these well-settled principles in mind, it has to be seen whether interest payable on the agreed instalments of unpaid purchase money can be treated as a separate "source" being interest on any form of "indebtedness" contemplated in Art. VIII of the Agreement.

75. We are of the opinion that the interest agreed to be paid along with each of the instalments of unpaid purchase money was agreed to be part of the sale consideration itself and cannot be treated as an independent "source" of income. The words "any other form of indebtedness from source" in the other territory can only mean interest arising or accruing as a separate "source" of income. It cannot include interest payable on the unpaid purchase money agreed to be part of the sale consideration. There is nothing in the initial contract or any novation converting the interest payable with the instalments as a "loan". Hence the interest specified in cl. 12(a) of the contract is, in our opinion, not liable to income-tax

76. Therefore, we hold on the fourth point in favour of the port trust and against the Department.

77. For all the above reasons, we agree with the Tribunal and answer the question referred to us in the affirmative, in favour of the assessee, port trust, and against the Department, that assessee is immune from liability either wholly or partly to income-tax in view of the provisions of the Double Taxation Avoidance Agreement between the Federal Republic of Germany and India.

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